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Insurance law

M05

2025-26
**STUDY
TEXT**

Insurance law

M05: 2025–26 Study text

RevisionMate

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1. Visit www.cii.co.uk/qualifications.
2. Select the appropriate qualification.
3. Select your unit from the list provided.

Under 'Unit updates', examination changes and the testing position are shown under 'Qualifications update'; study text updates are shown under 'Learning solutions update'.

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Using this study text

Welcome to the **M05: Insurance law** study text which is designed to support the M05 syllabus, a copy of which is included in the next section.

Please note that in order to create a logical and effective study path, the contents of this study text do not necessarily mirror the order of the syllabus, which forms the basis of the assessment. To assist you in your learning we have followed the syllabus with a table that indicates where each syllabus learning outcome is covered in the study text. These are also listed on the first page of each chapter.

Each chapter also has stated learning objectives to help you further assess your progress in understanding the topics covered.

Contained within the study text are a number of features which we hope will enhance your study:



Activities: reinforce learning through practical exercises.



Be aware: draws attention to important points or areas that may need further clarification or consideration.



Case studies: short scenarios that will test your understanding of what you have read in a real life context.



Consider this: stimulating thought around points made in the text for which there is no absolute right or wrong answer.



Examples: provide practical illustrations of points made in the text.



In-text questions: to test your recall of topics.



Key points: act as a memory jogger at the end of each chapter.



Key terms: introduce the key concepts and specialist terms covered in each chapter.



Refer to: section/chapter that provides valuable information on or background to the topic, from either within this or another CII study text. Sections/chapters from other study texts are available for you to view and download on RevisionMate.



Reinforce: encourages you to revisit a point previously learned in the course to embed understanding.



Sources/quotations: cast further light on the subject from industry sources.



On the Web: introduce you to other information sources that help to supplement the text.

At the end of every chapter there is also a set of self-test questions that you should use to check your knowledge and understanding of what you have just studied. Compare your answers with those given at the back of the book.

By referring back to the learning outcomes after you have completed your study of each chapter and attempting the end of chapter self-test questions, you will be able to assess your progress and identify any areas that you may need to revisit.

Not all features appear in every study text.

Note

Website references correct at the time of publication.

Coursework assignments – referencing is required

You must always make it clear – through italics and a citation – where content taken from the study text begins and ends in your assignment. Please see our [webinar recording](#) on how to reference.



RevisionMate

**Revision just
got a whole
lot easier**

RevisionMate is an online study support tool that is designed to help you consolidate your learning and increase the chances of exam or coursework success.

RevisionMate has a responsive design and ensures seamless usability across a variety of devices. Key features can include:

- **Digital course** – access the core learning content with interactive features (available for units PL1-PL4 and R01)
- **Printable PDF and ebook of the study text**
- **Student discussion forum** – interact with your peers and share queries
- **Quiz questions** – check understanding of the study text as you progress
- **Specimen assignment or exam guide** – this contains a specimen coursework question and answer/mock exam paper for multiple-choice questions/past paper for written exams. To help you practise your assignment or exam writing techniques, along with useful information on the depth and breadth of answers that examiners are looking for
- **Calculation guide** - covers the basics to help students prepare for their exams, focusing on the more challenging calculations (available for units R02, R03, R04 and R06).

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Examination syllabus

Insurance law



Purpose

At the end of this unit, candidates should be able to:

- demonstrate a knowledge and understanding of the laws which form the background to the operation of insurance;
- demonstrate a knowledge and understanding of the system within which these laws operate and are administered;
- apply knowledge and skills to practical situations.

Assumed knowledge

It is assumed that the candidate has knowledge of the fundamental principles of insurance as covered in IF1 Insurance, legal and regulatory or equivalent examinations.

Summary of learning outcomes	Number of questions in the examination*
1. Understand the nature and sources of English law and the concept of natural legal persons.	5
2. Understand the principles of the law of torts and the characteristics of the main torts.	4
3. Understand the law of contract.	4
4. Understand the law of agency and its application to insurance.	4
5. Understand the main principles governing the formation of insurance contracts.	9
6. Understand the classification and interpretation of insurance contract terms, the effects of their breach and other vitiating factors.	8
7. Understand the main legal principles governing the making of an insurance claim.	6
8. Understand how losses are measured and how the principle of indemnity applies to insurance claims.	4
9. Understand how the principles of subrogation and contribution apply to insurance claims.	6

* The test specification has an in-built element of flexibility. It is designed to be used as a guide for study and is not a statement of actual number of questions that will appear in every exam. However, the number of questions testing each learning outcome will generally be within the range plus or minus 2 of the number indicated.

Important notes

- Method of assessment:
Mixed assessment consisting of two components, both of which must be passed. One component is a coursework assignment and one is a multiple choice question (MCQ) examination. The details are:
 1. an online coursework assignment using RevisionMate consisting of 10 questions which sequentially follow the learning outcomes. This must be successfully completed within 6 months of enrolment; and
 2. an MCQ exam consisting of 40 standard format and 10 multiple response questions. 1 hour is allowed for this exam. This exam must be successfully passed within 18 months of enrolment.
- This syllabus will be examined from 1 May 2025 until 30 April 2026.
- Candidates will be examined on the basis of English law and practice unless otherwise stated.
- This PDF document has been designed to be accessible with screen reader technology. If for accessibility reasons you require this document in an alternative format, please contact us at online.exams@cii.co.uk to discuss your needs.
- Candidates should refer to the CII website for the latest information on changes to law and practice and when they will be examined:
 1. Visit www.cii.co.uk/qualifications
 2. Select the appropriate qualification
 3. Select your unit from the list provided
 4. Select qualification update on the right hand side of the page

- | | |
|--|---|
| <p>1. Understand the nature and sources of English law and the concept of natural legal persons.</p> <p>1.1 Describe the classifications and characteristics of English law.
 1.2 Describe the sources of English law.
 1.3 Describe the professions involved within English law.
 1.4 Describe the structures and procedures of the courts.
 1.5 Describe the status and capacity of natural legal persons and corporations.
 1.6 Apply the nature and sources of English law and the concept of natural legal persons to practical situations.</p> <p>2. Understand the principles of the law of torts and the characteristics of the main torts.</p> <p>2.1 Describe the nature and classification of torts.
 2.2 Explain the main torts.
 2.3 Explain how the law of torts apply to employers' liability, products liability and occupiers' liability.
 2.4 Explain the main defences, remedies and limitations of actions in tort.
 2.5 Apply the law of tort to practical situations.</p> <p>3. Understand the law of contract.</p> <p>3.1 Explain the nature of contractual liability and classification of contracts.
 3.2 Explain the formation of a contract.
 3.3 Explain how contract terms are classified under the general law.
 3.4 Explain defective contracts.
 3.5 Explain the circumstances in which a contract may be discharged.
 3.6 Explain the remedies for breach of contract.
 3.7 Explain the doctrine of privity of contract.
 3.8 Explain the assignment of contractual rights and duties and how it applies to insurance.
 3.9 Apply the law of contract to practical situations.</p> <p>4. Understand the law of agency and its application to insurance.</p> <p>4.1 Explain the nature of agency and how an agency relationship can be created.
 4.2 Explain the nature of an agent's rights, responsibilities, authority and duties.
 4.3 Explain the termination of agency and its effects.
 4.4 Explain how the principles of agency law apply to insurance and practical situations.</p> <p>5. Understand the main principles governing the formation of insurance contracts.</p> <p>5.1 Explain how the principles of contract law apply to the formation of insurance contracts.
 5.2 Explain the concept and key elements of insurable interest.</p> | <p>5.3 Explain how the law of insurable interest applies to the main classes of insurance.
 5.4 Explain the duty of fair presentation in non-consumer insurance and the effect of a breach.
 5.5 Explain the duty to take reasonable care not to make a misrepresentation in consumer insurance and the effects of a breach.
 5.6 Apply the main principles governing the formation of insurance contracts to practical situations.</p> <p>6. Understand the classification and interpretation of insurance contract terms, the effects of their breach and other vitiating factors.</p> <p>6.1 Explain the classification, formation and interpretation of insurance contract terms.
 6.2 Explain the effect of breach of warranty or condition and how illegality arises in insurance contracts.
 6.3 Apply the classification and interpretation of insurance contract terms to practical situations.</p> <p>7. Understand the main legal principles governing the making of an insurance claim.</p> <p>7.1 Describe the parties who can claim on or benefit from an insurance contract.
 7.2 Explain the rules governing notice and proof of loss.
 7.3 Explain the insured's contractual duty to mitigate or prevent an insured loss.
 7.4 Explain the doctrine of proximate cause.
 7.5 Explain the investigation of fraudulent claims and the remedies available to the insurer.
 7.6 Apply the main legal principles governing the making of an insurance claim to practical situations.</p> <p>8. Understand how losses are measured and how the principle of indemnity applies to insurance claims.</p> <p>8.1 Explain the principle of indemnity.
 8.2 Explain the measure of indemnity in various classes of insurance.
 8.3 Explain the factors which limit, reduce, extend or modify the principle of indemnity.
 8.4 Explain the methods of providing indemnity.
 8.5 Explain the doctrine of salvage and abandonment.
 8.6 Explain the effect of claim payments on policy cover.
 8.7 Apply how losses are measured and the principle of indemnity to practical situations.</p> <p>9. Understand how the principles of subrogation and contribution apply to insurance claims.</p> <p>9.1 Explain the doctrine of subrogation in insurance.
 9.2 Explain the source of subrogation rights and apply the law to practical situations.
 9.3 Explain how subrogation rights may be modified or denied and apply the law to practical situations.
 9.4 Explain the effect of market agreements on rights of contribution.</p> |
|--|---|

- 9.5 Explain the nature of double insurance and operation of contribution.
- 9.6 Apply the principle of contribution to the main lines of insurance and to practical situations.

Reading list

The following list provides details of further reading which may assist you with your studies.

Note: The examination will test the syllabus alone.

The reading list is provided for guidance only and is not in itself the subject of the examination.

The resources listed here will help you keep up-to-date with developments and provide a wider coverage of syllabus topics.

CII study texts

Insurance law. London: CII. Study text M05.

Insurance, legal and regulatory. London: CII. Study text IF1.

Books (and ebooks)

Bird's modern insurance law. 12th ed. John Birds. Sweet and Maxwell, 2022.

Colinvaux's law of insurance. 13th ed. London: Sweet & Maxwell, 2022.

Drafting insurance contracts: certainty, clarity, law and practice. Christopher Henley. London: Leadenhall press, 2010.

Insurance claims. 5th ed. Alison Padfield. Bloomsbury Professional, 2021.

Insurance theory and practice. Rob Thoyts. Routledge, 2010.*

MacGillivray on insurance law: relating to all risks other than marine. 15th ed. London: Sweet & Maxwell, 2023.

The law of insurance contracts. Malcolm A Clarke. 6th ed. London: Informa, 2009.

Tort law: text, cases and materials. Jenny Steele. 5th ed. Oxford: Oxford University Press, 2022.

Tort law and liability insurance. Gerhard Wagner. Wien: Springer, 2005.

Online resources

The Insurance Institute of London (IIL) provides access to lectures from leading industry figures and subject experts speaking on current issues and trends impacting insurance and financial services. Available online at www.cii.co.uk/learning/insurance-institute-of-london (CII/PFS members only).

Recent developments in tort I and II. Alan Peck.

* Also available as an eBook through eLibrary via www.cii.co.uk/elibrary (CII/PFS members only).

Civil procedure rules. Alan Peck.
The regulatory framework. Simon Collins.

Journals and magazines

The Journal. London: CII. Six issues a year.
InsurancePOST. London: Incisive Financial Publishing. Monthly. Contents searchable online at www.postonline.co.uk.
Insurance law monthly. London: Informa. Monthly.

Reference materials

Colinvaux & Merkin's insurance contract law. Robert M Merkin. Brentford: Sweet & Maxwell. Looseleaf, updated.
Concise encyclopedia of insurance terms. Laurence S. Silver, et al. New York: Routledge, 2010.*

Exemplars

Exemplar papers are available for all mixed assessment units. Exemplars are available for both the coursework component and the MCQ exam component.

These are available on the CII website under the unit number before purchasing the unit. They are available under the following link www.cii.co.uk/qualifications/diploma-in-insurance-qualification.

These exemplar papers are also available on the RevisionMate website (www.ciigroup.org/en/my-dashboard) after you have purchased the unit.

Exam technique/study skills

There are many modestly priced guides available in bookshops. You should choose one which suits your requirements.



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Membership makes insurance and personal finance professionals better by enhancing your credibility, giving you a home within a community of like-minded individuals and the resources to achieve your career aspirations.

M05 syllabus quick-reference guide

Syllabus learning outcome	Study text chapter and section
1. Understand the nature and sources of English law and the concept of natural legal persons.	
1.1 Describe the classifications and characteristics of English law.	<i>1A, 1B, 1I</i>
1.2 Describe the sources of English law.	<i>1C, 1D, 1F, 1G</i>
1.3 Describe the professions involved within English law.	<i>1I</i>
1.4 Describe the structures and procedures of the courts.	<i>1E, 1H</i>
1.5 Describe the status and capacity of natural legal persons and corporations.	<i>1J</i>
1.6 Apply the nature and sources of English law and the concept of natural legal persons to practical situations.	<i>1A, 1B, 1C, 1D, 1E, 1F, 1G, 1H, 1I, 1J</i>
2. Understand the principles of the law of torts and the characteristics of the main torts.	
2.1 Describe the nature and classification of torts.	<i>2A, 2B</i>
2.2 Explain the main torts.	<i>2C, 2D, 2E, 2F, 2G, 2K</i>
2.3 Explain how the law of torts apply to employers' liability, products liability and occupiers' liability.	<i>2H, 2I, 2J</i>
2.4 Explain the main defences, remedies and limitations of actions in tort.	<i>2L, 2M, 2N</i>
2.5 Apply the law of tort to practical situations.	<i>2A, 2B, 2C, 2D, 2E, 2F, 2G, 2H, 2I, 2J, 2K, 2L, 2M, 2N</i>
3. Understand the law of contract.	
3.1 Explain the nature of contractual liability and classification of contracts.	<i>3A</i>
3.2 Explain the formation of a contract.	<i>3B</i>
3.3 Explain how contract terms are classified under the general law.	<i>3C</i>
3.4 Explain defective contracts.	<i>3D</i>
3.5 Explain the circumstances in which a contract may be discharged.	<i>3E</i>
3.6 Explain the remedies for breach of contract.	<i>3F</i>
3.7 Explain the doctrine of privity of contract.	<i>3G</i>
3.8 Explain the assignment of contractual rights and duties and how it applies to insurance.	<i>3H</i>
3.9 Apply the law of contract to practical situations.	<i>3A, 3B, 3C, 3D, 3E, 3F, 3G, 3H</i>
4. Understand the law of agency and its application to insurance.	
4.1 Explain the nature of agency and how an agency relationship can be created.	<i>4A, 4B</i>
4.2 Explain the nature of an agent's rights, responsibilities, authority and duties.	<i>4C, 4E, 4F, 4G</i>
4.3 Explain the termination of agency and its effects.	<i>4H</i>
4.4 Explain how the principles of agency law apply to insurance and practical situations.	<i>4A, 4B, 4C, 4D, 4E, 4F, 4G, 4H</i>
5. Understand the main principles governing the formation of insurance contracts.	
5.1 Explain how the principles of contract law apply to the formation of insurance contracts.	<i>5A</i>

Syllabus learning outcome		Study text chapter and section
5.2	Explain the concept and key elements of insurable interest.	5B
5.3	Explain how the law of insurable interest applies to the main classes of insurance.	5C, 5D
5.4	Explain the duty of fair presentation in non-consumer insurance and the effect of a breach.	6A, 6B, 6C
5.5	Explain the duty to take reasonable care not to make a misrepresentation in consumer insurance and the effects of a breach.	3D, 6A, 6B, 6C
5.6	Apply the main principles governing the formation of insurance contracts to practical situations.	5A, 5B, 5C, 5D, 6A, 6B, 6C
6.	Understand the classification and interpretation of insurance contract terms, the effects of their breach and other vitiating factors.	
6.1	Explain the classification, formation and interpretation of insurance contract terms.	7A, 7B
6.2	Explain the effect of breach of warranty or condition and how illegality arises in insurance contracts.	7B, 7C
6.3	Apply the classification and interpretation of insurance contract terms to practical situations.	7A, 7B, 7C
7.	Understand the main legal principles governing the making of an insurance claim.	
7.1	Describe the parties who can claim on or benefit from an insurance contract.	8A
7.2	Explain the rules governing notice and proof of loss.	8B
7.3	Explain the insured's contractual duty to mitigate or prevent an insured loss.	8C
7.4	Explain the doctrine of proximate cause.	8C
7.5	Explain the investigation of fraudulent claims and the remedies available to the insurer.	8D
7.6	Apply the main legal principles governing the making of an insurance claim to practical situations.	8A, 8B, 8C, 8D
8.	Understand how losses are measured and how the principle of indemnity applies to insurance claims.	
8.1	Explain the principle of indemnity.	9A
8.2	Explain the measure of indemnity in various classes of insurance.	9B
8.3	Explain the factors which limit, reduce, extend or modify the principle of indemnity.	9C
8.4	Explain the methods of providing indemnity.	9D
8.5	Explain the doctrine of salvage and abandonment.	9E
8.6	Explain the effect of claim payments on policy cover.	9F
8.7	Apply how losses are measured and the principle of indemnity to practical situations.	9A, 9B, 9C, 9D, 9E, 9F
9.	Understand how the principles of subrogation and contribution apply to insurance claims.	
9.1	Explain the doctrine of subrogation in insurance.	10A, 10B, 10C
9.2	Explain the source of subrogation rights and apply the law to practical situations.	10D
9.3	Explain how subrogation rights may be modified or denied and apply the law to practical situations.	10D
9.4	Explain the effect of market agreements on rights of contribution.	10I
9.5	Explain the nature of double insurance and operation of contribution.	10E, 10F, 10G

Syllabus learning outcome	Study text chapter and section
9.6 Apply the principle of contribution to the main lines of insurance and to practical situations.	10H

Exam guidance and accessibility

Before you begin the study text, we would encourage you to read about how to approach the exam.

Study skills

While the text will give you a foundation of facts and viewpoints, your understanding of the issues raised will be richer through adopting a range of study skills. They will also make studying more interesting! We will focus here on the need for active learning in order for you to get the most out of this core text.

Active learning is experiential, mindful and engaging

- **Underline or highlight key words and phrases** as you read – many of the key words have been highlighted in the text for you, so you can easily spot the sections where key terms arise; boxed text indicates extra or important information that you might want to be aware of.
- **Make notes in the text**, attach notes to the pages that you want to go back to – chapter numbers are clearly marked on the margins.
- **Make connections to other CII units** – throughout the text you may find ‘refer to’ boxes that tell you the chapters in other books that provide background to, or further information on, the area dealt with in that section of the study text.
- **Take notice** of headings and subheadings.
- **Use the clues in the text** to engage in some further reading (refer to the syllabus reading list) to increase your knowledge of a particular area and add to your notes – be proactive!
- **Relate** what you’re learning to your own work and organisation.
- **Be critical** – question what you’re reading and your understanding of it.

Five steps to better reading

- **Scan**: look at the text quickly – notice the headings (they correlate with the syllabus learning outcomes), pictures, images and key words to get an overall impression.
- **Question**: read any questions related to the section you are reading to get a feel for the subjects tackled.
- **Read**: in a relaxed way – don’t worry about taking notes first time round, just get a feel for the topics and the style the book is written in.
- **Remember**: test your memory by jotting down some notes without looking at the text.
- **Review**: read the text again, this time in more depth by taking brief notes and paraphrasing.

On the Web

Visit here for more detail on study skills: www.open.ac.uk/skillsforstudy.

Note: website reference correct at the time of publication.



Exam guidance

Answering multiple-choice questions

When preparing for the examination, candidates should ensure that they are aware of what typically constitutes each type of product listed in the syllabus and ascertain whether the products with which they come into contact during the normal course of their work deviate from the norm, since questions in the examination test generic product knowledge.

Some questions are simply questions of fact, whereas others may be more progressive in nature, requiring reasoning to determine the correct option or, perhaps, being answerable by a process of elimination. Whatever the question, read it carefully to identify what it is really asking. Do not assume that you 'know' what it is asking, even if the question is on a topic about which you feel very confident; answer the question exactly as it is asked. Also, look out for the occasional negative question (Which of the following is not ...?).

Try to answer all of the questions. While there is no substitute for a good grasp of the subject matter, and you cannot expect to pass the examination purely on guesswork, you do not lose marks for giving a wrong answer!

You can find more information on the specific unit in the exam guide (available on the unit page on the CII website and on RevisionMate).



On the Web

You can find more on preparing for your exam by visiting: <https://www.cii.co.uk/learning/qualifications/assessment-information/before-the-exam/>.

Note: website reference correct at the time of publication.

Accessibility

The CII has produced a policy and guidance document on accessibility and reasonable/special adjustments. The purpose of this is to ensure that you have fair access to CII qualifications and assessments.



On the Web

The 'Qualifications accessibility and special circumstances policy and guidance' document can be found here: www.cii.co.uk/media/bxsjd2e2/cii-qualifications-accessibility-and-special-circumstances-policy-and-guidance.pdf.

Note: website reference correct at the time of publication.

Introduction

At its core, insurance is a promise to pay claims: the policyholder pays the premium, and in return the insurer pays valid claims. For this to work, the policyholder must be secure in the knowledge that the insurer will be true to its word and honour its commitments. Should the insurer fail to fulfil its obligations, the policyholder is not without recourse. A well-established legal framework exists to protect their rights, ensuring that insurers remain accountable. If necessary, the policyholder can seek enforcement through the courts, compelling the insurer to meet its obligations and pay legitimate claims. Understanding this legal framework is not just beneficial – it is essential for anyone studying insurance. A strong grasp of insurance law enables students to appreciate the principles that uphold the industry, navigate complex disputes, and ensure fairness in the insurer-policyholder relationship.

In chapter 1, we examine the legal system and discuss legal personality – how the law applies to different types of natural persons (humans) and juristic persons (e.g. companies).

In chapter 2, we consider civil wrongs such as negligence, trespass and nuisance. This subject is particularly relevant to liability insurance, where most claims are based on tort.

Chapter 3 addresses the general principles governing private contractual relationships. This is fundamental to insurance, as an insurance policy is a contract whereby insurers promise to pay claims.

In chapter 4, we look at the principal-agent relationship. Again, this is of particular importance to insurance as in many developed insurance markets (including the United Kingdom), the insured and insurer often enter into a contract via an insurance broker. In most of these cases, the insurance broker represents and is therefore the agent of, the insured for the vast majority of tasks.

Chapter 5 deals specifically with insurance contract law – how contracts come into force and how the various contractual components operate. Insurance is governed by special legal principles and we look at insurable interest, which requires the insured person to have an interest in the subject matter insured, so that loss of the subject matter would cause a financial loss to the assured. In life insurance, for example, the interest is the wellbeing of the insured person.

Chapter 6 examines the information duty imposed on the assured prior to inception of the insurance contract: in other words, what must the potential insured tell the insurer before obtaining insurance. This differs between consumers and businesses. The reader will learn about the duty of disclosure, the duty to not make misrepresentations (tell untruths) to the insurer, the matters that fall under these duties, and the consequences of the insured's failure to comply with these duties.

Chapter 7 deals with the classification of terms in the insurance contract. In other words, dividing the terms of the insurance contract into different groups according to their type. This is important as the consequences of not adhering to different terms can differ markedly. According to the law, it is not always how the term is labelled but whether it is a risk-defining or a risk-mitigating term, and in the event of the former, whether the assured's non-compliance with it could have increased the likelihood of the risk in the loss event.

Chapter 8 is about the person who can make a claim under the insurance contract. As identified in chapter 3, contracts are private relationships and whether a third party outside this private relationship can make a claim under an insurance contract is one of the issues discussed. Moreover, the claims notification obligation imposed on the insured, the insured's burden of proof (the insured's duty to provide evidence that a loss has occurred and that it is covered under their insurance policy), and the insurer's potential liability for damages for late payment are examined in this chapter. We also cover the consequences of dishonesty when claiming (fraudulent claims) and outline the main types of claims fraud, the requirements to demonstrate fraud and the remedies available.

Chapter 9 covers the calculation of the loss payable to the insured and everything that entails. We also look at the contractual terms determining deductibles and the insurer's maximum liability, including valued policies, underinsurance, average clauses, successive losses and reinstatement of the subject matter insured.

Chapter 10 examines the meaning of subrogation and defines the circumstances under which the insurer's right of subrogation arises. We also look at different circumstances relating to the allocation of subrogation recovery. Lastly, we explain the principle of contribution – where two or more insurers are each liable for an insured loss, therefore each insurer contributes to the loss payment.

Scenarios included in the relevant chapters are linked with the application-based learning outcomes. The scenarios aim to encourage students to think critically and practise planning answers using the four-step IRAC approach:

- I – provide an introduction that identifies the focus of the question;
- R – look at the relevant areas of law;
- A – apply the principles of the law to the scenario; and
- C – provide a conclusion to your answer.

This will enable students to build on the skills required for the M05 multiple-choice questions examination and the coursework assignments.

All scenarios are set in England and it is important to note that the M05 study text is based on English law. However, international aspects of insurance law also apply on occasion and there are some references to the differences between insurance law in the United Kingdom and in other territories.

Each chapter summarises key issues and some key questions and answers are included on the final pages of each chapter.

Appendix 7 (available on RevisionMate) lists cases that are the most significant for the study of M05.

Finally, for the sake of simplicity, the word 'insurance' is used throughout this study text in connection with both life and non-life business. The word 'assurance' is used only where it appears in a direct quotation or in the name of a statute, even though in the insurance sector, the word 'assurance' is used for life and term insurance contracts.

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1

Law and legal systems

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Learning objectives

After studying this chapter, you should be able to:

- explain how law is classified in relation to public and private, criminal and civil law;
- describe the characteristics of the English legal system;
- discuss the development of English law, including common law, equity, custom and legislation;
- explain the common law system;
- discuss delegated legislation and statutory interpretation;
- discuss the effect of supranational legislation on national systems;
- describe the courts and the system of precedent;
- describe the basic elements of civil procedure and funding of litigation;
- explain the status and capacity of natural legal and juristic persons; and
- compare corporations and unincorporated associations.

Introduction



Consider this...

What do we mean when we speak about 'the law'?

We are referring to the body of general rules which governs and controls the behaviour of people in the country or sovereign state in which we live.



Consider this...

What happens if we break legal rules?

Unlike some types of rules, such as moral rules, legal rules are always backed by sanctions (consequences), which mean that we will face some penalty or adverse consequence if we break them. We may, for example, be punished for doing wrong or be made to pay compensation to a person we have harmed.

What are laws based upon?

Generally, laws are only acceptable to people if they reflect the feelings of the community as to what is right, and what is wrong. It is, therefore, true that some of our law, particularly criminal law, is based on morality.

At the same time, much of our law is simply to regulate the economy and to ensure that life is orderly and civilised.



Example 1.1

- Tax regulations exist simply for the sake of economic efficiency.
- The rule requiring all drivers to drive on the left side of the road (or right, as the case may be) exists in the interest of safety rather than morality.
- Much non-consumer (business) law, including the rules governing insurance contracts, is simply to ensure that commerce functions smoothly and according to principles which are clear and well-understood.

How are laws enforced?

Whatever the basis of legal rules, there must be mechanisms to enforce them. Otherwise they may be ignored, leading to disorder and confusion. Therefore, legal systems in developed societies have created systems for bringing wrongdoers to justice, established courts to hear disputes and try offenders, and designed mechanisms to ensure that disputes between private parties are resolved with decisions that can be enforced.

How do laws and legal systems differ from country to country?

Laws and legal systems vary from one state to another. It is important to note that the M05 study text is based on **English law**.

The body of rules which applies in England is known as English law.

In fact, it applies to England and Wales, and also generally, to Northern Ireland. The Scottish legal system has different origins from those of English law. It is more akin to the legal systems of some continental countries and, like them, is based upon Roman law. However, England and Scotland have been governed together for over 300 years, and most legislation enacted by the UK Parliament applies to both countries. The systems have much in common, even though their respective terminologies still vary.

English common law

English common law (a term which we will explain) is also one of the major legal systems in the world. It has been adopted in many countries including the US and most old Commonwealth countries, including part of Canada, Australia, New Zealand and many states in Africa and the Far East. The other system which has spread widely and dominates continental Europe is Civil law, which is based on the laws of ancient Rome.

How does this relate to insurance?

An insurance policy is a legal contract – insurers and insureds are subject to laws that apply to all contracts, and to principles that apply specifically to insurance. Having knowledge

of the framework, legislation and court decisions that underpin our legal system will help improve your understanding of how and why insurance operates in the way that it does.

Be aware

Generally, the term 'civil law' can denote two distinct meanings:



Civil law system: this is a legal system inspired by Roman law, and the primary basis for legal statutes is legislation, as opposed to case law (also known as common law). It is used in many countries worldwide, including most of continental Europe, Latin America, and parts of Asia and Africa.

Civil law as opposed to criminal law: civil law in this context refers to the branch of law that deals with disputes between individuals and organisations, which is distinct from Criminal Law, which is the body of law that refers to crime.

Key terms



This chapter features explanations of the following ideas:

Adversarial system	Balance of probabilities	Barristers	Civil Procedures Rules
Codification	Common law	Corporations	Criminal law
Delegated legislation	Jurisdiction	Juristic persons	Natural persons
Precedent	Private law	Solicitors	Statute law
Unincorporated associations			

A Classification of law

There are a number of ways in which law may be classified. We have already distinguished between countries whose systems are based on **English common law** and countries whose systems are based on civil, or Roman, law.

A basic distinction is often made between **public law** and **private law**.

A1 Public law

Public law is concerned with the legal structure of the state and relationships between the state and individual members of the community. It also governs the relationship between one state and another.

It includes constitutional law, administrative law and **criminal law**.

A1A Constitutional law

Constitutional law refers to the structure of the main institutions of government and how they work with each other, including the relationship between the two Houses of Parliament in the UK and between central and local government.

It also includes:

- the making of treaties with foreign states; and
- the status, function and powers of the Monarch, Members of Parliament, Government Ministers, the Judiciary, the Civil Service and the Armed Forces.

Every country with a written or unwritten constitution will have its own body of constitutional law. For instance, in the United States, much of constitutional law revolves around interpretations of the U.S. Constitution by the Supreme Court. In the UK, which does not have a single written constitution, constitutional law is based on statutes, common law, and conventions.

A1B Administrative law

Administrative law is often regarded as a branch of constitutional law. It concerns the legal relationship between private citizens and the various agencies of local and central government, and the impact of their activities on ordinary individuals.

Examples falling within the area of administrative law include:

- questions of local rating;
- taxation and compulsory acquisition of land;
- the powers of local boards and authorities in relation to highways;
- health and education; and
- the granting of licences for various trades and professions.

A1C Criminal law

Criminal law touches everyone's lives in more ways than we might realise. Think about it – have you ever driven your car over the speed limit? Disregarded a red light while driving? Accidentally placed something in your shopping bag without paying? Each of these actions could potentially be a criminal offence with associated penalties. It's likely that at some point most people have either fallen victim to a crime, witnessed one, or perhaps even unknowingly committed one.

Criminal law covers a broad spectrum, addressing a wide range of criminal offences such as:

- offences against persons and property including theft and burglary;
- offences against the person such as murder, manslaughter, rape, and assault;
- drug offences;
- road traffic offences;
- offences against public order; and
- offences against public morals.

On the other side there is a range of both specific and general defences, such as loss of control, self-defence, duress, and automatism.

The definition of what is deemed criminal can differ based on geographic location and historical context. Take homosexuality as an instance: while it's a crime in places like Saudi Arabia, it's not in countries like England and Wales. Also, perceptions of certain behaviours evolve over time. In England and Wales, for instance, attempting suicide was once a crime, but this changed in 1961 with the introduction of the Suicide Act. This illustrates how societal views and legal frameworks evolve, shaping our understanding of what's considered a criminal act.

A crime is conduct which the law deems to be criminal under statute (an Act of Parliament) or common law (case law). Such conduct is prohibited because it involves the threatening or causing of harm to individuals or to public interests. Conduct may be deemed to be criminal due to moral and/or social reasons. Although a crime may be committed against a specific individual, a crime is classed as a public wrong as it affects the public at large by making society feel less secure and safe from harm.

Comparing criminal law to the law of tort and contract law

Criminal law is distinct from other legal realms like tort or contract law, though intersections exist between them. While criminal law falls under public law, impacting the broader society, tort and contract law are subcategories of private law, affecting individuals. The legal processes also differ. In criminal cases, the state (or the Crown) brings charges against a person, while in tort or contract law, an individual initiates a lawsuit against another party. The essence of criminal law is to address actions that society deems unacceptable, marking them as public wrongs. In contrast, tort and contract law address private disputes between parties.

The outcomes of trials in these domains also differ. In criminal cases, a verdict concludes the trial, with the accused either being declared guilty or not guilty. Those found guilty face varying penalties, from imprisonment to fines or community-based sentences. On the other hand, if found not guilty, the accused is acquitted. Meanwhile, in civil trials, the judgment is whether the defendant is liable or not. The main goal of civil law is to offer compensation to the aggrieved party, typically in the form of monetary damages.

Function of criminal law

Criminal law serves several key purposes:

1. It establishes behavioural benchmarks that citizens are expected to adhere to, and these benchmarks mirror societal values, which can be rooted in morality or religious beliefs.
2. It forbids actions that pose harm either to individuals or the broader community.
3. The core of the criminal justice system is retributive, aiming to penalise those who commit offences.
4. A commonly cited rationale for labelling certain behaviours as criminal is the principle of deterrence. The notion is that by designating an act as unlawful, it deters the general population from engaging in such behaviour. Through penalising wrongdoers, the system aims to motivate the public at large to abide by the law.

Sources of criminal law – statute and common law

Over time, some crimes have been established through court decisions, known as common law offences. Murder and manslaughter, for instance, are crimes defined by the precedent set by judges in past cases, and their definitions continue to rely on case law.

Conversely, there are crimes explicitly defined by legislations or statutes, termed as statutory offences. For example:

- Theft, as per the Theft Act 1968 (s.1).
- Rape, as outlined in the Sexual Offences Act 2003 (s.1).
- Intentional wounding or grievous bodily harm, according to the Offences Against the Person Act 1861 (s.18).

While these offences are statutorily outlined, their specifics can sometimes be further refined by subsequent case law. In some unique instances, an offence might be prosecuted based on a statute, but its exact definition is grounded in common law. A case in point is assault and battery: they are prosecuted under the Criminal Justice Act 1988 (s.39), but their definitions are influenced by the court decision in *Fagan v. Metropolitan Police Commissioner (1969)*.

Categories of criminal offences

Offences are often classified by their seriousness. There are three categories of criminal offence:

- summary offences;
- either-way offences; and
- indictable-only offences.

Summary offences are minor crimes, dealt with exclusively in Magistrates' courts. Either-way offences can be tried at either a Magistrates' court or Crown court, depending on the severity of the crime. Indictable only offences are the most serious offences and include murder, manslaughter, rape, robbery, and wounding or causing grievous bodily harm with intent. These offences carry high penalties upon conviction, sometimes with a maximum sentence of life imprisonment. These offences must always be tried in the Crown Court with a jury.

The criminal justice process

When a criminal offence occurs, it is usual practice for the police to investigate the alleged offence and for the state (more specifically, the Crown Prosecution Service (CPS)) to prosecute the alleged offender.

Let us imagine that your car is stolen. Most people would phone the police to report the car stolen – upon reporting, the criminal process begins:

Investigation

The next step would be for the police to investigate this offence. They would take a witness statement from you and from any other witnesses who may have been around at the time, they would seize any CCTV footage which might be available, and they would try to find the offender.

Arrest and charge

When a potential culprit is identified, the police officer would arrest them on charges of theft and then question them at the police station. It's crucial to understand that there are specific rules and guidelines regarding the treatment and procedures involving arrested individuals at the station. You, as a victim or witness, might be asked to participate in an identification

lineup to possibly recognise the offender. If the evidence is deemed substantial, the officer, after liaising with the Crown Prosecution Service (CPS), would formally charge the suspect with theft and forward the case details to the CPS. The CPS holds the authority to decide whether to press charges. If they choose not to, the case is dropped.

Should the CPS decide against prosecution, you have the alternative to pursue a private prosecution.

First court appearance

Following the charging of a suspect, the next step in the criminal journey is their initial court appearance. The individual in question, now referred to as the defendant, will be presented in court promptly after being charged. The case is typically labelled as R v [Defendant], where the 'R' represents the King, symbolising the state's action against the accused. This initial hearing invariably happens at the local Magistrates' court. Here, the defendant hears the charges against them and verifies personal details like their name and address. A date for a subsequent court hearing is then scheduled.

As the process advances, there may be multiple pre-trial hearings before the actual trial date is determined. The trial can be held either at the Magistrates' court or the Crown Court, depending on the nature and severity of the charged offence. In this context, since the defendant is accused of theft (an offence that can be tried either way), a 'mode of trial' procedure will decide if the trial will occur at the Crown Court or remain at the Magistrates' court.

The trial

When a case is brought against a defendant, the onus falls on the prosecution to establish the defendant's guilt for the crime. The prosecution presents their arguments and evidence first, bringing forth their witnesses (referenced as figure 1.3). Once the prosecution concludes its presentation, the defence has the option to challenge with a 'no case to answer' argument. Often termed a 'half-time submission', the defence claims that the prosecution either hasn't convincingly demonstrated the crime's components or that the presented evidence is so insubstantial that no reasonable jury (or magistrates) could convict based on it. If this challenge succeeds, the trial ends with a directed acquittal. If not, the defence proceeds to present their side and witnesses. Following this, both parties give their closing statements.

If the trial is in the Magistrates' court, the decision-makers – typically three Justices of the Peace or a single District Judge – will adjourn to deliberate on their verdict. If the case is in the Crown Court, the presiding judge summarises the case's facts and instructs the jury on the relevant laws. The jury then takes its time to decide the outcome. The verdict, be it from magistrates or a jury, is then announced publicly in court.

The verdict and sentencing

When the jury or magistrates declare a defendant not guilty, the individual is acquitted and permitted to depart from the courtroom. Conversely, if a guilty verdict is reached, the individual is formally recognised as having committed a crime, and the court then decides on a suitable punishment. However, the sentencing might not occur immediately post-verdict. It's common for the presiding judge to postpone the sentencing for around a month to obtain a pre-sentence report (PSR). This report, crafted by a probation officer after several sessions with the convicted individual, suggests potential sentencing options. The judge takes this report into consideration during the sentencing phase. During the actual sentencing hearing, after listening to both prosecution and defence arguments, the judge selects an appropriate punishment based on the crime's nature and the defendant's circumstances.

The spectrum of potential sentences is vast, encompassing options like jail terms, suspended prison sentences, community rehabilitation directives, and community service orders, among others.

Burden of proof

In most instances, when an individual (referred to as the defendant) is charged with a crime, it's the government or the state that initiates the prosecution. Given that the state, with its vast resources and authority, is taking action against an individual, who doesn't possess similar resources or power, the legal system mandates that it's up to the prosecution to establish the defendant's guilt and counter any defences raised. The defendant isn't obligated to prove anything, operating under the foundational legal principle that they are innocent until the prosecution proves their guilt.

This foundational principle is often termed the 'presumption of innocence'. This concept is protected under Article 6.2 of the European Convention on Human Rights and is integrated into the legal system of England and Wales via the Human Rights Act of 1998.

Standard of proof

In criminal cases, the onus of proving guilt lies heavily on the prosecution, and they must establish guilt 'beyond reasonable doubt.' This stringent standard is set because the consequences for the defendant in criminal trials can be severe, ranging from potential loss of freedom through imprisonment to significant reputational damage.

On the other hand, in civil cases, where disputes might revolve around contracts or personal injuries, the most common consequence for the liable party is typically monetary compensation. The heightened threshold for proof in criminal trials also acknowledges the inherent imbalance between the vast resources of the state and the limited resources of an individual defendant.

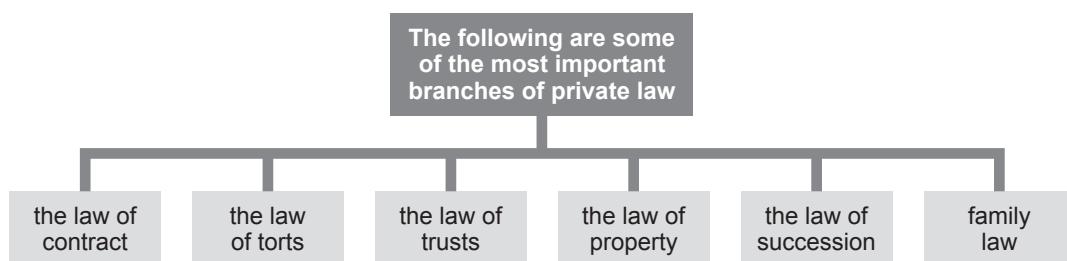
In contrast, civil cases typically involve disputes between parties who, in many cases, possess more comparable resources, although there are notable exceptions, such as when an individual challenges a large corporation. For juries in criminal trials, the guiding principle is clear: unless the prosecution's evidence convinces them of the defendant's guilt beyond a reasonable doubt, they are obligated to acquit the defendant.

Summary

- Criminal behaviour varies from country to country and from era to era.
- A crime is classed as a public wrong as it affects the public at large.
- The criminal law is punitive and seeks to act as a deterrent.
- In criminal proceedings, a prosecution is brought by the state (the Crown Prosecution Service (CPS)).
- There are two sources of criminal law: statute and common law.
- Offences may be classified as: indictable only, either-way, or summary only.
- Criminal trials will take place either in the Magistrates' court (with three Justices of the Peace or one District Judge) or in the Crown Court (with a judge and jury).
- The prosecution bears the burden of proving that the defendant committed the offence.
- The standard to which they must prove this is 'beyond reasonable doubt'.

A2 Private law

Private law governs the relationships between legal persons such as individuals, businesses and other organisations. We will look at these in turn in [Legal personality](#) on page 1/37.



Private law is also commonly known as civil law (from the Latin word for citizen). In fact, this term is used more often than the term 'private law' in England.

How does this relate to insurance?

The legal rules which govern insurance are part of civil law. The areas most applicable to insurers are the **law of contract** and the **law of torts** – the latter being particularly relevant to liability insurance. We will discuss both areas in detail in this study text. The other branches of private and public law mentioned above are of limited importance in the context of insurance so we will not explore them, although occasional references will be made to criminal law.

A3 Jurisdiction

Before we continue further in our analysis of law and legal systems, it is important to consider the concept of jurisdiction in a broad sense. Jurisdiction means both:

- the **authority or power of a specific court** to determine a dispute between parties; and
- the **territory over which the legal authority of a court extends**.

Let's look at an example where jurisdiction forms part of the insurance contract. For example, suppose a dispute arises between an insurer and a policyholder regarding a claim under a marine insurance policy. If the insurance policy specifies that disputes are subject to the exclusive jurisdiction of the High Court in England, then only the High Court has the authority to resolve the matter. This jurisdictional clause ensures that any legal actions related to the policy will be heard in the specified court, even if one of the parties is based outside England. Such clauses are common in international insurance contracts to provide certainty and predictability about where disputes will be adjudicated, particularly in industries like marine or aviation insurance, where parties from different jurisdictions are often involved.

Let us now consider an example where jurisdiction is determined independently of any contractual agreement. Imagine a dispute arising from a car accident in London, England, that caused personal injury to one of the parties involved. For the purposes of this example, we will set aside any references to insurance. If the case is brought before a court, the English court's jurisdiction would generally be established based on the following factors:

- **Territorial jurisdiction**: since the accident occurred in London, the English courts have territorial jurisdiction as the event took place within their geographical area of authority.
- **Subject matter jurisdiction**: the case involves a personal injury claim, a matter that falls within the scope of issues that English civil courts are authorised to adjudicate.

In this scenario, jurisdiction is determined by general principles of law, such as territorial and subject matter jurisdiction, rather than by any agreement between the parties.

More generally, jurisdiction can also refer to a **specific geographical area where a legal system or authority operates**. For example, Switzerland and the United Kingdom have different legal systems, and each jurisdiction applies its own legal system, laws and regulations.

B Characteristics of English law

English law has some characteristics which distinguish it from other legal systems, and particularly from those of continental Europe.

These include:

- age and continuity;
- little codification;
- judge-made law;
- independence of the judiciary;
- adversarial system;
- no written constitution; and
- rule of law.

B1 Age and continuity

English law has a long history and has developed without interruption over 900 years. Many cases and statutes which go back more than 500 years remain in force and some examples, such as the old cases on trespass, are quoted in this text.

B2 Little codification

A legal code is a systematic collection of written laws arranged to avoid inconsistency and overlapping.

In many countries the entire law, or at least a great part of it, has been reduced to a series of written codes, each containing the whole of the law on a particular subject.

Certain parts of English law have been codified, including a fair proportion of the criminal law. However, codification of the civil law is only in a few areas, such as the law relating to partnerships, the sale of goods, bills of exchange and marine insurance.

We will return to the topic of codification when we discuss the various types of legislation.

B3 Judge-made law

The decisions of judges in the superior courts have had, and continue to have, a profound effect on the growth and development of English law. In many other countries the function of a judge is merely to interpret and apply statutory codes of law.

In England, however, the system of binding *precedent* allows the decisions of judges to become part of the law itself and allows the law on a particular subject to adapt and develop through a series of binding decisions. We will look at this in more detail in *Precedent and case law* on page 1/19.

B4 Independence of the judiciary

Consider this...

In some jurisdictions such as the US, some judges are elected by the voters. How are English judges appointed?



Judges are appointed by the Monarch on the recommendation of the Lord Chancellor. The Judicial Appointments Commission (JAC) is an independent commission that selects and recommends candidates for judicial office in courts and tribunals in England and Wales. The Commission was set up on 3 April 2006, under the terms of the **Constitutional Reform Act 2005**. Senior judges can only be removed from office before their retirement age of 70 by a motion approved by each House of Parliament. Junior members of the judiciary may be removed by the Lord Chancellor only on grounds of incapacity (e.g. through illness) or misbehaviour.

Reinforce

Judges in the UK are, therefore, largely free from political interference.



B5 Adversarial system

Under the English legal system, a court case is essentially a **contest** between two sides:

- In a civil case, it is between the claimant (previously called the plaintiff) and the defendant.
- In a criminal case, it is between the prosecution and the defence.

The court itself, consisting of a judge or judges and sometimes a jury (a body of twelve ordinary citizens who provide a verdict on the basis of evidence submitted), remains neutral. The role of the court is not to investigate but simply to listen to the evidence presented by the two sides and then give judgment for one side or the other. This is known as an **adversarial system**.

In civil proceedings, the claimant has the burden of proving their case on the **balance of probabilities** (i.e. more likely than not).

In criminal proceedings, guilt must be proven 'beyond reasonable doubt'. This means that the court must be completely sure that the allegations made by the prosecution are true before the defendant can be convicted.

A different system that is common in continental Europe is the **inquisitorial system** in which the court does not remain neutral but plays an active part in discovering the truth. The only courts in England which employ an inquisitorial procedure are the coroners' courts, which inquire into cases of violent, unnatural or suspicious death.

Activity

What are the advantages and disadvantages of an adversarial system as opposed to an inquisitorial system?



Refer to

Refer to [Elements of civil procedure](#) on page 1/28 for civil procedure

The **Civil Procedure Rules**, which came into force in April 1999, could be said to signal a gradual change in the role of the English courts. These rules grant the courts more extensive powers to 'manage' cases which come before them.

B6 No written constitution

English law differs from that of many other countries in that it has not traditionally defined any fundamental, unchangeable rights for its citizens. In England there is simply freedom to do anything not specifically prohibited by law.

Many countries, on the other hand, have a written constitution, one function of which is to specifically define the fundamental rights and freedoms of citizens – a so called 'bill of rights' – (such as freedoms of speech, religion and the freedom to associate with others).



Example 1.2

The US constitution provides a well-known example. This even allows legislation to be challenged in courts on the grounds that it is 'unconstitutional'.



Be aware

Although the UK does not have its own 'bill of rights', it is party to the European Convention for the Protection of Human Rights and Fundamental Freedoms and recognises the right of its citizens to take grievances to the European Court of Human Rights in Strasbourg. Many convention rights have been 'incorporated' into English law by the **Human Rights Act 1998** (see [The effect of the Human Rights Act on statutory interpretation](#) on page 1/18). New legislation presented to Parliament must now include a declaration as to whether it is compliant with the protected convention rights.

B7 Rule of law

Although the constitution of the United Kingdom is unwritten, it includes what has become known as the 'rule of law'. This is a rather imprecise concept but is generally regarded as embracing the following principles:

- the powers exercised by politicians and officials must have a proper foundation and be based on authority given to them by law – this is linked to the separation of powers between the executive (policy makers), legislature (law makers) and judiciary (enforcement);



Be aware

The UK Supreme Court's ruling that the Prime Minister's decision 'to advise Her Majesty to prorogue Parliament was unlawful because it had the effect of frustrating or preventing the ability of Parliament to carry out its constitutional functions without reasonable justification' is a clear illustration of the UK courts' role in ensuring that the constitutional principles are observed by the executive.

- the law generally should be reasonably certain and predictable;
- people should be treated equally under the law, which should not allow unfair discrimination;
- no one should be punished or deprived of their property, status or other rights unless they are given a fair hearing by an impartial court or tribunal; and
- every person should have a right of access to the courts, which will defend the liberties and freedoms of the individual.

C Development of English law

In this section, we will look at the process whereby local customs were developed into *common law*, i.e. a system of rules which applied throughout the country. We will also consider how the development of common law led to the creation of another set of rules, known as **equity**.

C1 Development of common law

Although there were laws and courts in England before the Norman conquest in 1066, there was no single system of law for the whole country. Justice was administered in local courts and the legal rules applied were based largely on local customs, which often varied from place to place.

After the conquest of 1066, the Normans sought to establish a strong central government and administration to reinforce their hold on the country. Central 'Royal' courts developed and eventually became established permanently at Westminster in London. At the same time, the King regularly sent out official representatives to other parts of the country to check on the local administration. These 'travelling judges' gradually adopted a judicial function and started to select the best customary rulings and apply them everywhere, adding new general rules which they created themselves.

Local variations in law slowly disappeared and a uniform body of law emerged. The power of the local courts declined, and justice increasingly became associated with the Royal Courts in London and the King's representatives in the shires or counties.

The common law had many defects. For example, in the early years, the only remedy given was an award of damages, i.e. financial compensation. Elaborate rules governed the procedure which had to be followed in bringing a case and a breach of these might leave the claimant without redress. Furthermore, the rich often escaped justice by bribing witnesses and juries, and sheriffs were often biased in their favour.

Those who were dissatisfied with the common law sometimes petitioned the King for relief as he had the power to make law and hear cases. In practice, the King passed these petitions to the Lord Chancellor, his chief minister and head of the secretarial establishment. Eventually, petitions were addressed directly to the Chancellor and dealt with solely by him.

In the early days, the Lord Chancellor was always a churchman and the spiritual adviser to the King. As such, he was more concerned with ensuring that individuals carried out their moral obligations than with applying the strict letter of the law.

In 1474, a **Court of Chancery**, distinct from the King's Council and the royal 'common law' courts, was formally established and presided over by the Lord Chancellor. The system of rules which was developed and applied in the Court of Chancery became known as equity. This literally means fairness, reflecting the Chancellor's original role as a spiritual leader.

C2 Development of equity

1500s

By the sixteenth century, the Court of Chancery's influence was widespread and its jurisdiction became a threat to that of the common law courts. The conflict this caused between the two systems came to a head in the **Earl of Oxford's case (1616)**. This resulted in a ruling that if there was a conflict between common law and equity, equity should prevail.

1600s

During this period, the Court of Chancery began to follow its own precedents in the same way that the common law courts did. This meant that equity also came to have its own fixed rules and principles.

Equity and common law operated alongside each other as two separate systems administered in different courts. A claimant who lost their case in the common law courts and wished to invoke the rules and remedies of equity might have to start their action all over again in the Court of Chancery, involving extra cost and delay.

Judicature Acts 1873–75

The **Judicature Acts 1873–75** amalgamated the common law courts and Court of Chancery into a single system called the Supreme Court of Judicature (now named the Senior Courts of England and Wales).

The principles and remedies of both common law and equity could now be administered in any court and in the same action. The principle that equity should prevail in the case of a conflict with common law was restated.

C3 Summary

Legal writers disagree as to whether the common law and equity are now 'fused' into one set of rules and principles, or are still in some way separate.

The term 'common law' refers to a unified system of law: the parts of English law that are contained in the decisions of the courts, such as in case law (judge-made law) rather than in statute law (which consists of Acts of Parliament and written rules and regulations).

However, equity can be described as a 'gloss' or supplement to the common law, and is best understood as a collection of rules offering an alternative solution to some legal problems.

The principles and remedies which equity has given to our legal system are:

- the law of trusts – a trust is a legal relationship created (in lifetime or on death) by a settlor through which assets are placed under the control of a trustee either for the benefit of a beneficiary or a specified purpose;
- specific performance – a court order compelling a person to carry out a promise which they have given to another; and
- injunction – a court order compelling a person to do something or prohibiting them from doing something.

There are various other examples of principles which derive from equity, including the principles of promissory estoppel (the rule that a promise can be enforceable by law, where the promisee relies on that promise to their detriment) and the insurance principles of subrogation and contribution (which we will discuss in chapter 10).

D Sources of English law

We have examined the way in which English law developed historically.



Consider this...

Would the law as it was in Victorian times still be effective now? What has changed since then, and what does that mean for the development of the law?

In the last 100 years or so, the pace of industrial and social change has been rapid – think of inventions such as the motor car, aircraft, nuclear power and the internet.

The law must continue to develop to reflect changes in the way we live:

Social changes	Changes in the way in which people are expected to behave.
Technological changes	New inventions or scientific developments which require legal control.

Whatever the source of change, old laws which have become obsolete will need to be removed, and new laws will become necessary, requiring the whole system to constantly evolve.

We will now look at the ways in which new legal rules can be made and how the legal system can develop.

There are two main sources of new law:

- legislation; and
- judicial precedent (or case law).

In addition, there are one or two minor sources, such as:

- local custom; and
- legal books and treatises.

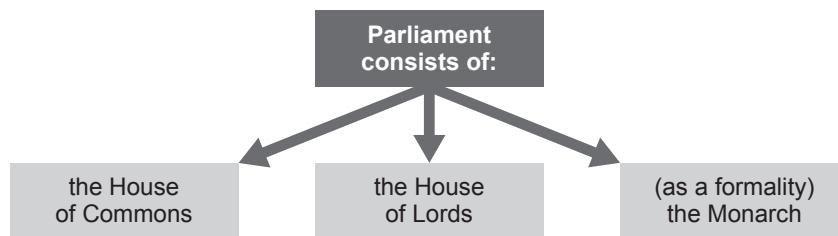
The Protocol on Ireland/Northern Ireland (Northern Ireland Protocol) sets out the arrangements required to avoid a hard land border in Ireland, maintain the necessary conditions for continued north-south co-operation, and protect the Good Friday Agreement.

The Protocol:

- Requires Northern Ireland to remain aligned to EU single market and customs rules required to avoid a hard land border in Ireland (Articles 5–10, Protocol). These include specified provisions of EU law relating to goods and customs, VAT and excise on goods, agriculture and the environment, the single electricity market, and state aid.
- Requires the UK to provide opportunities for the Northern Ireland Assembly to decide to discontinue the application of Articles 5 to 10. The first opportunity to make such a decision arises just under four years after the end of the transition period.
- Provides that Northern Ireland remains part of the UK's customs territory and the UK's VAT area, and sets out the circumstances in which EU, UK, or no customs duty is payable on goods entering Northern Ireland.
- Makes UK authorities responsible for implementing and applying the provisions of EU law which apply to Northern Ireland under the Protocol.

D1 Legislation

Legislation is law which has been created in a formal way and set down in writing. In England the only body which has the power to make general legal rules is Parliament.



Sometimes Parliament delegates (i.e. transfers) its law-making power to lesser bodies, such as government ministries and local authorities.

Be aware

The principal form which Parliamentary legislation takes is **Acts of Parliament** or **statutes**.



For this reason legislation is sometimes called **statute law**.

Since Parliament is the supreme law-making body there are, at least in legal theory, no limits to its law-making powers. As there are no legal limits to what Parliament can do (with the exception of European Law), Acts of Parliament may:

- create entirely new law;
- overrule what already exists;
- modify or extend existing principles of common law or equity; and
- repeal or modify existing statute law.

Although statute law is supreme, it has assumed major importance only within the past 200 years or so. It still forms only a relatively small part of the total body of law.

D1A Legislative process

In reality, the power to legislate rests almost completely with the Government. This is because, in the UK, the Government has effective command of a majority in the House of Commons, which is the focus of law-making power. However, before new law can be made, a formal process must be followed and the approval of both Houses of Parliament gained.

Green and White Papers

Before new legislation is introduced, the Government will often consult interested parties and the general public. This is sometimes done by publishing a 'Green Paper' inviting responses to proposed changes in the law. After considering these responses, a further 'White Paper' may be published giving advance notice of more definite proposals. In any event, once the Government has firmly decided to legislate, the new law will be drawn up in the form of a bill.



Activity

Look at the UK Parliament website: www.parliament.uk. All bills and legislation being considered by Parliament are shown, together with their current status. Pick one bill which you think is of interest from an insurer's perspective and check the website regularly to see how it progresses through the various parliamentary stages before (possibly) becoming law.

Private and public bills

Bills may be either public or private. If they pass into law they become known as Public or Private Acts respectively.

- A Public Act involves law affecting the whole community, such as the **Theft Acts**, which are part of general criminal law.
- A Private Act, on the other hand, is passed for the benefit of a particular individual, organisation or group. Very often the promoter of a private bill is a local authority seeking the power to make a compulsory purchase of land for a new local development. Examples of Private Acts relating to insurance include the **Lloyd's Act 1982** and the **Insurance Brokers (Registration) Act 1977** (now repealed), which directly affect only certain members of the insurance community. Again, some of the older insurance companies were formed by Private Act of Parliament.



Be aware

You should not confuse private bills with Private Members' bills. The latter are bills introduced by individual Members of Parliament rather than by the Government. However, unless it has government support, a Private Member's bill has very little chance of becoming law. This is because the Government controls the timetable of Parliament and the subjects for debate and legislation. For all practical purposes it is for the Government to decide what legislation is to be introduced.

D1B Procedure for the enactment of public bills

The procedure for the enactment of Public Bills is described briefly below (private bills follow a slightly different procedure). Bills may be introduced in either the House of Parliament or House of Lords. We are assuming that the bill in this case is introduced first into the House of Commons, which is more usual.

The stages are as follows:

First reading	This is largely a formality. The Clerk of the House reads out only the title of the bill to inform the members of its existence. It is then printed and published.
Second reading	At this stage the general merits of the bill are debated in the House and a vote taken as to whether it should proceed. Alternatively, in a procedure designed to save time, the bill is first referred to a Standing Second Reading Committee, which recommends whether the bill should be read a second time. This procedure is automatically followed for Public Bills in the House of Commons unless 20 members object, and for all private bills.
Committee stage	If the bill survives the second reading it will pass to the Committee stage. Details of the bill are discussed by a Standing Committee which usually consists of 20 to 30 members, chosen so as to reflect the strength of the various political parties in the House of Commons. At any given time there are a number of Standing Committees, each dealing with different bills. Some of the more important bills, always including the Annual Finance Bill (giving effect to the Chancellor's budget proposals), are debated in a Committee of the Whole House. At this stage, amendments to the bill are proposed and (unless accepted by the Government) are voted upon.
Report stage	Here, the bill as amended by the Committee is reported to the House as a whole. The amendments may be debated and in some cases the bill may be referred back to the Committee for further work.
Third reading	The third reading offers a final opportunity for debate. In theory, amendments may be proposed but, in practice, only minor changes in wording are likely to be made.

Assuming that the bill survives all these stages in the House of Commons, it then goes through a similar procedure in the House of Lords. The House of Lords no longer has the power to reject a Public Bill and, at most, may only delay its progress.

Having passed the Lords, the bill receives the Royal Assent (a mere formality now) and is afterwards referred to as an Act or statute. Unless otherwise stated in the Act itself, the new law comes into force immediately when it receives the Royal Assent.

Example 1.3

The **Consumer Insurance (Disclosure and Representations) Act 2012** was granted Royal Assent on 8 March 2012 and came into force on 8 April 2013. Similarly, the **Insurance Act 2015** gained Royal Assent on 12 February 2015 and came into force on 12 August 2016. We will look at the principles covered by these Acts later in the study text.



If a Public Bill has not completed all its stages during a particular session of Parliament, or when Parliament is dissolved, it lapses. It must start its passage anew during the next session or be dropped completely. This does not apply to private bills, the passage of which may straddle two or more sessions. For example, the Lloyd's Act 1982, mentioned above, was introduced in October 1980 but not completed until July 1982.

Activity

Look again at the UK Parliament website, and review the guide to how laws are made:



www.parliament.uk/about/how/laws.

When you read this study guide consider where the UK is in respect of the Building Safety Bill. Has it successfully passed through all the stages mentioned above to pass into law?

D1C Codifying and consolidating Acts – tidying up the law

An Act may introduce law which is entirely new. However, there will usually be existing law on the same subject in the form of earlier statutes and existing case law. Often there will be a whole series of previous Acts and regulations existing side by side together with, perhaps, many hundreds of decided cases. The result is that the law appears complex and disorganised. Therefore, Parliament decides from time to time to tidy up the law, particularly in fields where legislation is passed frequently, such as tax, company law, employment, safety at work and road traffic. This can be done either through a consolidating Act or a codifying Act.

Consolidating Acts

A consolidating Act is one which repeals all previous legislation on a subject and re-enacts it in one logically arranged statute.

No new law is created but existing statutory enactments are brought under one 'umbrella'. Examples in the insurance sector include:

- the **Road Traffic Act 1988**; and
- the **European Parliament and Council Directive 2009/103/EC** – consolidated five previous EU Directives relating to motor vehicle insurance, without making substantive changes to the law as set out there in.

Refer to

Refer to [Directives](#) on page 1/27 for EU Directives

Codifying Acts

Sometimes the Government may decide not only to consolidate current legislation on a particular topic, but to also include principles embodied in case law. As a result most or, in some cases, all the law on a particular topic, including existing statute and case law is reduced to a single code. There are a number of examples in non-consumer (business) law including:

- the **Bills of Exchange Act 1882**;
- the **Partnership Act 1890**;
- the **Sale of Goods Act 1979** – the law relating to the sale of goods was codified in the **Sale of Goods Act 1893** which was subsequently amended by a number of later acts. The legislation was then consolidated in the Sale of Goods Act 1979, since when there have been further amendments; and

- the **Marine Insurance Act 1906** – consolidated previous legislation on marine insurance together with legal principles contained in around 2,000 decided cases.

D1D The Law Commission

There are a number of bodies concerned with the reform and modernisation of the law including a permanent body, the Law Commission (LC) which was established by the **Law Commission Act 1965**.

The LC is responsible for the consolidation and revision of statute law. It also has the general role of reviewing English law as a whole and recommending ways in which it can be updated, simplified and developed in a systematic way. Codification, which is part of this process, may increase as a result of the Commission's work, although progress has been slow. Over the last decade, the Commission has carried out a programme of reform, codification and consolidation of insurance contract law, with the introduction of the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) and the Insurance Act 2015 (IA 2015).

The LC continually works on reforming several areas of law. In April 2021, the LC's consultation paper made proposals to the effect that electronic trade documents would have the same legal effect as paper trade documents.

The consultation closed on 30 July 2021. The LC analysed the responses it received and refined its provisional proposals and draft bill taking into account comments from consultees and other stakeholders. An Electronic Trade Documents Bill was presented before Parliament on 12 October 2022.

D1E Retroactive (or retrospective) legislation

Retroactive legislation is legislation which affects acts done or rights acquired before it came into effect.

D1F Delegated legislation

The complexities of the modern world are such that the law itself must be extensive and very detailed. Parliament obviously does not have the time to lay down all the intricate rules which are necessary in the field of, say, road traffic, social security or taxation. Acts of Parliament (which for this purpose we can describe as primary legislation) often only lay down a general framework of rules, leaving the detail to be filled in by civil servants (i.e. government officials) working in the appropriate ministry.

However, detailed rules of this sort cannot be made unless the persons in question have been given the power to make law by Parliament itself. Acts of Parliament which lay down general rules often confer on persons or bodies (particularly government ministers) the power to make detailed rules and regulations for the purpose of implementing the Act.

Acts which confer such power are called Enabling Acts (or Parent Acts) and rules made under the authority of these Acts are known as delegated or subordinate legislation.



Be aware

Delegated legislation has exactly the same legal force as primary legislation.

The most important forms of delegated legislation are as follows:

Statutory instruments

Most Enabling Acts which give ministers and their civil servants power to enact delegated legislation, stipulate that the powers in question are to be exercised in the form of departmental regulations or orders. These are known collectively as statutory instruments.

Orders in council

When power of special importance is delegated by statute, such as power concerning constitutional matters, it is usually conferred on the Privy Council. Originally this was the name given to the group of the Monarch's private advisers. The Privy Council now includes past and present members of the Cabinet (senior government members) and various other eminent people. An Order in Council is drafted by a minister, and comes into force when approved by a meeting of the Privy Council where at least three Privy councillors are present. The powers in question are effectively exercised by the Cabinet.

Byelaws

Statutory authority may be given to certain bodies, particularly local authorities, to make byelaws which are of local application. They require the approval of the appropriate minister.

D2 Interpretation of statutes

Care is taken in the drafting of legislation to ensure there is no room for doubt as to the meaning and intention of the Act or regulation. Nevertheless, disputes arise quite frequently about the meaning of words used in both primary and subordinate legislation. The claimant (or prosecution) will usually claim the words mean one thing and the defendant will insist they mean another. In this case, the court may be called upon to adjudicate on the question of meaning. As a result, statute law itself is subject to some influence by the judiciary.

Be aware

The judges have a number of aids to interpretation, which can be classified as either statutory aids or common law rules.



D2A Statutory aids

1. The **Interpretation Act 1978** lays down certain rules of interpretation which apply to statute law generally:

- words used in the singular are deemed to include the plural and vice versa;
- the use of the masculine gender includes the feminine and vice versa; and
- the term 'person' is deemed to include artificial entities such as companies as well as human beings.

These general rules may be overridden in the express provisions of a particular Act.

2. Acts of Parliament often contain an 'interpretation' section in which important words and phrases are given a precise definition.
3. Acts of Parliament have a preamble or long title setting out the general scope and purpose of the Act.

D2B Common law rules

These are rules which the courts themselves have developed to assist with interpretation. The three rules of interpretation include the following.

Literal rule

This rule is the primary rule which takes precedence over the others. According to the rule, words and phrases should be construed by the courts in their ordinary sense, and the ordinary rules of grammar and punctuation should be applied. If, applying this rule, a clear meaning emerges, then this must be applied. The courts will not try to establish whether this represents what Parliament intended when the legislation was passed. In some cases a strict application of the literal rule may lead to a result which is clearly at odds with the intention of the legislation. There are various subsidiary principles to the literal rule:

'Noscitur a sociis rule'	A general principle that a word must be determined by its context.
'Eiusdem generis rule'	Under this rule the meaning of any general term depends upon any specific words which precede it.

These rules (and the literal rule itself) apply not only to the interpretation of statutes but also to non-consumer (business) contracts such as insurance policies. You will find examples of their application in chapter 8, which deals with insurance claims.

Golden rule

Where the meaning of words in a statute, if strictly applied, would lead to an absurd result, and there is an alternative interpretation which avoids the absurdity, the courts are entitled to choose that latter meaning and to assume that Parliament did not intend the absurdity. This is sometimes called the golden rule.

Mischief rule

This is sometimes called the rule in Heydon's case, from the decision in 1584 in which it was first set out. Under this rule, the judge will consider the meaning of the words in the Act in

the light of the abuse or 'mischief' which the Act was intended to correct, and choose the interpretation which makes the Act effective in suppressing this mischief.

Presumptions

Finally, there are a number of presumptions which apply to the construction of a statute, unless there are clear words to the contrary in the statute itself. Among the most important are the presumptions that the statute:

- is not intended to create a 'strict' criminal offence (i.e. liability without criminal intention or fault);
- is not intended to oust (do away with) the jurisdiction of the courts;
- is not intended to have retrospective effect;
- applies only to the UK;
- is not intended to infringe the requirements of international law;
- does not bind the Crown (i.e. the Government); and
- is not intended to interfere with vested (i.e. existing and established) rights or allow confiscation of property without compensation.

D2C The effect of the Human Rights Act on statutory interpretation

We noted earlier that many of the rights set out in the European Convention of Human Rights are now protected in English law as a result of the Human Rights Act 1998. Under s.3 of that Act the courts are obliged where possible to interpret statutory provisions in a way which is compatible with the rights protected in the Human Rights Act. Where such an interpretation cannot be reached the higher courts may issue a 'declaration of incompatibility.' This does not, however, invalidate the statutory provision, nor does it place the Government or Parliament under any legal obligation to change the offending provision.

D2D The effect of the European Communities Act on statutory interpretation

Before Brexit and the end of the transition period on 1 January 2021, European Community law had a fundamental influence on English law. Under 2(4) of the **European Communities Act 1972**, any domestic (UK) legislation passed was to be construed by the courts and take effect subject to EC obligations. The effects of s.2 are complex but, broadly, it had led the English courts, where necessary, to adopt a 'purposive' approach to interpreting domestic legislation.

As noted above, the UK is no longer a Member State of the EU. The **European Union (Withdrawal) Act 2018 ('EUWA')** section 1 repealed the European Communities Act 1972 on exit day.

UK law passed or made before the end of the transition period (1 January 2021) must be interpreted, as far as possible and so far as relevant, in accordance with EU law. For example, UK legislation which implemented an EU directive must continue to be interpreted in light of the wording and purpose of the EU directive.

From the end of the transition period, the UK can implement new policies in many areas that previously fell within EU competence, to the extent consistent with its international obligations.

The principle of the supremacy of EU law over UK law passed or made after the end of the transition period is not part of the 'retained EU law'.



Be aware

This means that for the UK law passed or made after the end of the transition period the UK is not under the obligation to achieve an interpretation consistent with EU law – subject to the UK's international obligations.

However, Article 4 of the withdrawal agreement (in Part One, common provisions) requires the provisions of the Northern Ireland Protocol, and the EU law that applies under the Protocol, to have supremacy and (where the conditions are met) direct effect in the UK legal system.

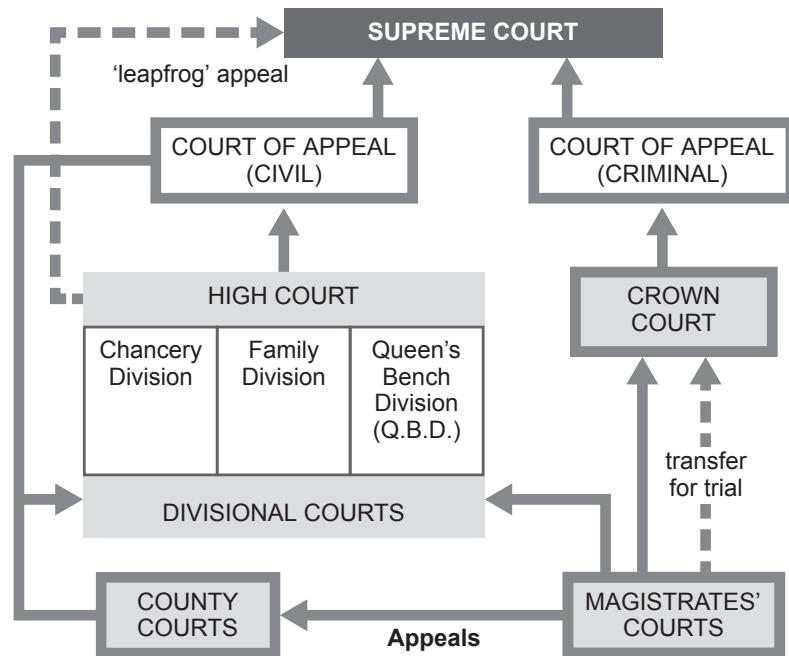
Article 13 of the Protocol sets out the common provisions for Protocol purposes, which differ in some cases from the common provisions in Part One of the withdrawal agreement. For example:

- Protocol provisions referring to EU law or concepts must, in their implementation and application, be interpreted in conformity with relevant CJEU case law (Article 13(2), Protocol). This requirement extends to post-transition CJEU case law, notwithstanding Article 4(4) and 4(5) of the withdrawal agreement.
 - Unless otherwise provided, where the Protocol refers to an EU act, the reference to that act must be read as referring to it as amended or replaced, notwithstanding Article 6(1) of the withdrawal agreement (Article 13(3), Protocol).

E Precedent and case law

In order to understand fully the effect of judicial precedent as a source of law, it is necessary for us to look briefly at the hierarchy of the civil and criminal courts. Figure 1.1 shows this in a simplified diagrammatical form.

Figure 1.1: Court system



E1 Civil courts

Minor civil cases are dealt with by the County Courts. Most cases are heard by a Circuit judge, who usually sits alone.

Major cases (usually those involving claims for substantial sums of money) are heard at first instance by one or other of the three divisions of the High Court. The following table shows which matters the Chancery Division and the Family Division deal with.

Chancery Division	Family Division
<ul style="list-style-type: none">• Company matters.• Partnerships.• Trusts.• Mortgages.• Revenue matters.	<ul style="list-style-type: none">• Matters of family law including disputes about family property.• Matters concerning children such as adoption and guardianship.

The Queen's Bench Division (QBD) is perhaps the busiest sector of the High Court, with the largest staff of judges. It includes a Commercial Court, Admiralty Court (which deals with shipping matters) and a Technology and Construction Court. The QBD has jurisdiction over every type of common law civil action, the principal areas of which are contract and torts.

Each of the three divisions of the High Court has its own divisional court (e.g. the Divisional Court of the Queen's Bench Division) which hears certain appeals from the County and Magistrates' courts and from various tribunals. A High Court judge normally sits alone, although a divisional court will normally consist of two or more judges.

Appeals from both the county court (in most cases) and all divisions of the High Court are dealt with by the Court of Appeal (Civil Division). Three judges normally sit, but on occasion there may be a 'full court' of five or seven. The Court of Appeal does not hear any cases at first instance but, as the name suggests, hears appeals from the lower courts only.

The final court of appeal within the UK is the Supreme Court; this replaced the House of Lords on 1 October 2009. The Supreme Court:

- is the final court of appeal for all United Kingdom civil cases, and criminal cases from England, Wales and Northern Ireland;
- hears appeals on arguable points of law of general public importance;
- concentrates on cases of the greatest public and constitutional importance; and
- maintains and develops the role of the highest court in the United Kingdom as a leader in the common law world.

There are twelve Justices. The normal complement to hear a case is five Justices, with a greater number sitting on some occasions. Appeals from the Court of Appeal go to the Supreme Court, and, in certain cases, appeals may be taken directly from the High Court under what is known as a 'leapfrog' procedure, missing out the Court of Appeal.



Be aware

Although the House of Lords is no longer the final court of appeal, its previous decisions still stand as precedent and so you will still see reference to the House of Lords when reading later in this text about cases dating from before October 2009.



Activity

Current and recently decided cases are published on the Supreme Court website which you can access at: <https://supremecourt.uk/>.

E2 Criminal courts

Minor criminal offences (and some minor civil matters) are dealt with by Magistrates' Courts, from which there may be an appeal to the Crown Court or High Court. More serious offences are dealt with at first instance in the Crown Court after 'transfer for trial proceedings' (usually a 'paper' process) in the Magistrates' Court. Trial in the Crown Court is before a single judge and a jury, normally of twelve persons. You should note that juries are no longer used in civil cases, with certain exceptions, such as libel proceedings.

Appeal from the Crown Court is to the Court of Appeal (Criminal Division). As in civil cases, there is the possibility of a further appeal to the Supreme Court, to which the same general principles and restrictions apply.

E3 History of precedent

Along with legislation, precedent is a major source of new law today. A precedent is a decision in a previous legal case where the facts were similar to the case before the court.

Historically, the Royal judges developed a doctrine of '*stare decisis*' ('let the decision stand') and looked to previous decisions in similar cases to ensure consistency. However, the early judges were not compelled to follow previous decisions. Precedents were, at most, only persuasive – i.e. a guide to what the law was. As the standards of printing and law reporting developed from the sixteenth century onwards, greater attention was paid to previous decisions. By the early nineteenth century, it had been accepted that regard must be paid to previous decisions, and that it was not for the courts to reject them.

E4 Nature of precedent

Consider this...

An old case may have similar issues but very different facts to a case before the courts now. How does the judge in the current case determine which parts of the judgment they should follow?

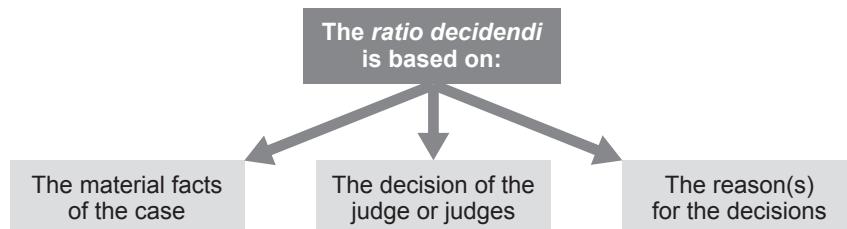


The doctrine of binding precedent requires a judge to base their decisions on the law established in earlier cases where the facts were the same. However, if, as is usual, the whole of the case is reported, the judge who is required to follow it must choose which parts of the earlier decision are binding on them, since some of the things said in the earlier decision may not be relevant to the case in hand.

In fact, the 'precedent' which the judge is bound to follow is not the earlier case as such, but the principle established in it.

This principle is known as the '*ratio decidendi*' (literally, 'the reason for deciding').

E4A Ratio decidendi



To establish these, it is necessary to consider the case and the report as a whole. Sometimes, however, there will be key passages in the summing-up of a judge which appear to encapsulate the principle of the case.

E4B Obiter dicta

When deciding a case, the judge or judges may say a number of things in passing. The comments may concern hypothetical situations (i.e. situations which have not arisen in this particular case but which might occur), or concern questions which it is unnecessary to decide for the purposes of settling the dispute in question.

Statements made by a judge which are not essential to the decision are known as '*obiter dicta*' ('things said by the way'). They are not part of the *ratio decidendi* nor binding for the future. However, *obiter dicta* may be persuasive, i.e. of some influence in future cases, particularly if they come from cases heard in the Supreme Court or its predecessor the House of Lords.

E5 Operation of binding precedent

Whether a precedent is binding or not depends on the level of the court in which the decision was made. As a general principle, a judge is only bound by decisions made in a court higher than their own or, in some cases, a court of equal standing.

We will look briefly at each of the major courts, beginning with the civil court hierarchy.

E5A Civil courts

Supreme Court (formerly the House of Lords)

Be aware

The decisions of the Supreme Court are binding on all lower courts.



The rule that the House of Lords is bound by its own decisions was abolished in 1966 through a statement by the Lord Chancellor made on behalf of the House of Lords. It was declared that, where too rigid an adherence to precedent would lead to injustice in a particular case or restrict the proper development of law, the House could depart from a previous decision when it seemed right to do so.

The Supreme Court is not now bound by its own decisions. However, the power to depart from its own previous decisions has been used quite sparingly.

The Supreme Court hears appeals in civil cases from both the English and the Scottish courts. Where the principles of English and Scots law are the same, a decision in an English case is binding on the Scottish courts and vice versa.

Court of Appeal (Civil Division)	A decision of the Court of Appeal (Civil Division) is binding on the lower courts (i.e. High Court and County Courts). The Court of Appeal is also generally bound by its own decisions, unless two such decisions conflict (in which case one may be chosen) or, if its own previous decision is inconsistent with a decision of the Supreme Court or the Judicial Committee of the Privy Council. We have already noted that the Court of Appeal is bound by decisions of the Supreme Court.
High Court	A decision of the High Court is binding on lower courts. However, the decision of a High Court judge at first instance is not binding on another High Court judge sitting alone. It is instead only a strongly persuasive influence. As a result, there may be a conflict between two or more High Court decisions which will only be resolved when the same point of law is considered by a higher court. Sometimes High Court judges hear appeals from lower courts, sitting in what is known as a Divisional Court, with two or more judges present. The decisions of Divisional Courts are binding on judges of the High Court sitting alone, and on Magistrates' Courts, but not on the Crown Courts.
County Courts	The County Courts are bound by all decisions of the higher courts. County Court cases (which are not reported officially) are not binding on any court, although one or two decisions have been influential when there has been no relevant decision at a higher level.

E5B Criminal courts

Supreme Court (formerly the House of Lords)	As with civil cases, the decisions of the Supreme Court in criminal matters are binding on all lower courts. You will recall that since 1966 the House of Lords/ Supreme Court has had the power to overrule its own previous decisions. However, this has been done very rarely in criminal cases (which often concern the liberty of an individual). The power was exercised for the first time in a criminal case in 1987.
The Crown Court	The Crown Court is bound by decisions of the Supreme Court and of the Court of Appeal (Criminal Division), but not by decisions of a Divisional Court of the High Court. Decisions of the Crown Courts themselves are not binding on any court and are, at most, persuasive.
Court of Appeal (Criminal Division)	Decisions of this court are binding on the lower criminal courts (Crown and Magistrates' Courts). The court is normally bound by its own decisions, although it is more flexible in this regard than the Civil Division. A 'full court' (of five judges) can overrule a decision of an ordinary court (of three). The court is not bound by decisions of the Court of Appeal (Civil Division) and vice versa, but is bound by decisions of the Supreme Court.
Magistrates' Courts	These courts are bound by decisions of higher courts, except that they are not bound by the decision of a Crown Court hearing appeals from Magistrates' Courts. Cases heard in the Magistrates' Courts are not reported officially and have no binding force.

The final court of appeal is as follows:

Judicial Committee of the Privy Council

The Judicial Committee of the Privy Council is the final court of appeal from some Commonwealth countries and overseas territories. It performs the same function for the Channel Islands and the Isle of Man. In this capacity it is, strictly speaking, outside the system of English courts. However, the majority of members who hear appeals are Justices of the Supreme Court and for this reason, judgments of the Privy Council have much the same standing as those of the Supreme Court itself. They are regarded as highly persuasive precedents which will be followed unless there is some compelling reason for departing from them. See, for example the decision of the Privy Council in *The Wagon Mound (1961) (Overseas Tankship (UK) Ltd v. Mort's Dock and Engineering Co Ltd (1961))* discussed in *Causation and remoteness of damage* on page 2/11.



The importance of the Privy Council has diminished somewhat in recent years as a number of countries have left the Commonwealth and others, while remaining in the Commonwealth, have established a supreme court of their own from which there is no appeal.

The Judicial Committee of the Privy Council is also the final court of appeal for:

- Ecclesiastical and Prize cases (disputes concerning captured ships in times of war); and
- tribunals of the medical, dental and opticians' professions.

Its decisions in these cases are part of English law and are binding.

E5C Reversing and overruling

If a person, A, loses a case against another, B (for example, in the High Court) but then appeals successfully (to the Court of Appeal) the decision in the first hearing is said to be reversed. It is possible, of course, that B themselves may now appeal (to the House of Lords) and, if they are successful, the decision is reversed again and the original judgment restored. You will appreciate that all three hearings concern the same case. No change in the law need necessarily result from the reversing of a case.

Overruling occurs where a higher court decides a matter which is governed by a precedent set in an earlier case on a different principle. This effectively cancels out the principle of law contained in the *ratio decidendi* of the earlier case and substitutes a new one. Although the old case is no longer good law it is important to recognise that the overruling does not in itself affect the position of the parties in the earlier case. There is no right of appeal by a person wishing to have a case reopened after it has been overruled in a later case. If this were to be allowed, people would never be sure that a particular piece of litigation had ever ended.

E5D Disapproving and distinguishing

A decision is said to be disapproved when a court offers the opinion that an earlier case is wrongly decided but is not in a position to overrule it. Overruling will not be possible if the *ratio decidendi* of the case before the court does not cover all the matters raised in the earlier decision, so that the two cases are not exactly comparable. Such an opinion is *obiter dictum* and the earlier case still stands. However, its authority may well be weakened as a result of the disapproving and this may help to lead to the overruling of the case in the future.

Distinguishing occurs when a court declines to follow a previous decision on the grounds that there are important points of difference in the preceding case. In other words, the two cases are distinguished 'on the facts'. Distinguishing is a means by which a court can avoid following a precedent which would otherwise be binding on it, although this may lead to an element of artificiality in the law, with very fine distinctions which are not at all obvious.

E5E Persuasive precedents and authorities

Persuasive precedents are influential but non-binding decisions.

The following may be persuasive to a greater or lesser extent:

- Decisions made in lower courts or courts of equal standing.
- Decisions of courts outside the English system (e.g. Judicial Committee of the Privy Council, Irish, Scottish, Commonwealth and United States Courts).
- Obiter dicta* (especially of senior judges in high-level decisions).
- Textbooks, learned treatises and the law of other jurisdictions (e.g. Roman law) – these sources are very rarely used, and only in cases where there is no other authority, binding or persuasive.

E6 Advantages and disadvantages of precedent

The system of precedent has both strengths and weaknesses.

Advantages of the system	Disadvantages of the system
Precedent provides certainty for persons as to their rights and liabilities. Precedent provides certainty.	Once a rule has been laid down as binding it is not easy to change, even if the decision is thought to be wrong – this creates rigidity in the system. Change can be made only by Parliament, through legislation, or through the decision being overruled by a higher court. The only option available for another court at the same level as that which decided the precedent case is to distinguish the precedent from the present case if it is possible to do so. But distinguishing does not mean that the precedent is not good law any more; it is still applicable until it is overruled. Once a rule has been laid down as binding it is not easy to change – this creates rigidity in the system.
The system allows for the possibility of development and growth, with precedents that can be extended to new situations.	The bulk and complexity of case law makes it difficult to navigate, and so the system depends heavily on 'equality of arms' (i.e. expertise) between the lawyers acting on either side of a dispute.
Where a precedent will lead to a nonsensical decision in a case with different facts, its scope can be restricted by the process of distinguishing. This provides an element of flexibility in the law.	In some circumstances, the system of precedent may develop slower than desired. The emergence of rules depend entirely upon litigation. The courts cannot try imaginary cases to develop the law or clear up uncertainties. Therefore, if a point of law requires clarification one simply has to wait for a case on the point to be litigated, which may not occur for many years. The only alternative is legislation, as mentioned above.
The system of precedent gives English law a wealth of detailed practical rulings, based on real situations rather than legal theory.	The principle of law contained in some decisions is sometimes obscure. For example, all five judges in a Supreme Court case might come to the same decision but each give different reasons for doing so. In this instance the <i>ratio decidendi</i> of the case will be unclear.

E7 Law reports



Consider this...

If precedent is the cornerstone of English law, what is required for it to work well? How will judges find earlier judgments and decide whether they are bound by those judgments?

The system of precedent can work well only if it is supported by an effective system of law reporting.

The Council of Law Reporting was established by the legal profession in 1865 to provide a systematic and accurate law reporting service. This body, now the Incorporated Council of Law Reporting, still publishes these semi-official law reports, known simply as the Law Reports. Separate volumes are published each year in respect of cases heard in the Queen's Bench, Family and Chancery divisions of the High Court and appeals from those courts to the Court of Appeal.

Decisions of the House of Lords are published in a separate volume of Appeal Cases. These can be identified by the letters AC in the citation.

In addition to the annual volumes, the Council also issues a series known as the Weekly Law Reports, which enables accounts of important decisions to be available quickly.

Besides the semi-official reports mentioned above, there are various private series. An important example is the All England Reports, which started in 1936. The All England Reports are general reports (i.e. they include cases heard in various courts) and are published (approximately) weekly and in volumes each year.

Other important law reports exist which are:

Specialist law reports	There are various other private reports of a specialist nature. An important example, from the point of view of insurance students and practitioners, is Lloyd's Reports, which specialise in reporting non-consumer (business) (including insurance) cases.
Other sources of law reports	Brief reports of cases also appear regularly in the <i>Times</i> , <i>Independent</i> , <i>Guardian</i> (and some other newspapers) while the courts are in session. Sometimes the cases described are not reported elsewhere. It is also possible to access law reports (including many which appear in none of the major series) through online computer information services such as LexisNexis, i-law and Westlaw.

F Local custom

Local custom is a minor source of law. English common law was originally based on customs which, over time, were generally adopted throughout the country. This process was completed many centuries ago and custom is no longer a source of general law.

However, a long-established local custom which applies to a particular area and group of people may give these people rights which the law will support.

G European Community law

Europe had been a major source of law for both the United Kingdom and all the other EU Member States. As stated earlier, Brexit has changed the situation. During the transition period, most EU law continued to apply to the UK. At the end of the transition period (1 January 2021), the European Union (Withdrawal) Act 2018 ('EUWA') created a new body of UK law, known as retained EU law, based on the EU law that applied to the UK at the end of the transition period. The EUWA repealed the principle of the supremacy of EU law over UK law passed or made after the end of the transition period. However, the Northern Ireland protocol provides different provisions for Northern Ireland, as previously stated in this chapter.

G1 Aims of the European Treaties

The **Treaty of Rome 1957** established the European Economic Community (EEC) which aimed to set up a large European 'free trade area'. The EEC created a common market and customs union among its members.

The **Maastricht Treaty** is officially known as the **Treaty of the European Union**. It was signed in Maastricht on 7 February 1992 and came into force on 1 November 1993. The Maastricht Treaty created the European Union (EU), which consists of 'three pillars':

- the European Communities;
- common foreign and security policy; and
- police and judicial cooperation in criminal matters.

Following the advent of the EU in 1993, the Treaty of Rome remained one of the EU's core documents, even though the EEC had been renamed the European Community (EC) and become embedded in the EU. With the passing of the **Lisbon Treaty** in 2009, the EC was eliminated and the Treaty of Rome that had established it was formally renamed the **Treaty on the Functioning of the European Union**.

The aims of the Maastricht Treaty are at least partly political and are outside the scope of this course. However, the aims of the Treaty of Rome are largely economic. The object is to remove internal barriers to trade between Member States, and to establish a common policy

to (external) third countries trading with Member States. The resulting 'single market' should benefit the consumer by achieving economies of scale and by stimulating competition. This should enable Europe to compete effectively with economic giants such as Japan and the USA.



Be aware

In simple terms, the object is the economic integration of the Member States. This is achieved by two main methods:

- Allowing free movement of goods, people, services and capital within the Community.
- Harmonising law in certain key areas, especially in relation to trade and commerce.

Most 'European law' is concerned with economic matters, e.g. agriculture, transport, trade, commerce, finance and business in general.

G2 Institutions of the European Union

The four main institutions are listed below.

- **Council:** this body has the greatest legislative power. It is made up of representatives of the Member States which are drawn from the governments of the Member States.
- **Commission:** each Member State is represented by one Commissioner who has the power to initiate legislation (and complete it in some cases) and who administers some of the Community's funds. It may also initiate legal proceedings against a Member State that fails to fulfil Community law.
- **European Parliament:** members of the European Parliament are directly elected in elections held at five-year intervals. The Parliament has supervisory powers but its legislative powers are limited and it has little or no formal control over delegated legislation passed by the Commission.
- **Court of Justice:** the Court of Justice (based in Luxembourg) is the ultimate court of appeal on matters of European law. The Court sits in 'chambers' of three or five judges or in 'plenary' sessions of seven to seventeen. Judges have renewable terms of six years (three years in the case of the President). The judges' post-hearing 'deliberations' are secret. The French language is used for discussion and one 'collegiate' (i.e. collective) judgment is given, which all the judges sign. It should be noted that the European Court is not obliged to follow precedent in the fashion of an English court.

G3 Sources of European law

The main sources of EU law are:

- the Treaties – especially the Treaty of Rome;
- regulations;
- directives;
- decisions;
- recommendations; and
- opinions.

G3A The Treaties

The Treaties are best regarded as the 'constitution' of Europe, setting out the basic framework and fundamental principles of European law (such as the right to free movement of goods, people, services and capital).

G3B Regulations

Regulations are laws made by the Council or Commission which have general application. They are automatically binding in their entirety on all Member States without any action by national governments or legislatures and, for this reason, are sometimes described as 'self-enacting'. The **General Data Protection Regulation (GDPR)** is an example of European legislation that has a direct effect on Member States. The **Data Protection Act 2018 (DPA 2018)** has been used to repeal previous data protection legislation, and to clarify how the GDPR should be applied in the UK. However, the GDPR would have taken effect without any specific UK legislation.

G3C Directives

Directives of the Council or Commission are binding on Member States to which they are addressed (normally to all Member States) as to the result which is to be achieved. However, the method of implementing the law contained in the Directive is left to each Member State. In the UK implementation is through primary or subordinate legislation (e.g. an Act of Parliament or delegated legislation of some sort). Directives are used as a form of general legislation for the Community.

Be aware

Although European Directives are not 'self-enacting' and have to be converted into national law, the European Court of Justice has ruled that a Member State which fails to implement a Directive can be sued for damages by an individual who suffers loss as a result of the failure to implement (*Francovich v. Italian Republic (1991)*).



G3D Decisions

Decisions do not have general application and are binding only upon those to whom they are addressed. They may be addressed, for example, to a particular Member State or a particular organisation.

G3E Recommendations and opinions

Recommendations and opinions have no binding force and are advisory only.

G3F The European Communities Act 1972

International law is not applied by the English courts unless it has been incorporated into English law by domestic legislation. The European Communities Act 1972 (ECA) set out how European Community law was to take effect in English law.

As noted earlier, ECA was repealed by EUWA. This will have the effect of removing the mechanism for the automatic flow of EU law into UK law (through section 2(1) of the ECA) and removing the power to implement EU obligations (under section 2(2) ECA).

However, please see below that the Northern Ireland Protocol provides different provisions for Northern Ireland.

Section 2(1) of the ECA had the effect that certain forms of EU law (treaties and regulations) were to have direct effect in English law with no further formalities. In other words, they passed directly into English law without the need for domestic legislation. Where this 'direct' EU law was inconsistent with domestic statutory provisions, the English courts would, if necessary, grant an injunction preventing the domestic law from being applied.

Lesser forms of EU law such as directives require legislation to incorporate them into English law, but this might be achieved by delegated legislation and the courts would interpret such legislation to give effect to EU obligations. But this has all been repealed now under EUWA – but subject to the Northern Ireland Protocol.

G4 Examples of European law

You will appreciate that most European law concerns matters of trade and commerce which have a European dimension. By way of illustration, we will look briefly at some examples of European law which affect insurance, some of which are discussed in more detail later in this study text. The main object of the legislation in nearly every case is to harmonise the law relating to insurance in certain key areas, in order to promote free and fair competition between insurers in Europe.

First, a large proportion of the current law concerning insurance companies is European in origin.

Example 1.4

Much of the **Insurance Companies Act 1982**, which dealt with the regulation of insurers, was based on European Directives. The Act has now been replaced by the **Financial Services and Markets Act 2000**.



Second, there are a number of Directives concerned with particular classes of insurance.



Example 1.5

Among the most important are the various Directives on motor insurance, which aim to harmonise key aspects of the law and practice of motor insurance across Europe. Harmonisation is particularly important, given that motor vehicles provide one of the main methods of moving people and goods between the Member States, and that motor claims often involve people from different countries. The relevant EU Directives have become part of the UK law through a number of statutory instruments or amendments to the *Road Traffic Act 1988*.

Finally, there is a great deal of European legislation which affects insurance indirectly. For example, the **Consumer Protection Act 1987** which is based on an EC Directive and affects product liability insurance.



Be aware

It is also worth noting that much new industrial safety legislation and many laws on the environment now originate in Europe. Both of these areas are of concern to liability insurers.

H Elements of civil procedure

In the sections that follow we look briefly at how the legal system operates in practice and we outline the procedure that is followed when a civil case is taken to court. In fact, both the procedure that is followed and the court in which a case is heard depend upon the type of dispute that needs to be settled. We will look at the subject mainly from the viewpoint of the insurance industry.



Consider this...

In what situations might an insurer become involved in court proceedings?

Insurance firms may find it necessary to go to court for a number of different reasons.

In the FCA test case the parties to the litigation were the insurers and the Financial Conduct Authority (FCA). Normally a dispute over insurance cover takes place between the assured and the insurer. However, in the FCA test case, the action was brought by the FCA to seek clarity for about 20 different policy wordings selected by the FCA, insurers and policyholders. The objective of the test case was to seek judicial clarity on the meaning of those clauses, namely, whether they provided cover for the BI losses suffered by the SMEs. About 370,000 businesses were expected to be affected by the decision of the Court in the FCA test case.

The test case was triggered under Practice Direction by the FCA. After the test case, the relevant provision of the Practice Direction was revoked. Hence, the FCA test case was certainly the first and, perhaps, the only one brought (and perhaps the only one that will ever be brought) in the history of the FCA.



Example 1.6

- They may become involved in disputes about taxation or matters of company law, or about the buildings and other property that they own.
- Again, on some occasions they may need to go to court to settle a dispute with their own employees about pay, working conditions, pension rights or other employment-related matters.

In this respect, insurance firms are no different from other commercial organisations.

The vast majority of court cases involving insurance companies arise in connection with the insurance policies they issue. These 'insurance' cases fall into three broad categories:

1. Cases in which there is a dispute between the insurance company (and, sometimes, insurance broker) and the policyholder. Most of these cases involve disputed claims, with the insurers arguing that they are not liable to pay (or not obliged to pay as much as the policyholder demands) and the policyholder insisting otherwise.

Essentially, these are claims against insurers for breach of contract and they may involve either general issues of contract law or special legal principles that apply to insurance, such as the duty of fair presentation of risk. The general law of contract and the special legal principles of insurance are covered in later chapters of this book.

2. Disputes between insurers themselves. Often these disputes are about the sharing of claims, either between two or more insurers or between insurers and reinsurers.
3. Cases in which insurance companies are seeking to defend their own policyholders, who are themselves being sued for compensation by third parties, that is, liability insurance claims.

They may be third party motor claims, arising from an accident in which the insured has allegedly injured a third party; employers' liability claims, where an injured employee is suing the insured; or involve public liability, professional indemnity or other liability insurance.

The claim in question may be in respect of personal injury, damage to property, financial loss or all of these. In legal terms, these are usually tort claims but in some cases (such as claims against professional persons or producers of goods) a breach of contract may also be alleged.

Refer to

Refer to chapter 2 for the law of torts

Before moving on, we should note that while court cases in all three categories (especially the third) are quite numerous, they still represent only a tiny proportion of insurance claims, the vast majority of which are settled without resorting to any form of legal action. Furthermore, only about 5% of cases started in the civil courts get as far as a full trial; the vast majority are settled before that stage.

H1 Current system – the Civil Procedure Rules

The current system of civil justice is based on reforms recommended by Lord Woolf in his report 'Access to Justice' (the 'Woolf Report') (1996). The reforms were aimed at improving a system that was widely seen as being too expensive, slow, uncertain and complicated.

The Woolf Report made 303 recommendations, which included the following:

- Three separate 'tracks' for cases, depending on their value and complexity.
- Encouraging the use of alternative dispute resolution (ADR).
- Giving judges more responsibility for managing cases.
- More use of information technology.
- Simplifying documents and procedures and having a single set of rules for proceedings in both the High Court and County Court.
- Shorter timetables for cases to reach court and for the length of trials.

As a result of the Woolf Report, new Civil Procedure Rules (CPR) were introduced with effect from 26 April 1999.

H1A Pre-action protocols

One of the main aims of the Woolf reforms is to encourage people who are in dispute to give information to each other at an early date. This is in order to facilitate negotiation and, if possible, avoid court action altogether. It is also intended to assist the parties to identify the real issues in dispute at an early stage.

To help achieve this, pre-action protocols have been issued for different types of claim. These are essentially lists of things that the parties are expected to do before they start any legal action.

Activity

Look at the list of current protocols on the Ministry of Justice website: www.justice.gov.uk/courts/procedure-rules/civil/protocol.



Which protocols will be most relevant to disputes involving insurance?



Example 1.7

The Pre-Action Protocol for personal injury cases is particularly important for insurers because many liability insurance claims, including all employers' liability claims and a significant proportion of motor claims, are for bodily injury. Among many other things, this Protocol requires that:

- The claimant should send the defendant (and insurers, if known) a letter of claim promptly once they have enough information to support their claim.
- The defendant should respond (identifying their insurer) within 21 days.
- The defendant (usually, in effect, the insurer) should investigate the claim and respond within three months, either admitting liability or, if it is denied, giving reasons for denial and enclosing the relevant documentation.
- The parties should co-operate in appointing any expert witnesses that are required and should try to agree to use one expert.

Pre-action proceedings are issued through the Ministry of Justice (MoJ) claims portal for:

- road traffic accident (RTA) claims;
- employers' liability (EL) claims; and
- public liability (PL) claims

that are between £1,000 and £25,000.

As part of the pre-action protocol, there are fixed recoverable legal costs that a claimant can recover from a defendant (or, most often, their liability insurer) for different stages of the process. This encourages early engagement between the parties and settlement of claims.

If the Protocol is not adhered to, and this leads to unnecessary litigation, the party who is at fault may be penalised by the court by having to pay the costs of the proceedings. If the claimant is at fault they may also be deprived of interest on their award; or, if the defendant is at fault, they may have to pay extra interest on top of the damages.



Example 1.8

The new Pre-Action Protocol for Personal Injury Claims Below the Small Claims Limit in Road Traffic Accidents

The RTA Small Claims Protocol, supported by the online service, provides the framework for claimants, whether represented or not, in making and settling low value road traffic accident related personal injury claims at the pre-action stage.

A key feature of this Protocol is the use of an online portal. The portal is an online service through which the parties communicate. The portal is used to make a claim, to exchange information and documents, and to negotiate a settlement or start court proceedings. All claims to which this protocol applies must be submitted through the online portal, which can be accessed at www.officialinjuryclaim.org.uk/make-a-claim/.

Once the compensator is notified about the claim, the portal must be used by both the claimant and the compensator, as set out in this protocol.

Support for unrepresented claimants who are unable to use the portal can be obtained from the Portal Support Centre.

Where claims cannot be settled, the portal provides a process by which the claimant can proceed to court with the evidence and other information uploaded onto the portal in a form suitable for use at court.

H1B Which court?

If the claim cannot be settled out of court and it does proceed to litigation, the claimant must first choose the court in which to start the action.

As we have seen, the two courts that hear civil cases at first instance are the County Court and the High Court. Proceedings (whether for damages or for a specified sum) may not be started in the High Court unless the value of the claim is more than £100,000. Proceedings which include a claim for damages in respect of personal injuries must not be started in the

High Court unless the value of the claim is £50,000 or more (Art. 9 of the High Court and County Courts Jurisdiction Order 1991 (S.I. 1991/724 and Civil Procedure Rules 1998/3132 rule 16.3, as amended) describes how the value of a claim is to be determined).

Defamation actions must be started in the High Court.

Refer to

Refer to [Allocation of cases](#) on page 1/31 for the allocation stage

Cases that begin in one court may not, in the end, be tried there because cases may be transferred from one court to another, commonly at the allocation stage.

Note that the limits applicable to each court are under review by the Justice Department – you should ensure that you keep up to date with developments by reading trade press and looking at legal publications such as the Law Society Gazette.

H1C Issuing the claim

The claimant must begin by drawing up a statement of their case, which is normally done by entering the appropriate details on a claim form provided by the court office and providing more detailed 'Particulars of Claim'. The details will include the court in which the claim is being brought, the names of the claimant and defendant, details of the claim (a summary of the facts and the nature of the injury suffered) and the amount of money (or other remedy) that is being claimed.

H1D Defending the claim

When the defendant receives a copy of the Particulars of Claim they may admit the claim and pay the full amount, in which case the claim ends. However, if the defendant wishes to defend the claim they must send either an acknowledgement of service or a defence to the court within 14 days. If only an acknowledgement of service is sent the defendant has a further 14 days to serve a defence. If the defendant does neither of these things the claimant can ask the court to make an order that the defendant should pay the amount claimed plus costs (a judgment in default).

H1E Allocation of cases

Once the claim is defended, the court will allocate the case to the most appropriate 'track' for dealing with it. The decision is made by the District Judge in the County Court or a District Judge or Master (procedural judge) in the High Court. There are three tracks:

- **Small claims track** – this is normally used for disputes up to £10,000, except for personal injury cases and housing disrepair cases, where the limits are usually £1,500 and £1,000, respectively.
- **Fast track** – this is used for straightforward disputes where the financial value is not more than £25,000.
- **Multi-track** – this is used for disputes which are neither small claims nor have been allocated to the fast track. It includes cases with a financial value exceeding £25,000, and cases of a lower value if the court considers the trial likely to last longer than one day or if any oral expert evidence given at the trial will not be limited to one expert per party in up to two expert fields.

The claimant and the defendant will each complete an allocation questionnaire to assist the judge in deciding the choice of track. Although value is usually the determining factor, cases may be allocated to a higher track due to complexity or, with the consent of all the parties, to a lower track.

H1F Stay to attempt settlement

Either party may ask for a stay of proceedings in order to attempt to settle outside court by way of Alternative Dispute Resolution (ADR). The initial stay (requested via the allocation questionnaire) will be for one month, but a further period can be ordered. The courts are increasingly encouraging the parties to consider the use of ADR and an unreasonable refusal to do so may result in cost penalties.

H1G Power to strike out

The court has the power to strike out all or a part of the statement of case (either the claim or the defence) either on request of one of the parties or on its own initiative. They can do this on a variety of grounds, for example, where the statement of case makes no sense or shows no reasonable grounds for bringing or defending the claim.

H1H Small claims track



Consider this...

What sort of claims would be allocated to this track? Remind yourself of the financial threshold.



Example 1.9

A dispute arising out of a consumer contract involving sums less than £10,000; or a very minor personal injury claim worth less than £1,000 for general damages (the non-financial element of the claim).

On allocation, the court will issue 'standard directions' (in effect, a timetable) instructing each party to file and serve copies of all documents, including any experts' reports, at least 14 days before the final hearing, the date of which is sent out with the directions. The aim is to have a relatively cheap and simple procedure and, for this reason, no expert evidence is allowed without the permission of the court and the use of lawyers is discouraged (though, in fact, they are used quite frequently). A District Judge will hear the case. District Judges are encouraged to take an active part in the small claims proceedings, by asking questions and making sure that both parties explain important points.

The small claims track (SCT) limit for personal injury claims arising from a road traffic accident (RTA)

The Civil Procedure (Amendment No. 2) Rules 2021 came into force on 31 May 2021 amending the Civil Procedure Rules 1998. Accordingly, rule 26.6 is amended to increase the SCT limit for personal injury claims arising from a road traffic accident to £5,000.

The new limit applies to claims where the accident occurred on or after 31 May 2021. This limit applies to the figure for pain, suffering and loss of amenity for the injury alone. The overall SCT limit for the value of all parts of the claim remains at £10,000. For road traffic accidents before 31 May 2021 and for employer's liability and public liability accidents and all other injury claims before and after that date, the SCT injury limit remains at £1,000.

There are other exceptions to the new £5,000 limit; these are all categories of cases excluded from the road traffic accidents Small Claims Protocol and new Official Injury Claims Service. These are the exceptions specified in new rule 26.6A, in respect of which the old SCT injury limit of £1,000 will continue to apply to claims, namely:

- where, on the date that proceedings are started, the claimant is a child or protected party;
- where, when the accident occurred, the claimant was a 'vulnerable road user', which means, motor cyclists and pillion/sidecar passengers, cyclists, pedestrians, horse riders and those using mobility scooters;
- where, on the date that proceedings are started, the claimant is an undischarged bankrupt, or the claimant or defendant acts as a personal representative of a deceased person;
- where, on the date that the accident occurred, the defendant's vehicle was registered outside the United Kingdom; and
- children or protected parties: because these claimants are excluded from the new road traffic accident SCT limit and the road traffic accident Small Claims Protocol, they will not be able to source their own medical report, which under the Civil Liability Act 2018 is required to settle claims for whiplash injuries, via the online service. New rule 26.6B provides that where the claim arises from a road traffic accident which occurred on or after 31 May 2021, and the claim is for, or includes a claim for a whiplash injury, the normal track for that claim will be the fast track and the claim must not be allocated to the SCT.

A claim for personal injuries arising from a road traffic accident on or after 31 May 2021 and which is subject to the increase in the small claims track limit, should be started under the road traffic accident Small Claims Protocol.

H1I Fast track cases

Consider this...

What sort of claims would be allocated to this track? Remind yourself of the financial threshold.



Example 1.10

A claim for breach of contract or for financial losses resulting from professional negligence where the total claimed exceeds £10,000.



In fast track cases, the judge will encourage the parties to agree directions, i.e. a strict timetable for dealing with pre-trial matters such as disclosure of documents, and the exchange of witness statements and experts' reports. The purpose is to prevent one or both sides from wasting time and running up costs. If no agreed directions are submitted by the parties then the timetable will be set by the judge.

The general aim is to have the case heard within 30 weeks and to conclude the trial in one day. The case will usually be heard by a District or Circuit Judge. Although the proceedings are more formal than in small claims cases, the court may limit the use of oral evidence and cross-examination. The number of expert witnesses is also restricted, with usually only one expert (jointly instructed by the parties) being allowed.

H1J Multi-track cases

Consider this...

What sort of claims would be allocated to this track? Remind yourself of the financial threshold.



Example 1.11

More serious personal injury claims, for example one involving industrial disease or ongoing incapacity, a professional indemnity claim involving complex expert evidence, or any other dispute for sums exceeding £25,000.



Claims for more than £25,000 are usually allocated to the multi-track. Cases that are started in the County Court are usually tried there, though they can be sent to the High Court, especially for claims in excess of £50,000.

A multi-track case will usually be heard by a Circuit Judge or High Court Judge who will 'manage' the case from the time it is allocated through to conclusion. The judge will give directions for the management of the case and set the timetable or fix one or more case management conferences (CMCs) to arrange directions and review the progress of the case.

H2 Part 36 offers and payments

It has always been possible for a person involved in litigation to make the other party an offer in the hope of settling the case before it comes to trial, and/or to make a payment into court. The rules governing these offers and payments are now contained in Part 36 of the Civil Procedures Rules mentioned earlier, hence the terms 'Part 36 offer' and 'Part 36 payment'.

Be aware

A Part 36 offer or payment is essentially an attempt to force the other party into a compromise.



If an offer or payment into court is accepted by the other party, then the case ends. However, if the offer or payment is not accepted within the time allowed for doing so, and the person refusing it fails to 'beat' the offer at trial, they will normally have to pay extra costs (despite

winning the case). The aim of Part 36 is to encourage the acceptance of reasonable offers, and avoid the need for unnecessary court hearings.



Example 1.12

Suppose that Annie is suing Beatrice and, before starting court proceedings, invites her to settle the claim for £70,000. Beatrice, without admitting liability, offers Annie £50,000 in full and final settlement. Annie does not accept this and commences proceedings. Beatrice pays the £50,000 into court. Annie refuses to accept this payment and the case goes to trial. If Annie wins her case but fails to 'beat' Beatrice's offer and payment of £50,000 (e.g. the judge awards her any lesser sum) the court can order Annie to pay any costs incurred by Beatrice after the latest date when she (Annie) could have accepted the £50,000. This, effectively, puts pressure on Annie to accept the £50,000 that is offered.

The significance of a payment into court is that, in the case of money claims, the defendant can only make offers to settle prior to the start of proceedings. In fact, once proceedings begin, pre-action offers usually become ineffective unless there is prompt payment into court of the money offered. So, in our case above, the court would probably disregard Beatrice's offer of £50,000 if she had not paid the money into court.

Finally, you should understand that a Part 36 offer can be made by either party. For example, in our case above Annie could, after refusing the £50,000 that was offered by Beatrice and paid into court, invite Beatrice to pay her, say, £60,000, to settle the case. Annie's proposal could be framed as a Part 36 offer. In this case, Beatrice would have to pay enhanced costs and enhanced interest on damages and costs if the judge awarded Annie more than £60,000. This would then put some pressure on Beatrice to pay the £60,000. For reasons that are obvious, judges are not made aware of any amounts that are offered or paid into court until after their judgment has been given.

H3 Funding of civil litigation

Background

Going to court is expensive, so the potential cost of litigation is likely to be a problem for most people of ordinary means. There is also the additional risk in all civil cases that the loser has to pay the winner's costs.

A further major problem in taking a civil case to court is the uncertainty about cost. This is because the claimant may not know how serious the other party is in defending the case. If the defendant admits liability and settles early the costs may be small but, otherwise, they will soon start to rise. Apart from lawyers' fees there may be heavy costs associated with obtaining evidence, getting medical reports and other expert opinions as well as court fees to pay. If the claimant wins, they should be able to recover most or all of these costs, but significantly, under English law if the case is lost the claimant will have to pay the defendant's costs as well.

Litigation funding has been permitted in England and Wales since 1967 (and in insolvency matters since the late nineteenth century). However, the recent years have seen its growing acceptance as part of the litigation landscape. It is important for insurance because it generally means that more lawsuits will be brought (and perhaps with greater legal skill), and insurers may have to pay more claims, and in total pay out more for claims.

Litigation funding can be broadly split into four different forms in the UK: conditional fee agreements, damages based agreements, fixed fees and third party funding.

In 2005, in the case of *Arkin v. Borchard Lines Ltd & Others (2005)*, the English Court of Appeal made it clear that litigation funding is a legitimate method of financing litigation. In January 2010, chapter eleven of the Jackson Review of Civil Litigation Costs was published, effectively providing judicial endorsement to litigation funding.

As a result of the claimant's potential exposure to legal costs, the insurance industry has developed legal expenses insurance (LEI) products. Some LEI policies can be bought after an incident giving rise to a legal claim (at the beginning of the legal action or before a letter of claim is sent to the defendant), as there will still be uncertainty regarding the outcome of the case (the litigation risk). This is known as After the Event (ATE) cover.

Significant reform to the funding of civil justice came into force in April 2013. The following are areas of key change.

Damages-based agreements (DBAs)

The new rules allow contingency fees or damages-based agreements (DBAs). Under these rules, lawyers will be able to conduct litigation in return for a share of damages, but the defendant will be liable for costs only on the conventional basis; the claimant will have to pay any shortfall out of damages. The cap on amount of damages that can be taken as a contingency fee is 25% for personal injury; 35% for employment; 50% for all other claims.

Conditional fee agreements (CFAs)/after the event (ATE) insurance:

CFA success fees/ATE insurance premiums are no longer recoverable from the losing party where arrangements are entered into on or after 1 April 2013. Note that because claimants will no longer be able to recover the success fee or ATE premium, there has been a 10% uplift in general damages for non-pecuniary loss (pain and suffering, loss of amenity).

Costs management:

Judicial costs management procedures have been introduced for multi-track cases commenced on or after 1 April 2013. The parties will have to file and exchange detailed costs budgets before the first case management conference. The court may make a costs management order recording the extent to which parties' budgets are agreed or approved; and when assessing costs, the court will not depart from budget without good reason. It will be essential for all parties to prepare accurate budgets and keep them up to date as recoverable costs may be restricted to the budget last approved or agreed.

Qualified one-way costs shifting (QOCS) for personal injury claims:

Claimants will be awarded costs if successful but will not have to pay the defendant's costs if they lose. Exceptions are where a claimant has failed to beat a defendant's Part 36 offer, or where a claim is 'fundamentally dishonest' or struck out for example as an abuse of process. This means that defendants to personal injury claims will not normally be able to recover costs even where the action is successfully defended.

These far-reaching changes to the civil funding regime came into force in April 2013, and you should ensure that you follow developments in this area by reading the legal and insurance press.

Third-party funding

Litigation funding, also known as third-party funding, is where a third party (with no prior connection to the litigation) agrees to finance all or part of the legal costs of the litigation, in return for a fee payable from the proceeds recovered by the funded litigant. In other words, if the litigant wins their case, part of the proceeds go to the funding third party. If the litigant loses, the funding third party loses their 'investment'.

I The legal profession

In England and Wales, practising lawyers are divided into two groups: *solicitors* and *barristers* (known as 'advocates' in Scotland).

In one sense the legal profession is rather like the medical profession in the UK, in which physicians are either 'General Practitioners' or 'Specialists'. However, in the case of lawyers the division is not quite so clear cut.

I1 Solicitors

When people need legal advice they generally contact a solicitor – a qualified legal professional. Solicitors offer professional advice on all kinds of legal matters, from buying a home or matters of family law to major commercial deals, such as the selling of a major corporation. A solicitor's clients can be individual people, groups, private companies or public sector organisations.

Solicitors deal with all the paperwork and communication involved with their clients' cases, such as writing documents, letters and contracts tailored to their clients' needs; ensuring the accuracy of legal advice and procedure, and preparing papers for court.

Solicitors will also negotiate with clients and opposing parties to secure agreed objectives, gather evidence, supervise the implementation of agreements, calculate claims for damages, compensation, loss of earnings, maintenance etc., and co-ordinate the work of all parties involved in the case. Their work ranges across the whole spectrum of legal work from high value commercial work to personal injury cases, family law issues such as children law and divorce, criminal law and wills probate and the general administration of estates.

Solicitors can also represent their clients in court. They do this mainly in the lower courts but some solicitors apply for and obtain advocacy rights in the higher courts. In complex disputes and where they do not have advocacy rights, solicitors instruct barristers to appear in court on behalf of their clients. In such cases, this means that the client hires both a solicitor and a barrister.

Most solicitors work in private practice. Their businesses vary in size from multinational firms with hundreds of staff to 'high street' offices where one solicitor works as a sole practitioner. Other solicitors work in central or local government, the civil service or in commerce and industry.

The Law Society represents solicitors in England and Wales (there are equivalent Law Societies in Scotland and Northern Ireland) and the profession is regulated by the Solicitors Regulation Authority.

I2 Barristers

In general, barristers in England and Wales are hired by solicitors to represent a case in court and only become involved once advocacy before a court is needed. Often they have little direct contact with members of the public (unless they are a 'Public Access' barrister, as established in 2004). The role of a barrister is to 'translate and structure their client's view of events into legal arguments and to make persuasive representations which obtain the best possible result for their client'.

Barristers usually specialise in particular areas of law such as criminal law, chancery law (estates and trusts), commercial law, entertainment law, sports law and common law; which includes family law and divorce, housing and personal injury law.

Although a barrister's work will vary considerably depending on their level of expertise and the area of law in which they practise, they will typically advise clients on the law and the strength of their case and provide them with a written 'opinion'. Barristers will advocate on behalf of their clients and the client's solicitor in court, presenting their case, examining and cross-examining witnesses and giving reasons why the court should support the case. They will then negotiate settlements with the other side.

In other words, barristers perform two main roles. First, when specialist expertise is needed they give opinions on complex matters of law. Second, when clients need representation in the higher courts (i.e. the Crown Courts, High Courts, Courts of Appeal and Supreme Court) barristers provide a specialist advocacy service. Barristers are specialists at how to present a case in court, and understanding the nuanced preferences of certain judges.

The barristers' governing body is The General Council of the Bar of England and Wales, commonly known as the Bar Council (Faculty of Advocates in Scotland). Regulation of the profession is achieved through the Bar Standards Board.



Example 1.13

In order to illustrate the work of solicitors and barristers in the context of insurance, let us consider a complex dispute that has arisen between insurers and an insured regarding coverage for a claim:

- The insurers' claims handlers might refer the dispute to their solicitors for advice who, in turn, might seek 'Counsel's Opinion' (i.e. the advice of a barrister specialising in the area of law in question).
- If the case eventually goes to court the same barrister would probably be appointed to present the insurers' case in court. Similarly, the insured might seek legal advice from solicitors who themselves might engage the services of a barrister to give expert opinion and speak in court on the insured's behalf.

J Legal personality

Legal personality can be defined as the lawful characteristics and qualities of an entity (a living person, company, charity etc.). It includes legal rights and duties, the capacity to enter into contract and to be otherwise subject to the requirements of the law.

In general terms, all persons are subject to legal rules which protect them, give them rights and impose duties on them. But the law does not affect everybody in exactly the same way. As we shall see, some organisations and groups of people have their own particular rights and duties. Different areas of the law can affect, for example, organisations, minors, persons of unsound mind, bankrupts, married people and other special categories of people in different ways and it is important to be aware of this.

The law generally divides persons into two broad categories; '*natural persons*' and '*juridical persons*' (e.g. corporations). We will focus first on natural persons then highlight some of the key points to be aware of regarding corporations and other juridical persons.

J1 Natural persons

For the purposes of law, all human beings are referred to as natural legal persons. As one would expect, this type of legal personality begins at birth and ends at death.

A person may, in some cases, sue for injuries inflicted before birth and legal actions started before death can be continued afterwards. Furthermore, a legal action can sometimes be initiated on behalf of a deceased person after their death.

Most natural persons possess the full range of rights which the law allows and are subject to a full range of duties. However, some classes of natural person have a special status which may carry with it a limited legal capacity, such as, a more limited set of rights and duties. These include **minors**, persons of unsound mind, bankrupts and aliens, some of which we will discuss later.

Be aware

A person's **status** indicates that they belong to a particular group whereas **capacity** refers to what that person is legally entitled to do.



Status indicates that a person is part of a particular class or group. However, an individual may have several statuses, each of which imposes particular obligations and gives particular rights. For example, a person may:

- be a British citizen (which imposes a duty of loyalty and gives entitlement to the protection of the Crown);
- be married (which imposes an obligation to maintain the partner in marriage and gives rights in respect of children); and
- have attained their majority (which brings with it a generally unrestricted capacity to enter into contracts and the capacity to vote).

Another person might share the status of British citizenship but differ in being a minor and unmarried – the latter statuses carry with them different rights and duties. We will now briefly explore some of the other classes of natural persons.

J1A Minors

Those under the age of 18 are treated differently by the English legal system, as outlined below.

Contracts

Because they are likely to be relatively inexperienced in such matters, there are special rules to protect minors who enter into contracts. This is an important topic and we will look at it in some detail in [Minors](#) on page 3/11, where the law of contract in general is discussed.

Torts

In the law of torts (another important area of civil law, dealt with in [Law of torts](#) on page 2/1), minors are usually fully responsible for their acts. For example, a minor that causes a motor accident by negligently running out into the road would generally be treated as liable in the same way as an adult. However, injured parties will generally find it difficult to recover compensation from a minor, due to the lack of legally owned assets.

Property

As far as property is concerned, a minor may own personal property, such as clothing, books, sports equipment or a car but may not hold what is known as a legal estate in land. This means that a minor cannot, for instance, own a house outright, but can do so indirectly as a beneficiary under a trust.

Criminal law

For the purposes of criminal law, minors divide into two classes. Full criminal responsibility applies in England and Wales in the case of minors over the age of ten, although the legal procedures followed and punishments employed differ from those used for adults. Children under the age of ten are presumed incapable of committing a crime and this presumption cannot be rebutted.

Litigation

Minors involved in civil litigation must sue through a 'next friend', i.e. an adult who is primarily responsible for any costs awarded against the minor. Minors also defend civil actions through a litigation friend, but a defendant friend/litigation friend is not liable for costs. The father, mother or legal guardian of the minor normally acts in these capacities.

In addition to the above, minors are ineligible to vote or stand at elections. They cannot sit on a jury, make a valid will (unless a member of the armed services on active service or a seaman at sea), and cannot marry at all before they are 16 or without parental consent before they are 18.



Be aware

National Lottery (Revocation and Amendment) Regulations 2021/1009 revoke the **National Lottery (Amendment) Regulations 2020 (S.I. 2020/1475)** and amend the **National Lottery Regulations 1994 (S.I. 1994/189)**.

Regulations 2021/1009 raise the minimum age at which a National Lottery ticket may be sold to a person from 16 to 18. Restrictions on sales of National Lottery tickets by vending machines are also amended to reflect this increased minimum age.

These regulations also raise the minimum age at which a person may sell a National Lottery ticket to 18.

J1B Persons lacking mental capacity

Within the English and Welsh legal system, various branches of law address the issue of mental capacity differently, each with its own set of rules and definitions. Many of the provisions are contained in statutes, and particularly in the **Mental Health Acts**.

Below are some examples illustrating how different areas of law approach mental incapacity:

Criminal law

Mens rea and fitness to plead: for certain crimes, a defendant must have the necessary mens rea, or 'guilty mind', to be convicted. If they lacked the mental capacity to form this intent, this may constitute a defence. Further, a person might be found 'unfit to plead' if they can't understand the proceedings due to a mental disability. As an example, in the case of **R v. M'Naghten (1843)**, the defendant was found not guilty by reason of insanity because he suffered from paranoid delusions when he committed murder.

Contract law

In the realm of contract law, mental capacity is a critical factor in determining whether an agreement is enforceable. The underlying principle is that for an agreement to be binding, both parties must have the requisite capacity to understand and appreciate the implications of the contract they're entering into. If a party lacks this capacity, the contract may not be enforceable against them.

The general rule is that a person must understand the nature of the contractual act. If at the time of entering into the contract, one party lacked the capacity to understand its nature, then the contract with that person is voidable at their option. This means that the incapacitated party can choose to enforce or set aside the contract, but the other party cannot enforce it against the incapacitated party.

Determining lack of capacity: mental incapacity in the context of contract law typically involves conditions like dementia, severe learning difficulties, or other cognitive impairments

that affect an individual's ability to understand the nature and implications of a contract. Temporary conditions, such as being under the influence of drugs or alcohol or even a temporary psychotic episode, might also render someone incapable. The test is whether the person was incapable of understanding the general nature of what they were doing at the time they entered into the contract.

If a third party, in good faith and without knowledge of the incapacity, acquires an interest in property from a person who lacked the capacity to sell it, the law might protect that third party's interest, especially if they've provided value for it.

If a person who lacked capacity at the time of entering into a contract later regains capacity, they may choose to ratify the contract, making it binding. Ratification means that the person confirms they intend to be bound by the contract despite their earlier lack of capacity.

If goods or services have been exchanged under a contract which is then set aside due to one party's lack of capacity, the courts may order the incapacitated party to return the goods or pay for the services if they've benefitted from them. This is called restitution and is to prevent unjust enrichment.

Example 1.14

See the following examples:



1. An individual suffering from bipolar disorder, during a manic phase, might enter into a contract to buy an expensive item they cannot afford. If, during this phase, they lacked the capacity to understand the nature and consequences of the purchase, the contract might be voidable at their option.
2. A person heavily intoxicated might enter into a service contract. If they lacked understanding due to their intoxication, they could argue the contract is voidable.
3. If a person with severe dementia enters into a contract to buy a car, that contract might be set aside if it's shown they didn't understand the nature and implications of their actions.
4. In conclusion, while the principle of upholding contracts is fundamental in English law, equally important is the protection of vulnerable individuals who may lack the capacity to fully comprehend their actions. Contract law seeks to balance these concerns by making contracts voidable at the option of the incapacitated party while still allowing for restitution and protection of innocent third parties.

Tort law

Persons lacking mental capacity are not exempt from liability for tortious acts. Their actions, if they cause harm, can result in liability in the same way as any other individual. For instance, if a person lacking mental capacity negligently causes a car accident, they can be held liable for the damages arising from the accident. However, while a person's lack of mental capacity doesn't exempt them from liability, it might influence the application of certain defences.

Contributory negligence: if a person lacking mental capacity was involved in an incident with another person who contributed to the harm due to their failure to acknowledge or adapt to the impaired individual's condition, the defence of contributory negligence might reduce the damages payable by the person lacking capacity. An example of this is: if a person with Alzheimer's disease accidentally harms someone due to their condition, they might still be liable in negligence, but issues like contributory negligence could arise.

Recovery and enforcement: while persons lacking mental capacity can be held liable for tortious acts, practical issues can arise when seeking compensation. If such individuals have no means to satisfy a judgment, or if the act was a result of their condition and they are under institutional care, recovering damages can be problematic.

Property law

Capacity to transfer property: similar to contracts, the transfer of property (like land or houses) requires the parties to have the capacity to understand the transaction. For example, if a person with a severe mental disability is coerced into selling their home, the sale could be invalidated if they lacked the capacity to understand the transaction.

Family law

Capacity to marry: a person must understand the nature of the marriage contract for the marriage to be valid. One example: a person with learning difficulties is forced into a marriage – it could be annulled if they didn't have the capacity to comprehend the nature of marriage.

Mental health law

Detention and treatment: the Mental Health Act 1983 provides for the involuntary detention and treatment of individuals with certain mental disorders, but specific criteria must be met. For example, a person suffering from severe schizophrenia might be involuntarily committed to a hospital for treatment under the Mental Health Act if they pose a risk to themselves or others.

Wills and inheritance

Testamentary capacity: for a will to be valid, the testator must have the mental capacity to understand the nature of the will and the distribution of their assets. Example: if an elderly person with advanced dementia makes a new will, it may be challenged on the grounds that they lacked testamentary capacity.

Conclusion

In conclusion, these examples illustrate that while the core concept of mental capacity permeates various branches of law, its application and definition can differ substantially depending on the legal context.

We look at the differences that apply to such persons' position in contract law in *Persons with a mental health condition* on page 3/12.

J1C Bankrupts

In England, the term 'bankrupt' refers to an individual against whom a bankruptcy order has been made by the court. Bankruptcy is a specific legal status, and it typically involves individuals who cannot repay their debts when they are due.

Bankruptcy can occur in two ways:

Voluntary bankruptcy: an individual can voluntarily apply to the court to declare themselves bankrupt because they cannot pay their debts.

Creditor's petition: if an individual owes more than a specified amount (this figure can change, but as of the last update, it was £5,000), a creditor can petition the court to declare the individual bankrupt.

Here's a breakdown of what it means for a person to be bankrupt in England:

- **Assets:** most of the bankrupt person's assets (property, possessions, income) can be used to pay off the debts. These are taken control of by an official receiver or a trustee.
- **Banking:** bankrupt individuals may be limited in terms of opening or using bank accounts.
- **Business operations:** a bankrupt person is prohibited from directing a company or being involved in its management without the court's permission.
- **Credit:** bankruptcy status severely affects one's credit rating, making it hard to borrow money.
- **Duration:** bankruptcy usually lasts for a year, after which the individual is 'discharged' from their debts. However, the effects of bankruptcy on one's credit report might last longer.
- **Responsibilities and restrictions:** during bankruptcy, the individual must adhere to certain restrictions and cooperate fully with the official receiver/trustee. They must report any increases in income, cannot obtain credit over a certain amount without disclosing their bankruptcy, and must not act as a company director, among other restrictions.

Impact of bankruptcy on various branches of law

Bankruptcy has a significant impact across various branches of law in England, and each area has distinct rules regarding the effects and implications of bankruptcy, as follows:

Contract law

Effect on existing contracts: when a person is declared bankrupt, it doesn't automatically terminate or void their existing contracts. However, the other party to the contract might have

a right to terminate if a bankruptcy clause is included. Example: a business lease might include a clause stating that the lease can be terminated if the lessee goes bankrupt.

Property law

Ownership and control: upon bankruptcy, the bankrupt individual's beneficial interest in their property transfers to the trustee in bankruptcy. This includes both real and personal property. Example: if a bankrupt person co-owns a house, their share of the house is now effectively controlled by the trustee, who might sell the share to pay off debts.

Employment law

Restrictions: a bankrupt individual might be restricted from practising in certain professions or running a business without informing those they do business with of their bankruptcy. Example: a bankrupt individual cannot act as a director of a company or be involved in its management without the court's permission.

Criminal law

Fraudulent bankruptcy: bankruptcy itself is not a crime. However, certain behaviours connected to bankruptcy can be such as hiding assets or lying about one's financial situation can lead to criminal charges. Example: a bankrupt individual who hides cash in a secret bank account and doesn't declare it might be prosecuted for fraud.

Tort

Claims and compensation: if someone has a tort claim against a bankrupt individual (e.g., for personal injury), they would typically have to join the list of creditors and might only get a fraction of what's owed, if anything, depending on the assets available. Example: if someone gets injured in a car accident caused by a now-bankrupt individual, their claim for compensation becomes part of the bankruptcy estate and might not be fully satisfied.

J1D Married persons

The status of marriage and the legal relationship between married persons is part of family law, which is outside the scope of this study text. However, marriage is a contract (albeit a special example) and therefore it shares many characteristics with other contracts. Depending on circumstances, the contract can be fully valid, void (e.g. where either party is under 16) or voidable (e.g. in cases of duress or mistake). Like any other contract, it can be dissolved – in this case, through divorce. Historically, spouses could not legally sue each other in tort but this rule was removed by the **Law Reform (Husband and Wife) Act 1962**.

J2 Corporations

Consider this...

Not all legal rules relate to individuals. How does the law treat companies and other groups of people?



Corporations are non-human legal entities. For this reason, they are sometimes known as 'artificial legal persons' or 'juristic persons'. They are incorporated (formed) by people who wish to combine their resources for a common purpose, which may be a non-consumer (business) enterprise, or involve social or other activities. They vary in size and complexity from vast multi-national firms to small clubs and societies.

The most common examples are companies registered under the **Companies Acts**. These include public limited companies, private companies, limited companies and unlimited companies. Corporations are subject to the law in much the same way as natural legal persons except where their very nature demands a different kind of treatment.

Here are the ways in which corporations are similar to natural legal persons under English law:

A company has been defined as a juristic person having an independent and separate existence from its shareholders.

Separate legal personality: a fundamental principle of English company law is that a registered company has its own separate and independent legal personality. Just like a natural person, a company is a distinct entity, separate from its owners, shareholders, or

directors. In other words, a corporation is a 'juristic person' having an independent and separate existence from its shareholders.

Rights to own property: both natural persons and companies can own, lease, buy, and sell property in their own name.

Contractual capacity: companies, like natural persons, have the ability to enter into contracts, be bound by them, and enforce them. They can also sue and be sued based on contractual obligations.

Legal liabilities: companies are responsible for their actions and the actions of their agents (like employees) in a manner comparable to the way natural persons are legally responsible for their own actions.

Litigation: companies can initiate or be the subject of litigation in their own name, similar to natural persons.

Taxation: both companies and natural persons are subjects of the UK tax system, albeit with different specifics regarding rates, deductions, and allowances.

Why form a corporation?

Corporations are incorporated (formed) by people who wish to combine their resources for a common purpose – often a commercial purpose, but sometimes non-commercial, such as social or other activities. More generically, corporations are formed for various reasons, driven by both legal and commercial factors.

Here are some reasons why corporations are formed:

Limited liability: one of the main attractions of forming a limited company is the benefit of limited liability. Shareholders' financial liability is limited to the amount they have invested or guaranteed to the company. This protects personal assets in the event the company incurs debts or faces legal actions.

Tax advantages: companies may benefit from a more favourable tax regime compared to sole traders or partnerships. Corporation tax rates can be lower than personal income tax rates, and there are certain allowable expenses and reliefs which can be beneficial.

Professional image: having a limited company status can enhance the credibility and professional image of a business. It can instil greater confidence in customers, suppliers, and potential investors.

Raising capital: companies can raise funds by issuing shares, either privately or, in the case of public limited companies, on the stock exchange. This can provide significant capital for expansion and development.

Types of corporation

Companies also have legal duties (such as the obligation to pay corporation tax) which are obviously inapplicable to natural legal persons. There are two types of corporations: **corporations sole** and **corporations aggregate**.

Corporations sole

A corporation sole is a legal person representing an official position which will be occupied by a series of different people.

Under law of England and Wales, a 'corporation sole' is a legal entity that allows an individual to hold property and other rights in perpetuity for a specific official position. Unlike a 'corporation aggregate', which involves multiple members (e.g., a company), a corporation sole involves just one person at a time in their official capacity.

The characteristics of a corporation sole are as follows:

- A corporation sole is a succession of individuals holding a particular office (e.g., the Monarch).
- The official position remains constant while the individual occupying the position may change.
- It allows for continuity of the office, even if officeholders change. When one officeholder dies or resigns, their successor assumes the office and inherits all its official properties, rights, and duties.
- They are legal entities distinct from the people holding the position and who merely act on behalf of the corporation.

An example of this is a monarch: the reigning monarch – queen or king – of the United Kingdom is a corporation sole, which allows for continuity in the role, property holdings, and duties, regardless of the individual who occupies the throne. So when a monarch dies, their successor automatically inherits the Crown's properties and obligations without any need for legal conveyance.

Corporation aggregate

A corporation aggregate is a separate legal entity formed by several individual persons. The corporate aggregate has an existence which is separate from the persons comprising it. There are three types of corporation aggregate: chartered, statutory, and registered.

Chartered corporation aggregate

As stated above, the Crown can create a corporation aggregate by granting a Royal Charter (known as Royal Chartered Companies). The majority of corporations created by the Crown have the word 'chartered' in their title, for example Institute of Chartered Accountants and the Chartered Insurance Institute. However, not all corporations granted a Royal Charter have the word 'chartered' in the title, for example the British Broadcasting Corporation (BBC).

Statutory corporation aggregate

A statutory corporation aggregate, more commonly referred to simply as a 'statutory corporation' or 'public corporation', may only be created by Parliament using a specific piece of legislation for that purpose. For example, the Iron and Steel Act 1967, which created the public corporation British Steel.

In contrast to a corporation sole, which typically refers to a single officeholder, a corporation aggregate involves a number of persons acting together in some perpetual succession. Statutory corporations are distinct legal entities, separate from the state, but they are established to serve a particular public interest or function, and they often have specific powers and functions laid down in their establishing legislation.

Registered corporation aggregate

The most common corporate aggregate is the registered company. Most are formed under the provisions of the various Companies Acts and can be either:

- Public limited companies (abbreviated as 'PLC').
- Private companies (as set out above).
- Private limited companies (abbreviated as 'Ltd').
- Unlimited companies.

Currently a registered company is formed under the Companies Act 2006 and is regulated by the Companies Act 2006, the Companies (Audit, Investigations and Community Enterprise) Act 2004 and the remaining provisions of the Companies Act 1985 and Companies Consolidation (Consequential Provisions) Act 1985.

Consider this...

A corporation may be found guilty of some crimes, even though it can only act through human agents. However, there are some criminal wrongs which it would be difficult or impossible for a corporation to commit, such as assault, rape or bigamy. Again, only limited sanctions are available for companies which break the law – they can be fined, but not imprisoned.



J2A Companies

In England and Wales, corporations (often referred to as 'companies') are primarily regulated by the Companies Act 2006. The law recognises various types of corporation, each with its unique characteristics, formation requirements, and obligations. The treatment of these entities is distinct based on their nature and purpose.

The most common examples are companies registered under the **Companies Acts**. These include:

Private limited companies (abbreviated as 'Ltd'):

- **Definition:** these are companies whose shares are not available to the general public and cannot be traded on a public stock exchange.
- **Liability:** shareholders have limited liability up to the amount unpaid on shares they hold.

- **Regulation:** they are required to file annual accounts and other details with Companies House but have less onerous disclosure requirements than public limited companies.
- **Examples:** small to medium-sized businesses such as a local family-run restaurant or a tech startup might be registered as 'XYZ Restaurant Ltd' or 'TechSolutions Ltd'.

Reasons for choice:

- **Control:** shares are not available to the general public, allowing original owners to retain more control over the company.
- **Liability:** shareholders have limited liability, protecting personal assets from company debts.
- **Tax benefits:** there can be tax advantages to operating as a Ltd.
- **Flexibility:** fewer regulatory requirements compared to PLCs.

Public limited companies (abbreviated as 'PLC'):

- **Definition:** these companies have shares that can be freely sold and traded to the public, usually on a stock exchange.
- **Liability:** like limited companies, shareholders have limited liability – they are not responsible for the company's debts unless they have given personal guarantees on any business loans. Each individual's liability is limited to the value of the shares they hold.
- **Regulation:** they face stricter regulatory requirements compared to private limited companies, especially regarding disclosure, due to their potential impact on public investors.
- **Examples:** Barclays PLC, J Sainsbury PLC.

Reasons for choice:

- **Capital:** ability to raise capital by selling shares to the public through a stock exchange.
- **Share liquidity:** shares can be bought and sold, providing an exit strategy for early investors.
- **Profile and prestige:** increased visibility and status can attract high-quality staff and large contracts.

Limited liability partnerships (abbreviated as 'LLP'):

- **Definition:** combines elements of partnerships and limited liability companies. Commonly used by professionals like solicitors and accountants.
- **Liability:** members (partners) have limited liability, protecting their personal assets from the firm's debts.
- **Regulation:** LLPs must register with Companies House and adhere to certain disclosure requirements, similar to Ltd companies.
- **Example:** PricewaterhouseCoopers LLP.

Reasons for choice:

- **Flexibility:** LLPs offer more organisational flexibility than Ltds.
- **Liability:** limits the personal liability of partners.
- **Tax:** partners are taxed individually, allowing for tax benefits in some situations.
- **Transparency:** suitable for professional services where clients seek personal responsibility of partners.

Community interest companies (abbreviated as 'CIC'):

- **Definition:** these are limited companies created for the use of people who want to conduct a business or other activity for community benefit.
- **Liability:** shareholders or guarantors have limited liability.
- **Regulation:** they face special additional regulation to ensure they're not profiteering from their work and that their assets are used for the community's benefit.
- **Examples:** a local recycling initiative might be set up as 'GreenRecycle CIC', with the primary aim of benefiting the community rather than the shareholders.

Reasons for choice:

- **Community focus:** designed for enterprises that want to use their profits and assets for public good.
- **Regulation:** CICs face regulation to ensure they're upholding their community interest promise, which can inspire trust.
- **Flexibility:** can be limited by shares or by guarantee.

Guarantee companies:

- **Definition:** companies limited by guarantee are often used by charities, clubs, and associations. Instead of having share capital, they have members who guarantee to pay a certain amount towards company debts if the company is wound up.
- **Liability:** members' liabilities are limited to the amount they guarantee, often a nominal amount like £1.
- **Regulation:** they're subject to many of the same rules as standard limited companies.
- **Examples:** many non-profit organisations and charities are set up this way. The National Trust for Places of Historic Interest or Natural Beauty is a prominent charity registered as a company limited by guarantee.

Reasons for choice:

- **No share capital:** useful for non-profits where profit distribution isn't the goal.
- **Reinvestment:** profits can be reinvested into the company's objectives.
- **Membership:** allows for a membership structure, often used by clubs, charities, and other non-profit entities.

Unlimited companies:

- **Definition:** a company where the liability of members is not limited.
- **Liability:** members are jointly and severally liable for all the company's debts.
- **Regulation:** they have fewer obligations in terms of filing and disclosure compared to limited companies, given the high liability of their members.
- **Examples:** these are rarer due to their nature, but some professional service firms or family businesses might use this structure for tax or privacy reasons. An architectural firm might be 'BuildDesign Unlimited'.

Reasons for choice:

- **Privacy:** fewer disclosure requirements can offer more privacy than Ltds.
- **Risk:** suitable for low-risk ventures or situations where owners have external protection against liabilities.
- **Flexibility:** fewer regulatory restrictions and no share capital.

Royal chartered companies:

- **Definition:** established by a Royal Charter from the Monarch. Historically significant, they now typically act as professional bodies, charities, or institutions.
- **Regulation:** their governance and operations are overseen by the terms of their charter and any supplemental charters.
- **Examples:** BBC, The Royal Society.

Reasons for choice:

- **Prestige:** a mark of authority and excellence in a particular field.
- **Historical or traditional value:** many chartered organisations have a long history.
- **Regulation:** specific fields may be regulated under the charter, offering protection and ensuring standards.

Overseas companies:

- **Definition:** these are companies incorporated outside the UK but have an established place of business in the UK.
- **Regulation:** they have specific registration and reporting requirements with Companies House concerning their UK activities.

- **Examples:** a U.S.-based company like 'TechGiant Inc.' might set up a branch in London. In terms of UK operations, it would be considered an overseas company.

Reason for choice:

- **Market access:** offers a presence in the UK market without establishing a separate UK entity.

J3 Unincorporated associations

Unincorporated associations are groups of people which have not been incorporated (formed) in the same way as corporations. The association is defined by the mutual rights and duties of its members amongst themselves.

Examples of usage:

- **Clubs and societies:** many sports clubs, social clubs, and societies function as unincorporated associations.
- **Charitable organisations:** some smaller charities operate as unincorporated associations, especially when they are starting out and have yet to establish a formal structure.
- **Campaign groups:** groups that come together to promote a particular cause or aim, such as environmental or political campaigns, may operate as unincorporated associations.

They range in size from social clubs with a few participants to trade unions with memberships of a million or more.

Unincorporated associations, given their informal nature, might not necessarily make headlines as significant entities in the UK. They're often overshadowed by larger, incorporated bodies such as PLCs and limited companies. However, in terms of influence, reach, or membership, some prominent unincorporated associations have existed or continue to exist in the UK. Here are a few examples:

The Labour party: before it incorporated in 2007, the UK Labour party operated as an unincorporated association. Given its national prominence and significant membership, it was certainly one of the most prominent unincorporated associations in the country.

Trade unions: many trade unions started as unincorporated associations, but most of the larger ones now have some form of corporate structure. Some smaller trade unions or local branches might still function as unincorporated associations.

The nature of unincorporated associations means they are often more fluid and less permanent than other forms of organisational structure. Over time, as they grow or as their needs change, many prominent unincorporated associations may choose to adopt a more formal legal structure.

Differences to corporations

- **Legal personality:** unlike a corporation, an unincorporated association does not have a separate legal personality. This means it cannot hold property, enter into contracts, or incur debts in its own name.
- **Liability:** members of unincorporated associations can be personally liable for the association's debts and liabilities. Members are individuals, each of whom is a natural legal person with their own legal rights and responsibilities. In contrast, shareholders or members of a corporation typically have limited liability up to the amount they've invested.
- **Duration and continuity:** corporations have perpetual succession, meaning they continue to exist until they're wound up or dissolved. Unincorporated associations may end upon the death of a member unless stated otherwise in their rules or constitution.
- **Formality:** corporations are generally subject to more regulations and formalities, such as filing annual returns and accounts, whereas unincorporated associations may have more informal arrangements.
- **Transfer of interest:** shares in a corporation can typically be sold or transferred. Membership rights in an unincorporated association can't be transferred in the same way.

Rights of members

The rights of members within an unincorporated association are determined by the constitution or rules: many unincorporated associations have a written constitution or set of

rules that outline members' rights and duties, the purpose of the association, how decisions are made, and other organisational matters.

Every member is deemed to be in a contractual relationship (governed by the rules) with every other member. Therefore, a member who is denied rights given to them by the rules (such as the right to vote) or who is wrongfully expelled may be able to sue for damages for breach of contract or for an injunction to prevent the association from acting in breach of the rules.

Challenges faced by unincorporated associations

Members of unincorporated associations face several challenges. The primary issue is that an unincorporated association lacks a separate legal personality, which means it cannot hold property, enter into contracts, or sue or be sued in its own name. This has a variety of implications:

Liability in contract: since the association cannot enter into contracts in its own name, contracts are made in the names of its members. This means that individual members may be personally liable if the association breaches a contract.

Liability in tort: in the realm of tortious liability, if someone is injured as a result of the association's activities, individual members could be personally liable if a claim in negligence (or another tort) is made. There's a significant risk for members as they could be held liable for the wrongful acts or omissions of others within the association. This is particularly problematic if the association has insufficient assets to meet any claim – the assets of individual members may be at risk.

Holding property: an unincorporated association cannot hold property in its own name. Typically, property is held on trust by the members for the time being, which can make matters like the sale or leasing of property more complicated. If those holding the property leave or die, there could be significant complications and potential legal costs in transferring property.

Legal proceedings: as already mentioned, the association can't sue or be sued in its name. This can complicate legal processes. For instance, if an unincorporated association wishes to bring a claim, it must do so in the names of its members. Similarly, anyone wishing to sue the association will likely need to sue its members individually.

Despite these challenges, unincorporated associations remain popular due to their flexibility, lack of formal registration requirements, and ease of formation. However, as they grow and evolve, many choose to incorporate to mitigate the risks and challenges associated with the unincorporated structure.

Example 1.15

A member who makes a contract on behalf of an unincorporated association has a personal liability under the contract. This means that a member who arranges insurance for the activities of a social club is personally liable to pay for the cover. The other members of the club will only be liable if they authorise or ratify the making of the contract, which may well happen if the rules of the club provide for it.



Members of unincorporated associations are generally liable for their own torts even when they are committed in the course of the association's activities. This means that if one member of a club negligently injures another, they will be personally liable and no other member will bear any responsibility. The outcome could be different in situations in which the injury is caused by the dangerous conditions of the premises or by an employee of the club.

K Scenario 1.1

K1 Scenario 1.1: question

Apply the nature and sources of English law and the concept of natural legal persons to practical situations (LO1.6)

Arlo, a Romanian friend, is visiting you for a month. He has brought his car with him from Romania and wants to use it for the duration of his stay. His car is insured in Romania and he has not taken out any motor insurance in England. He tells you that in Romania, cars

are insured rather than the drivers – this is not the case in England. Arlo insists that his Romanian insurance policy states that it is valid in England. He believes that he will be able to drive in England without obtaining further cover.

At this stage you do not know the details of the rules that govern the compulsory liability insurance for users of motor vehicles. Therefore, can you please explain to Arlo where to find the legal principles that would tell him/you whether Arlo's insurance policy provides cover for his use of the vehicle in the UK. You are expected to explain the general matters regarding the roles of the legislation by the UK Parliament and the court cases and how they interact with each other and operate together. Your answer should be general, but its scope should be broad by considering where to find the source of the law and how the law applies by different relevant legal institution.

When planning your answer, use the following four-step IRAC approach:

- provide an **introduction** that identifies the focus of the question;
- look at the **relevant** areas of law;
- **apply** the principles of the law to the scenario; and
- provide a **conclusion** to your answer.

Note: the M05 study text is based on English law. All scenarios included are set in England; therefore English law applies.

K2 Scenario 1.1: How to approach your answer

Aim

This fictional case study tests the reader's ability to apply the nature and sources of English law and the concept of natural legal persons to practical situations (learning outcome 1.6).

It is recommended that you use the following four-step IRAC approach when planning your answer.

Provide an introduction that identifies the focus of the question

It is important to recognise that this question is not about compulsory insurances or motor insurance specifically. Its focus is the sources of English law.

Look at the relevant areas of law

English law has certain recognised sources: common law or case law, statute law and European law. Unless a law comes from one of these sources, it is unlikely to be part of English law.

Apply the principles of the law to the scenario

First one should look for any legislative instruments regarding compulsory liability insurance for users of motor vehicles. It may be the case that an Act regulates this (in the UK the relevant legislation is the Road Traffic Act 1988.) Additionally, there may be some statutory instruments that supplement the legislation. In the UK, courts may also make law and create new principles. The courts may interpret the legislation and explain how legislation should operate in real case scenarios, but courts cannot overrule Parliamentary legislation. Here, students may also refer to the differences between the common law and equitable principles.



Be aware

If the UK was still a member of the EU it would have been necessary to search for an EU Regulation or Directive regulating such a matter to see how the UK adopted the Regulation or Directive into its domestic law.

Remember to provide a conclusion to your answer that directly links back to the question and relevant area(s) of the law.

Key points



The main ideas covered in this chapter can be summarised as follows:

Classification of law

- Law can be classified in a number of different ways; distinguishing between common law and civil jurisdictions and between public and private law. Public law includes constitutional law, administrative law and criminal law.
- Private law includes the law of contract, the law of torts, the law of trusts, the law of property, family law and the law of succession.

Sources of English law

- The main sources of new law are legislation and judicial precedent (case law); as well as local custom, legal books and treaties.
- Legislation is law created by Parliament and includes statutes, statutory instruments and other forms of delegated legislation.
- There are a number of rules to assist in the interpretation of statutes including the Interpretation Act, the literal rule, the golden rule and the mischief rule.

Precedent and case law

- A precedent is a decision in a previous legal case where the facts were similar to the case before the court.
- The *ratio decidendi* of a case is based upon the material facts of the case; the decision of the judge and the reason(s) for the decision.
- Binding precedent means that the judge is obliged to follow the *ratio decidendi* of previous similar cases from courts higher than their own or in some cases of equal standing.
- Whether a precedent is binding or not depends on the level of the court in which the decision was made. The court hierarchy determines which courts' decisions are binding on other courts.
- The development of law reporting supported the development of the modern system of binding precedent.

European Community law

- European Union law had been a major source of law for the UK. But the ECA 1972 was repealed by the European Union (Withdrawal) Act 2018 ('EUWA'). The retained EU law is part of the UK domestic law but the UK may amend such rules.

Elements of civil procedure

- The Civil Procedure Rules (arising out of the Woolf reforms) set out the procedure that civil cases follow before and at court.
- The pre-action protocols list actions that both parties to a dispute are required to take before legal action is started.
- If the case is not settled during the protocol period it may be issued at court.
- The court will allocate the case to one of three tracks: the small claims track for cases under £10,000 or for personal injury claims with a general damages element of less than £1,000; the fast track for cases not over £25,000; the multi track for cases over £25,000 or more complex cases.
- Either party may make an offer of settlement to the other party; if the offer is made as a Part 36 offer or payment then there may be cost consequences if it is not accepted.
- Litigation can be very costly; conditional fee agreements and before-the-event or after-the-event insurance can assist but since April 2013 there have been significant changes to funding of civil litigation.

Key points**The legal profession**

- The legal profession is divided into solicitors and barristers.

Legal personality

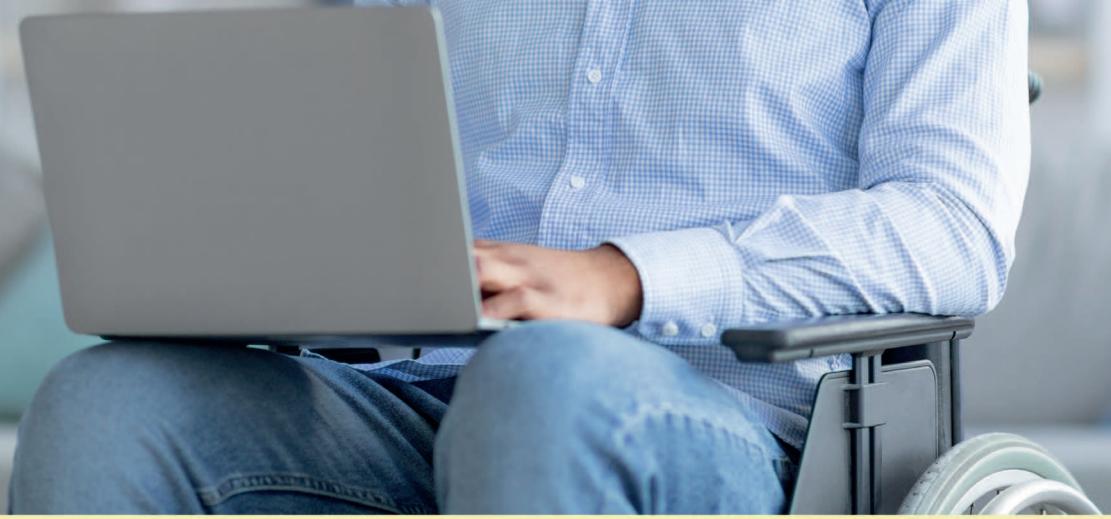
- The law divides persons generally into two broad categories: natural persons and juristic persons (or corporations).
- Special rules apply to the capacity of minors, persons lacking mental capacity and bankrupts.
- Corporations can be either:
 - corporations sole – a legal person representing an official position which will be occupied by a series of different people (such as the Monarch); or
 - corporations aggregate – a legal person consisting of a number of people.
- Corporations aggregate may be created by Royal Charter, private Act of Parliament or by registration under the Companies Acts.
- Unincorporated associations are groups of people who have not been incorporated in the same way as corporations. They range in size and importance.

Self-test questions

1. What is the difference between public and private law?
2. Name the main branches of private law.
3. Explain the terms *ratio decidendi* and *obiter dictum*.
4. Give three examples of legal principles or remedies derived from equity.
5. State the important types of delegated legislation.
6. Name the three rules of statutory interpretation.
7. What are the three 'tracks' to which civil cases may be allocated under the current rules of civil procedure?
8. What is a Part 36 offer or payment?
9. What are the two types of legal person?
10. Outline the key differences between a corporation sole and a corporation aggregate.

You will find the answers at the back of the book

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2

Law of torts

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Learning objectives

After studying this chapter, you should be able to:

- explain the nature of a tort and how torts are classified;
- understand the principles governing the main torts;
- explain the main defences in tort; and
- describe the main remedies in tort.

Introduction



Consider this...

Here are some duties which apply to all of us. Why do they exist?

- If we drive a car, the law requires that we drive carefully so as not to injure other people or damage their property.
- If we write or publish a newspaper article or a book, we must not make untrue statements about other people which might harm their reputation.
- If we go out for a walk, we must not wander onto private property without permission.

These duties are well known and apply, automatically, to all of us.

They exist not because we have agreed to drive carefully; or agreed not to make false statements about other people; or promised to keep off private property, but simply because the law imposes them on everyone, without us agreeing specifically. Importantly, ignorance of the law is no defence. If ignorance were accepted as an excuse, any person charged with an offence could claim ignorance to avoid the consequences. Laws apply to every person within the jurisdiction, whether they are known or not.

If we breach one of these duties and cause harm to another person, it is likely that they will be able to sue us and claim what are known as 'damages' – meaning financial compensation. The type of breach of duty or wrong which we are describing is known as a tort.

A tort is a civil wrong that causes a claimant to suffer loss or harm, resulting in legal liability for the person who commits the tortious act. Tort law can be contrasted with criminal law, which deals with criminal wrongs that are punishable by the state. While criminal law aims to punish individuals who commit crimes, tort law aims to compensate individuals who suffer harm through the actions of others.

A definition of a tort is as follows:

Tortious liability arises from the breach of a duty primarily fixed by the law; such duty is towards persons generally and its breach is redressable by an action for unliquidated damages.



Consider this...

Tort law is important in insurance because liability insurance compensates insured persons who cause harm as a result of their actions. Think of an example of an insurance claim under liability insurance cover that you have seen and consider whether it was based upon tort (a civil wrong).

Most people who are sued in tort are covered by insurance – normally some form of liability insurance, including third party motor insurance.



Key terms

This chapter features explanations of the following ideas:

Battery	Breach of contract	Breach of duty	Breach of statutory duty
Contributory negligence	Damages	Defamation	Duty of care
Employers' liability	Injunction	Libel	Malice
Psychiatric illness	Privilege	Tort	Trespass
Vicarious liability	Wrongful behaviour		

A Nature of tort

In this section, we will look at how *tort* relates to both crime and **breach of contract**.

A1 Torts and crimes

A quick comparison:

	Tort	Crime
Civil or criminal law?	Civil	Criminal
Purpose of legal action?	To provide compensation for the victim who has been harmed by the tortious (i.e. wrongful) act of the defendant.	The object of criminal proceedings is to punish offenders who are found guilty of a wrong which is harmful to the interests of society as a whole.
Who brings the legal action?	The victim themselves (the claimant)	More commonly brought in the name of the Crown by the police (in the UK) or a public prosecutor – although private prosecutions are occasionally found.

Be aware

In some cases, the same behaviour may amount to both a crime and a tort.



Example 2.1

- If A steals B's coat, there is a crime (theft) and a tort (*trespass to goods and conversion*).
- If A physically attacks B, there is a crime (assault in some form) and a tort (*trespass to the person*).
- If A carelessly drives into B's car, there may be a crime (perhaps driving without due care) and a tort (*negligence*).



The result, in each case, is that A may be prosecuted in a criminal court, punished, and then additionally sued in a civil court by B, and ordered to pay compensation to B. Separate legal proceedings, therefore, may arise from the same wrongful act. However, this does not happen very often (especially because A may not have any money).

In very rare cases, the criminal case may be lost, yet the civil case won, because of the different burdens of proof – see below.

A2 Tort and breach of contract

You will recall from the definition above that a tort is a *breach of duty* fixed by law, in other words a general duty which the law imposes on everybody. In the law of contract (an important branch of the civil law discussed in [Law of contract](#) on page 3/1) the duties are fixed by the parties themselves and set out in the contract. In other words, these duties are voluntary and known as contractual duties.

Example 2.2

Under an insurance contract, the insured has a duty to pay the premium and the insurers have a duty to pay claims. These are not general duties but duties which arise voluntarily by agreement.



Here, too, the same circumstances may sometimes give rise to a breach of contract and a tort.



Example 2.3

- If A hires a taxi and is injured as a result of careless driving by the taxi driver (B), then A may be able to sue B for breach of contract (because a contractual duty to drive carefully is implied in the agreement to hire the taxi) and also for the tort of negligence (because B owed A a duty of care, and B breached that duty).
- If a doctor (A) causes harm to a private patient (B) by improper medical treatment, then A may be sued by B both for breach of contract and negligence (because B owed A a duty of care, and B breached that duty).

In these examples, however, there would be one set of proceedings only, in a civil court, and the issues of negligence and breach of contract would be considered together. There would be no criminal proceedings.

A3 Remedy of damages



Consider this...

Look back to the definition of tort quoted in the introduction to this chapter. It states that the remedy in tort is 'an action for unliquidated damages'.

Refer to

Refer to *Remedies in tort* on page 2/31 for damages and remedies

There are, in fact, other remedies in tort but **damages** is the main remedy under common law.

We need only note here that damages in the context of remedies in tort mean financial compensation awarded to a person who has suffered loss or injury due to the wrongful act (or tort) of another party. The primary purpose of damages in tort law is to put the injured party in the position they would have been in had the tort not occurred, to the extent that money can achieve that result.



Be aware

You should not confuse damages in this context with the word damage, which, in legal terms, means harm or injury.

'Unliquidated' (or unspecified) means that the amount of damages is not fixed in advance but will be decided by the court, according to the seriousness of the injury which has been caused.

Damages in contract are sometimes liquidated (or specified); this means that the parties to a contract will have agreed, in advance, a fixed amount of compensation to be paid if there is a breach of contract. We shall also see that each tort has different ingredients and, although there is some overlap between the torts, there is no general principle of liability common to them all. Some writers refer to the law of torts because this branch of the law contains a number of distinct legal wrongs, rather than the law of tort, which suggests a single body of rules. However, both expressions are used and both are acceptable.

B Classification of torts

It will help our understanding of the subject to look at various ways in which torts can be classified.

B1 What interest is protected?

The general purpose of the law of torts is to protect people's rights by allowing them to sue if their interests are invaded, threatened or harmed.

However, different torts protect different interests. For example:

Defamation (libel and slander)	Protects a person's interest in their reputation.
Trespass to the person	Protects a person against deliberate physical harm.
Private nuisance, trespass to land	Protects a person's interest in the land they occupy.
Breach of copyright or patent design	Protects a person's interest in 'intellectual property' – i.e. creations of their own mind.

The interests protected by some torts are very broad. For example, in appropriate circumstances, one can sue for negligence for death, bodily injury, mental injury, financial loss or damage to land or goods – meaning one can bring a lawsuit based on the claim that another party acted negligently, leading to harm or damage.

B2 Is injury or damage required?

In most cases an action in tort will succeed only where the claimant has suffered some form of injury, damage or loss. However, in some cases a tort may be actionable per se (this means actionable 'in itself'). This means that the claimant does not have to prove that they have suffered loss or damage, only that the tort has been committed. This is easier to prove.

Example 2.4

One example is the tort of trespass, every form of which is actionable per se. So, for example, one can sue a person for trespass to land without having to prove that the trespasser caused any damage to the land.



B3 What sort of wrongful behaviour is necessary?

Another way to classify torts is to look at the type of behaviour which the wrongdoer must exhibit and, in particular, the degree of fault (if any) which is necessary.

B3A Intentional torts

Some types of tort are classed as 'intentional torts' as there is a requirement for intention on the part of the defendant to commit the tortious act. In other words, did the defendant intend to commit the acts?

Example 2.5

The major example, again, is the tort of trespass. So, for instance, to deliberately strike a person with an umbrella is trespass to the person. However, to do so accidentally is not a trespass and, according to the modern view, nor is it a trespass to do so negligently.



Another intentional tort is that of deceit, which is committed where one person deliberately makes a false statement to another with the intention that the other will rely upon it, and the person who is misled suffers loss or damage as a result. This tort is referred to again in *Misrepresentation* on page 3/27 (misrepresentation).

B3B Torts requiring negligence or other fault

In some cases, there is no requirement of intentional conduct on the behalf of the defendant. Instead, negligence or other fault, is required. The obvious example is the tort of negligence itself.



Example 2.6

Negligence is required in some forms of private nuisance and, even where no negligence is required, the defendant's conduct must at least be 'unreasonable'. It goes without saying that in these cases there will be no liability for conduct which is purely accidental, i.e. where there is no fault on the part of the defendant.

B3C Strict liabilities

Sometimes a person may be held liable even though their actions are neither intentional nor negligent. We call this strict liability, in other words, 'no-fault' liability. So, strict liability exists when a defendant is liable for committing an action, regardless of what their intent or mental state was when committing the action.

Liability in contract is normally strict, and it will usually be no defence to a breach of contract for the defendant to plead that all reasonable care was taken and there was no negligence on their part. Strict liability may arise in tort also.

Refer to

Refer to [Rule in Rylands v. Fletcher](#) on page 2/19 for **Rylands v. Fletcher (1868)**

A minor but interesting example of strict liability is found in the rule in **Rylands v. Fletcher (1868)** and there are many instances of strict liability arising under statute, some of which are discussed in this chapter. There is something of a tendency for the law to impose strict liability on people who engage in particularly dangerous activities but to require fault where harm is caused through activities which are not intrinsically dangerous.



Be aware

Finally, you should bear in mind that the existence of strict liability does not imply that there can never be any defence against it. We will see that even in cases of strict liability some defences may be available to the defendant.

B4 Malice or motive

We have seen above that liability in tort may depend on the existence of either negligence or intent in many cases.

The law of torts does not on the other hand usually concern itself with why the defendant behaved in the way they did, in other words, the motive for their actions. This is why *malice* is not usually relevant in the law of torts – malice in the legal sense meaning not just personal spite or ill-will but any improper motive.

Because malice or motive is not usually relevant, a person who acts with the very best of intentions in particular circumstances will still be held liable if the action is unlawful. On the other hand, even if a person carries out an act with malicious intent, they will not be liable if what they have done is not unlawful.

There are, nevertheless, one or two cases where malice is relevant in tort, as follows:

- malice is an essential ingredient in one or two minor torts, for example, malicious prosecution and malicious falsehood;
- in the tort of defamation certain defences are not available if there is malice;
- in the tort of nuisance some actions which are normally reasonable (and, therefore, lawful) will be held unreasonable (and, therefore, unlawful) if motivated by malice.

Refer to

Refer to [Nuisance](#) on page 2/17 for nuisance

We will now examine, in outline only, some of the main torts.

C Trespass

We will begin with the tort of trespass because, in some ways, it is the easiest to understand. It is also the oldest tort, with reported cases going back well over 500 years with origins that date back much earlier. Many of the more modern torts (including negligence) grew out of the law of trespass.

Trespass takes various forms, but all forms have the following characteristics:

The act of the defendant must be direct:	There is no liability in trespass unless the injury or harm is caused directly. For example, if I hit a person with a stick or shoot them with a gun or throw rubbish on their land, I may be liable in trespass. However, if I dump rubbish in the road and a motorist collides with it and is injured, there is no trespass because the injury is indirect. To succeed, the motorist would probably need to sue in negligence, or possibly, public nuisance.
The act of the defendant must be intentional:	There is certainly no liability in trespass for any purely accidental injury. There is some doubt as to whether an action in trespass can be brought for an act which is negligent rather than intentional.
The tort is actionable per se:	The claimant does not have to prove that they have suffered any loss or damage in order to succeed.

Trespass takes three main forms:

- Trespass to the person.
- Trespass to goods.
- Trespass to land.

We will look at each in turn.

C1 Trespass to the person

Trespass to the person itself takes three forms:

- Assault.
- Battery.
- False imprisonment.

C1A Assault

An assault is any act of the defendant which directly causes the claimant to fear an attack on their person. So, to point a loaded gun at the claimant or wave a stick at them or make any threatening gesture is an assault. There has always been doubt as to whether threatening words alone (without any accompanying gesture) could amount to an assault.

Be aware

The legal definition of assault is different to that commonly used in everyday language.



Example 2.7

However, in the historic case of *Tuberville v. Savage* (1669), the words spoken actually cancelled out what would otherwise have been an assault. The defendant had put his hand on his sword and said 'If it were not assize time, I would not take such language from you', meaning that he would have attacked the claimant if the (assize) judges had not been in the district. This was not an assault because the presence of the judges in the district meant that there was no prospect of the threat being carried out.



C1B Battery

Battery is the hostile application by the defendant of physical force, even though it may be slight, to the claimant. So, shooting a person or hitting them with a stick is a battery.

You will appreciate that assault and battery typically go together but it is possible to have one without the other: a real threat of violence which is not carried out is still an assault, and a sudden attack from behind, where the claimant is never threatened or put in fear of violence is a battery, but not an assault.

C1C False imprisonment

False imprisonment occurs when the defendant imposes total bodily restraint on the claimant, preventing them from going where they want to go. The word 'false', in this case, simply means wrongful.

No physical contact is necessary, so locking a person in a room which they have entered voluntarily may be false imprisonment. The 'imprisonment' may be in a house, a prison or mental institution (if a person is wrongfully detained there by the authorities) or even a vehicle (if a person is locked in the vehicle or it is driven so fast that they cannot safely get out).

Most actions for false imprisonment are brought against the police, prison authorities, store detectives and other officials whose job involves detaining people from time to time.

C2 Trespass to goods

Trespass to goods occurs where the defendant directly and intentionally interferes with goods which are in the possession of another. So, taking goods from the possession of another is a trespass, as is moving them from one place to another, throwing things at them or meddling with them in some other way. Other examples might include letting down the tyres of a bicycle or scratching a car, which belongs to another person.

C2A Conversion

Conversion is an intentional tort consisting of 'taking with the intent of exercising over the chattel an ownership inconsistent with the real owner's right of possession'. Under English law, it is a tort of strict liability. Its equivalents in criminal law include theft or larceny and criminal conversion.

This means that if the defendant deliberately deals with the goods in a way which is inconsistent with the rights of the person who owns or possesses them, they can be sued for conversion. In this case, the defendant does more than merely meddle or interfere with the goods.

For example, a person taking, selling or modifying goods that belong to another (therefore depriving the other person of their right to possess the goods) is conversion. The defendant does not necessarily need to be aware that the goods belong to someone else.



Example 2.8

Merely moving goods from one place to another is a trespass but not a conversion, whereas stealing goods or selling borrowed goods is a conversion.



Example 2.9

Wrongfully causing damage to another's goods will always be a trespass but will amount to a conversion only where the goods are effectively destroyed or made useless.

Receiving goods which belong to another person may also be a conversion. So, if you are unfortunate enough to buy a car or other property which has been stolen you must (in most cases) give it back if the true owner turns up and claims it. If you refuse to do so, the owner may sue you in conversion for the return of the goods.

Under the **Torts (Interference with Goods) Act 1977** the collective description 'wrongful interference with goods' was introduced to cover trespass to goods, conversion and certain other torts concerning goods. The Act simplified procedures and remedies relating to these torts but did not change the common law principle which we have briefly described.

C3 Trespass to land

Trespass to land is the direct interference with land which is in the possession of another. This is probably the most well-known form of trespass.

As we have suggested, the tort is actionable per se and no damage to the land need necessarily occur for an action to be brought. If it was necessary to prove damage it would, of course, be almost impossible to protect private property against trespassers.

Trespass to land must be intentional in the sense that the defendant must have intended to go on the land in question. If the defendant enters private land by mistake it is, nevertheless, a trespass, provided they intended to enter.

Trespass to land takes three forms:

- Unlawful entry onto the land of another.
- Unlawfully remaining on the land of another (i.e. where the defendant entered the land lawfully but refuses to leave when their permission to be there has expired).
- Unlawfully placing or throwing any material object upon the land of another (such as rubbish or litter).

Be aware

If a person enters land lawfully but abuses their right to be there they are treated as a trespasser from the moment they entered the land. This is known as trespass '*ab initio*' ('from the beginning').



The term 'land' generally includes anything beneath its surface and all space above the land, so tunnelling beneath a person's land or crossing their airspace may be a trespass. Non-consumer (business) organisations often have statutory power to work beneath private land to extract coal or other minerals. Similarly, aircraft operators are generally permitted to overfly private land.

C4 Trespass and insurance

Consider this...

Would an act of trespass be covered under a standard insurance policy? If not, why not?



We have dealt only briefly with the tort of trespass because its relevance to insurance is rather limited. You will appreciate that insurance policies only cover losses that are 'fortuitous', i.e. accidental, whereas actions that amount to a trespass in law will always be deliberate in some sense. So, for example, an insurance company would not normally have to pay for a claim against a person who had deliberately assaulted another person.

Nevertheless, some insurance policies do specifically cover the risk of trespass to land or goods.

Example 2.10

Public liability policies issued to contractors often cover the risk of trespass to the property of third parties. However, these insurances would not cover damage that was caused deliberately, or cases where the insured was sued for trespass that was actionable per se (i.e. when there was no loss or damage), since liability insurance policies respond only when the claimant has suffered some form of harm.



Activity

Look at your own personal home contents insurance policy. Is there an exclusion for any losses arising out of trespass?



D Negligence

Negligence is by far the most important tort today, particularly for insurers, and it is the source of most tort cases which come before the courts. For example, virtually all actions arising from motor vehicle accidents are based on negligence, and a high proportion of cases arising from employment injuries are also negligence cases.

The concept of negligence has been known to the law for centuries and actions based on negligence have their origin in the law of trespass. In the past, however, negligence was most often pleaded in order to establish that some other legal wrong (such as trespass or nuisance) had been committed – in other words, it was an ingredient of other torts. Negligence is, essentially, a failure to take care in circumstances where the law demands

that care should be taken. This gives rise to a claim for damages by the person who suffers harm as a result. However, careless behaviour will not always amount to negligence.

For an action in negligence to succeed, there are three essential elements:

- a duty of care owed by the defendant to the claimant;
- a breach of that duty by the defendant; and
- damage suffered by the claimant (which is caused by the breach).

However, only reasonably foreseeable losses that result from the negligent act will be compensated.

We will look at each of these in turn.

D1 Duty of care

Originally the law recognised only a certain number of situations where a **duty of care** was owed including, for example, that of one driver or other road user to another and that of an employer towards their employees. An action in negligence would, therefore, fail if the case fell outside the established categories. However, a general principle governing the duty of care was established in the famous case of ***Donoghue v. Stevenson (1932)***.



Example 2.11

In *Donoghue v. Stevenson*, the claimant, May Donoghue, had visited a café with a friend who had bought her a bottle of ginger beer. She drank some of this but when she poured out more, a decomposed snail emerged from the bottle. Although she was only mildly ill as a result, she was persuaded to sue. She could not sue the café proprietor for breach of contract because she did not buy the ginger beer, nor could she sue him for negligence, because the drink was in an opaque bottle and the proprietor could not have known that the snail was there. Therefore, she sued the manufacturers in negligence, and succeeded.

This was the first case in which it was held that a manufacturer owed a duty of care to the consumer of their products (this being a new 'category' of negligence at the time). Even more important, however, was the general principle which the case established, known as the 'neighbour principle' or 'neighbour test'. The principle of the 'neighbour test' comes from the words of Lord Atkin, when he was discussing the duty of care in the *Donoghue* case:

The rule that you are to love your neighbour becomes in law, you must not injure your neighbour; and the lawyer's question, 'Who is my neighbour?' receives a restricted reply. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who, then, in law is my neighbour? The answer seems to be – persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in to question.



Be aware

The neighbour principle is one of 'reasonable foreseeability'. A duty of care is owed to another person if it is reasonably foreseeable that they will be affected by one's acts or omissions.

The tort of negligence developed quickly after the *Donoghue* case because it was now clear that the law was not rigidly tied down by precedent to established 'duty' situations: another judge in the *Donoghue* case, Lord MacMillan, remarked that 'the categories of negligence are never closed'.

However, in recent years the courts have become more conservative in developing the law of negligence. In addition to 'foreseeability', they emphasise the need for sufficient 'proximity' (closeness) between the defendant and the claimant and take the view also that a duty of care should be imposed only where it is reasonable to do so.

D2 Breach of duty

A breach of duty occurs when the defendant fails to do what a 'reasonable' man would have done in the circumstances, or does what a reasonable man would not have done. Alternatively, we can say that a breach occurs when the defendant fails to take reasonable precautions.

Consider this...

By whose standards do we judge what a 'reasonable' man would have done?



Under English law, the standard by which the defendant's behaviour is judged is objective. This means that the same standard applies to everybody.

Example 2.12

Anybody who drives a car is expected to meet a basic standard of competence: the standard expected does not vary according to whether the driver is a learner or a professional racing driver.



However, a defendant who claims to have some particular skill or ability will be expected to exercise that skill in a competent fashion.

Example 2.13

A professional person such as a doctor will be judged by the standards prevailing in the medical profession and not according to the medical knowledge of the 'man in the street'.



Whether a breach has occurred is a question of fact, to be decided by the court in the light of all the circumstances of the case. The courts do, however, take into account a number of factors in examining the question, including:

- the magnitude of the risk involved in the defendant's activities (i.e. the likelihood of damage being caused and the potential seriousness of such damage);
- the ease with which the risk could have been eliminated or reduced and the potential costs involved; and
- the current state of scientific or technical knowledge.

In short, the greater the risk presented by the defendant's activities, the greater will be the care expected of them. In the case of the most hazardous activities (such as operating a nuclear power station), the utmost care and the greatest precautions will be demanded, even if the costs involved are high. On the other hand, where the risk of injury is trivial or remote (such as when playing table tennis), the courts will not expect any elaborate and expensive precautions to be taken. In other words, while the defendant is expected to take 'reasonable precautions' in any case, what is reasonable will depend on the circumstances.

D3 Damage

Be aware

Any degree of damage is actionable in negligence unless it is absolutely trivial.



Damage may take a number of forms, including death, bodily injury and damage to property. There are no special rules regarding liability in these cases. However, the rules governing the amount of compensation to be awarded for death and bodily injury (which are outside the scope of this course) are complex. However, there are special considerations where the damage takes the form of nervous shock or financial loss, and these are discussed separately later.

D3A Causation and remoteness of damage

A defendant is not liable in negligence (or tort generally) for every loss which has some connection with their wrongful act. The law attempts to place a reasonable limit on the defendant's responsibilities by releasing them from liability where the damage is 'too remote'.

Originally the 'test' for remoteness of damage was based purely on causation: the defendant was liable for any injury or damage which was caused directly by their negligence, but was not liable for indirect consequences. This principle was rejected and overruled by the Privy Council in 1961.



Example 2.14

***Overseas Tankship (UK) Ltd v. Mort's Dock and Engineering Co. Ltd (1961)* (often referred to as 'The Wagon Mound')**

This case established a new test based on foreseeability: damage would be too remote if it was of a type which was not reasonably foreseeable.

The facts were that men employed by the defendants negligently spilt fuel oil into Sydney Harbour. The oil mixed with cotton waste and other debris and spread to the claimant's wharf where welding operations were causing sparks to fall into the water. The sparks caused the oil to ignite, setting fire to the claimant's wharf.

Although the fire was a direct result of the defendant's negligence (which satisfied the 'old test'), the court held that the damage was too remote because it was of a type which was not reasonably foreseeable. At the time, apparently, it was not known that oil could catch fire in this way.

You will appreciate that the test for remoteness is not the same as the 'neighbour' test although both involve foreseeability. The defendants owed a duty of care to the claimants in *The Wagon Mound* case because some damage was foreseeable (perhaps contamination by the oil), but the type of damage which did occur was not foreseeable. Therefore, it was too remote.

The decision on *The Wagon Mound* did not alter an old common law rule that 'you take your victim as you find him'. This rule applies in what are known as 'thin skull' or 'eggshell skull' cases. These are cases where the damage is not reasonably foreseeable because it results from some pre-existing physical weakness or defect in the claimant of which the defendant is not aware.



Example 2.15

'Thin skull' rule: *Smith v. Leech Brain and Co. Ltd (1961)*

In this case, a worker had pre-malignant cancer of the lip which was activated when a blob of molten metal struck him through the negligence of a fellow employee, and he died of the disease. Although death from such an apparently trivial injury was quite unforeseeable, the employers were fully liable. Cases such as this are an exception to the general rule that no claim lies for damage which is not foreseeable.

Remoteness of damage: *Abouzaid v. Mothercare (UK) Ltd (2001)*

A 12-year-old boy was left blind in his left eye after attempting to attach a sleeping bag to a pushchair. The sleeping bag had two elasticated straps and, when the boy attempted to buckle the straps together, they slipped from his grasp. The strap with the metal buckle recoiled and hit his left eye.

The boy sued the defendants who sold the sleeping bag through their stores for compensation. His argument that the defendants were negligent was dismissed. This was on the basis that a reasonable person in the position of the defendants would not have realised there was a real risk that people like the claimant might suffer some form of physical injury as a result of the sleeping bag being designed the way it was. Before the claimant was injured, there was no reason for anyone to think that someone using the sleeping bag could suffer this kind of accident.

The claim did, however, ultimately succeed on the basis of product liability under the **Consumer Protection Act 1987**. The court accepted that there was a defect in the product in this case as no warning or instructions were included in the product by the manufacturer as to the incident that occurred.

Although the main test for remoteness is now 'reasonable foreseeability' the issue of causation is still important. If the defendant's negligence was not the direct cause of the

damage, they will not be responsible for it and the issue of foreseeability need not even be considered.

Where the 'chain of causation' leading from the defendant's negligent act is broken by a '*novus actus interveniens*' ('new intervening cause'), the defendant will not be responsible for any damage which occurs subsequently.

In other words, '*novus actus interveniens*' is a Latin term that refers to a new intervening act which breaks the chain of causation. The defendant would perhaps not be responsible in the following examples:

- **Third party intervention:** a defendant might argue that the act of a third party, which was neither foreseeable nor controlled by them, intervened and thus they should not be held responsible for the eventual outcome.
- **Natural events:** an extraordinary natural event (such as an earthquake or a flood), which could not have been anticipated, might break the chain of causation if it contributes to the harm or damage in a significant way.
- **Act of the victim:** if the victim does something unforeseeable and independent that contributes to the harm, this may constitute a *novus actus*, relieving the defendant of liability for the subsequent result.

D4 Negligent misstatement

Originally there was no liability in tort for negligent words or negligent advice, only for negligent acts. Liability for negligent advice could arise only where there was a contract between the parties. This meant that professional people who gave bad advice could be sued only by their clients, who would have a contractual relationship with them. They would not be liable to other people who suffered loss as a result.

The law was changed by the decision of the House of Lords in *Hedley Byrne v. Heller and Partners (1963)*.

Example 2.16

This case established, for the first time, that liability could arise in tort for negligent misstatement. As we shall see, it also established a new category of liability in tort for pure economic loss.



The facts were that the claimants had contacted the defendants, who were bankers to a firm with which they were about to do business, for a reference. The defendants gave a good reference concerning the firm's credit-worthiness, although the document was headed by the words 'Without Responsibility' – a disclaimer of liability. The claimants acted on this misleading report (the firm was in trouble) and gave substantial credit, so that they lost heavily when the firm went into liquidation. They sued the defendants and the House of Lords held that the bankers would have been liable in negligence if they had not expressly disclaimed liability.

Liability under the Hedley Byrne rule arises where:

- there is a 'special relationship' between the parties (but not a contract) where it is reasonable for the claimant to rely on the advice given;
- the giver of the advice can reasonably foresee that the advice is likely to be acted upon and that the recipient is likely to suffer if it is inaccurate; and
- the advice is, in fact, acted upon, causing loss to the claimant.

The key element in the Hedley Byrne case was the 'reliance' on the part of the claimant. However, the Hedley Byrne rule has expanded in recent years and it is clear that the rule now applies not just to negligent 'advice' or 'statements' but to negligent professional work generally, including the drawing up of plans, the carrying out of surveys and similar activities. Furthermore, it is now clear that actual 'reliance' on the part of the claimant is not necessary, provided there was an assumption of responsibility towards the claimant by the defendant.

D5 Economic (or financial) loss



Consider this...

A negligent act which causes physical damage may cause economic loss as well. If contractors negligently set fire to a factory the result may be physical damage to the premises but what other losses may be incurred?

The factory owner may also suffer economic loss, in the form of production lost while the damage is repaired.

Refer to

Refer to *Causation and remoteness of damage* on page 2/11 for remoteness

Where economic or financial loss accompanies physical damage and results directly from it, the defendant is liable for such loss, provided the economic loss is not too remote. However, the courts have been reluctant to allow claims in tort for 'pure' economic loss, such as claims for financial loss which are not accompanied by any physical damage to the claimant or their property.



Example 2.17

In *Spartan Steel and Alloys v. Martin and Co. (Contractors) Ltd (1973)*, the defendants negligently cut through a cable carrying electricity to the claimant's factory, interrupting the power supply for 15 hours. Metal in the claimant's furnaces was damaged, reducing its value by £368. The claimants also claimed for £400 profit they would have made on this 'melt' and a further £1,767 for profit on four further melts which they would normally have completed in the time that the electricity was cut. The court held that they could recover only the loss in value of the metal actually in the furnaces and the profit on that metal (£768). The rest of the loss was a pure financial loss which was not related to any physical damage which the firm had suffered.

It appeared at one time that the courts might extend the boundaries of pure economic loss in tort and develop new categories of liability. However, the principle in Spartan Steel (no liability in tort for any economic loss which does not flow directly from some physical damage suffered by the claimant) has been reaffirmed in a series of subsequent cases.

For instance, in *Network Rail Infrastructure Ltd v. Conarken Group Ltd (2010)* heavy goods vehicle drivers employed by C had caused physical damage to a railway bridge and to electrical equipment at a level crossing.

The claimant (N), the body responsible for the rail track system in the United Kingdom, brought claims against C. N had made track access agreements with various train operating companies (TOCs). Upon the accidents, delays were caused to the rail services and N had to make payments to TOCs in relation to the periods for which the train tracks upon which they operated were unavailable as a result of the damage and subsequent repairs.

The court applied Spartan and held in cases involving physical damage. Economic loss was recoverable if it was demonstrably consequential to the physical damage. The sums paid to the TOCs arose as the direct result of the railway lines in question being closed as a result of the physical damage caused by C's negligence, and by the necessary and reasonable time taken to repair and replace the damaged property. The sums paid to the TOCs were recoverable by N.

The one clear exception to the rule that pure financial loss is not recoverable in tort is the Hedley Byrne principle, where there is a 'special relationship' between the parties and pure financial loss is suffered when the claimant acts in reliance on negligent advice given by the defendant.

Be aware

Finally, you should understand that these restrictions apply only to the law of torts. Where there is a contract between the parties, economic loss resulting from a breach of the contract is always recoverable. The law of contract in general is considered in chapter 3.



D6 Psychiatric illness

Activity

Public interest in the subject of *psychiatric illness* has increased as a result of coverage given by the media to a series of recent disasters in the UK. Look at archive press coverage of 'PTSD' (post traumatic stress disorder) suffered by survivors and rescuers involved in the King's Cross underground station fire, the Piper Alpha oil platform explosion and, particularly, the catastrophe at Hillsborough football stadium in 1989.



This is an area where legal liability is expanding. The expansion has been caused, at least in part, by medical advances that have led to a better understanding of psychiatric illnesses and greater confidence in their diagnosis.

D6A Who can sue in negligence for psychiatric illness?

The first point to make is that a person who suffers bodily injury will always be allowed to recover damages for any psychiatric harm that accompanies it: there are no special rules or restrictions. Thus, a person who suffers bodily injury in a car accident caused by the negligence of another will be entitled to additional damages for any psychiatric illness that results from the accident.

**Consider this...**

What about the classic case of the victim who suffers psychiatric illness as a result of witnessing a terrible accident caused by the negligence of another? Should they be able to recover damages even though they have not suffered any bodily injury? What about someone who develops psychiatric illness that results from stress at work?

The position is less simple when the negligent act of one person causes psychiatric illness in another without the latter having incurred any bodily harm.

Before looking at the various types of claimant we should emphasise that:

- claims for psychiatric illness are subject to the general principles of the law of negligence, including the usual requirement of foreseeability; and
- only those claimants who suffer a recognisable psychiatric illness will succeed.

There is no liability for 'mere' grief or sorrow as they are not the symptom(s) of an illness. In practice, the vast majority of successful claims are for the illness known as post-traumatic stress disorder (PTSD).

**Be aware**

Successful claimants are likely to fall into one of two broad categories:

- Those who suffer psychiatric illness as a consequence of an 'accident', caused by the negligence of another, in which people are injured or put in danger (lawyers use the term 'nervous shock' to cover this sort of case).
- Those who suffer psychiatric illness by some other means.

D6B 'Nervous shock' cases

If a person develops a psychiatric illness following the shock of witnessing a terrible accident caused by the negligence of another, and seeks damages, they will have to establish that they fall within a class of persons to whom a duty of care is owed. At present there are two main categories – primary and secondary victims.

Primary victims	Persons who suffer shock through fear for their own safety. This category of claimant was the first to be recognised by English law.
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Example 2.18

In the decision of the House of ***Page v. Smith (1996)***, it was held that a primary victim of this type need only prove that some form of injury was foreseeable in order to recover compensation. They do not have to establish foreseeability of psychiatric injury. In Page, the claimant suffered a reoccurrence of myalgic encephalomyelitis ('M.E.') following a collision with a car negligently driven by the defendant. Whether this particular illness was foreseeable did not matter, given that some form of personal injury was foreseeable.

Secondary victims	Persons who suffer shock through fear for the safety of others. As the twentieth century progressed, the law came to recognise claims by persons who suffered shock through fear for the safety of persons other than themselves.
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The scope of the duty owed to secondary victims was set out by the House of Lords in an appeal that arose from litigation surrounding the 1989 Hillsborough football stadium disaster.



Example 2.19

This was in the important case of ***Alcock v. Chief Constable of South Yorkshire Police (1992)***. The South Yorkshire police, who were responsible for policing the match, negligently allowed an excessive number of football supporters to enter the ground with the result that 96 people were crushed to death and many more were injured. The cases of 16 claimants were considered in Alcock. They, themselves, had not suffered bodily injury and nor had they been at risk, but they had suffered psychiatric injury through witnessing the plight of others. The House of Lords held that in cases such as this, foreseeability alone was not a sufficient test of liability.

The court held that 'secondary victims' such as these should not be entitled to damages unless they could also establish proximity in terms of:

- their relationship with the immediate victim: this had to be characterised by a 'close tie of love and affection';
- their closeness in space or time to the incident or its immediate aftermath; and
- the means by which they learned about the accident, which had to be through their own unaided senses.

The effect of the decision was to deny compensation to claimants who were not closely related to the immediate victims of the Hillsborough disaster, those who were affected by the disaster only after it had occurred and those who were not present at the ground but saw the events unfold on television.

Some police officers who carried out 'rescue' work at the Hillsborough disaster initially won damages for 'nervous shock' in claims against their employers.

However, the decisions were later reversed by the House of Lords.



Example 2.20

In ***White v. Chief Constable of South Yorkshire Police (1999)***, the House of Lords held that the Chief Constable owed his police officers a duty to take reasonable steps to protect them from physical harm, but that duty did not extend to protecting them from psychiatric injury when there was no breach of duty to protect them from physical injury. In other words, 'rescuers' such as the police officers in question, who were not in any danger of physical injury themselves, were to be classified as 'secondary' victims. Accordingly, they would only recover damages if they were able to fulfil the additional control tests laid down by the House of Lords in Alcock, including a 'close tie of love and affection' with immediate victims.

D6C Other sources of liability for psychiatric illness

Beyond these 'nervous shock' cases are those where nobody has been injured or put in danger. We can divide them as follows:

1. Psychiatric illness caused by stress at work.

Example 2.21

The leading case under this heading is *Walker v. Northumberland County Council (1995)* where it was held that a senior local authority social worker was entitled to recover damages in respect of a nervous breakdown, caused by stress and pressure of work, which forced him to stop work permanently. Six months earlier, he had suffered a similar breakdown but little had been done to ease his burden. Although it was not reasonably foreseeable to the local authority that the claimant's workload would give rise to the risk of mental illness in the case of the first breakdown, the second was foreseeable, given what had happened before. In the light of the first breakdown, the local authority should have provided additional help to prevent it happening again.



Example 2.22

Similarly, in *Yapp v. Foreign and Commonwealth Office (2014)*, Y had been appointed to the post of High Commissioner in Belize by the FCO, but had been alleged to have sexually harassed women at social events and bullied and harassed staff members. The FCO withdrew Y from his role on the basis of the first allegation and he received a written warning in respect of the second allegation. That allegation was later found to be unsubstantiated. Y became depressed and remained unable to work for several years until his retirement. Although Y's claim was upheld by the trial judge, the Court of Appeal allowed the appeal that the losses attributable to Y's depression were not reasonably foreseeable either with respect to his claim in tort (breach of the common law duty of care) or for breach of contract.



Refer to

Refer to [Vicarious liability](#) on page 2/22 for vicarious liability

Harassment by colleagues or employees of another employer can also cause or contribute to stress at work, leading to psychiatric illness. Here, the employer may be vicariously liable, provided the harassment would be actionable in tort against the perpetrator. For harassment of a sexual or racial nature, an employer is liable for all acts of its employees committed in the course of employment and, in this case, damages may be awarded for injury to feelings not amounting to psychiatric injury.

2. 'Phobia' cases.

Most of these are cases where employees who have been exposed to something harmful (such as asbestos) through their employer's negligence are not yet physically ill but develop a psychiatric illness as a result of a well-founded fear for what the future may hold for them. However, this principle could also apply to people who suffer negligent exposure to hazardous substances when not in the course of employment.

3. Miscellaneous cases.

These include cases where the claimant has suffered psychiatric injury as a result of witnessing damage to property; it seems that people can form an attachment to property that is just as strong as their attachment to fellow human beings.

E Nuisance

Nuisance is a tort which is ancient in origin and, as in the case of trespass, the development of the modern tort of negligence has reduced its importance somewhat.

Nuisance can take two forms:

- Public nuisance.
- Private nuisance.

E1 Public nuisance

Public nuisance has been defined as the ‘carrying on of an activity which is likely to cause inconvenience or annoyance to the public, or a section of the public, or interference with a right common to all’.



Example 2.23

Public nuisance could arise if toxic fumes from a factory engulf a whole neighbourhood or if noise from a nightclub keeps the whole local community awake.

However, by far the most prevalent area of liability is nuisance on the highway, either by the defendant blocking or obstructing it, or making it unsafe to use.

The point is that the use of the highway is an important public right which the law is keen to protect.

Public nuisance is treated as a crime because it affects the public at large. However, an individual who suffers ‘special damage’, i.e. loss or inconvenience which is greater than that suffered by the general public, may bring a civil action.



Example 2.24

Digging a hole in the road might amount to a public nuisance (since it inconveniences the public as a whole) but an individual who suffers injury as a result of falling into the hole might be able to bring an action in tort for damages.

Actions in nuisance will generally succeed only where there is an element of repetition in the interference or it amounts to a continuous state of affairs.

E2 Private nuisance

The prime purpose of the tort of private nuisance is to protect a person’s interest in their land.

A private nuisance is an unlawful interference with a person’s use or enjoyment of their land (which includes houses and buildings attached to it).

E2A Forms of private nuisance

The interference on the part of the defendant may take either one of two forms:

- wrongfully allowing noxious (i.e. harmful) things to escape from their own property so as to interfere with the claimant’s land (such as noise, smoke, smells, vibration, damp or vermin); or
- wrongful interference with servitudes, or rights attaching to the claimant’s land (such as rights of way, rights to light or rights of support to land or buildings).

E2B Damage

For the interference to be actionable, damage must result. This means that the interference must either cause actual physical damage to the land or at least adversely affect the claimant’s use and enjoyment of it.



Example 2.25

If the claimant is unable to sit comfortably in their garden because of excessive and continual noise from neighbouring property, this might amount to a nuisance even though the land itself is not harmed.



Be aware

Damage in the form of personal injury is not actionable in nuisance, because the object of the tort is to protect a person’s interest in their land rather than in their person. However, personal injury is actionable in public nuisance and, of course, in other torts such as negligence or trespass to the person.

E2C Interference must be ‘unreasonable’

The law of nuisance attempts to create a fair balance between ‘neighbours’ by allowing people to make reasonable use of their own land but preventing unreasonable use of land which will adversely affect others. It is recognised that there must be some ‘give and take’ between neighbours so not every trivial interference will amount to a nuisance in law.

E2D Who may sue and who is sued?

The claimant in a nuisance case will usually be the occupier of the land which is affected, who may be the owner-occupier or a tenant.

The person who is sued (the defendant) is the person who creates the nuisance. This will normally be the occupier of the property from which the nuisance comes.

Be aware

However, a landlord could be liable if they create a nuisance and then let the property, or authorise a tenant to commit a nuisance or allow a nuisance created by a third party to remain.



E2E Defences and remedies

Defences are dealt with later in *General defences in tort* on page 2/28. However, a special defence in nuisance is available under the **Prescription Act 1832**. This provides that if the defendant can establish that the actionable nuisance has existed openly and continuously for at least 20 years, their right to continue with the activity in question cannot be challenged.

It is no defence in nuisance that ‘the claimant came to the nuisance’. Equally, it is no defence to claim that the activity which gives rise to the alleged nuisance is to the benefit of the community.

Refer to

Refer to *Remedies in tort* on page 2/31 for remedies

The usual remedies for nuisance will be damages or an injunction. However, the claimant may also employ ‘reasonable self help’ to abate (stop) a nuisance, for example, by cutting off roots or branches which project from a neighbour’s trees.

E2F Nuisance and insurance

The majority of liability insurance claims are founded on negligence, and claims based solely on the tort of nuisance are likely to be quite rare. However, work done by builders and other contractors can sometimes cause damage to adjoining property that leads to claims in nuisance.

Most forms of liability insurance require some form of concrete injury, loss or damage to occur before the policy will respond, whereas claims in nuisance may be based on a mere interference with the enjoyment of land. This interference could arise, for example, from excessive noise or unpleasant smells that cause no damage as such. Liability insurers are unlikely to become involved in cases of this sort.

F Rule in *Rylands v. Fletcher*

The rule developed in the case of *Rylands v. Fletcher* (1868) and is generally regarded as a separate form of nuisance. It is an example of strict liability – liability that can arise even where there is no fault or negligence on the part of the defendant.



Example 2.26

Rylands v. Fletcher (1868)

In the case of *Rylands v. Fletcher* the defendant employed independent contractors to construct a reservoir on his land to supply water to his mill. In the course of construction, the contractors came across some disused mine shafts filled with earth which, unknown to the defendant and the contractors, connected to the claimant's mine. After the work was completed, and the reservoir filled, one of the shafts gave way and water burst through the old workings and flooded the claimant's colliery. It was found as a fact that the defendant had not been negligent. Nevertheless, the defendant was held liable and the judgment was confirmed by the House of Lords on appeal. The 'rule' is contained in the judgment of Blackburn, J, in the lower court:

We think that the true rule of law is that a person who, for his own purposes, brings on his lands and collects and keeps there anything likely to cause mischief if it escapes, must keep it at his peril, and if he does not do so, is *prima facie* answerable for all the damage which is the natural consequence of its escape.

The House of Lords' decision in *Transco Plc v. Stockport MBC (2004)* seems to establish that the *Rylands v. Fletcher* rule applies where A has brought onto, or kept on, some land an exceptionally dangerous or mischievous thing in extraordinary or unusual circumstances. If the thing escapes from A's land and consequently damages B's land, and if the kind of damage that the thing causes is a kind that was a reasonably foreseeable consequence of such an escape, then B will be entitled to sue A for compensation for that damage unless A can raise a defence to B's claim. This type of claim is therefore relatively rare.

Although the rule in *Rylands v. Fletcher* imposes strict liability, the following defences are available:

- consent of the claimant;
- act of God;
- unexpected act of a stranger; or
- statutory authority.

We will look at general defences in tort in *General defences in tort* on page 2/28.

G Breach of statutory duty

The torts we have looked at so far are part of the common law and developed almost entirely through decisions of the courts over the years. Other torts are to a greater or lesser degree the product of statute law (meaning Acts of Parliament and written rules and regulations). In some cases, the statute in question was passed merely to rationalise or 'tidy up' the existing common law rules with, perhaps, some small changes. This is the case with the **Occupiers' Liability Act 1957** and the **Occupiers' Liability Act 1984** which are discussed later. It is not usual to describe a case brought under this sort of legislation as an action for breach of statutory duty because the underlying rules are those of the common law.

However, Parliament has in other cases created new duties by legislation which are quite distinct from those of the common law.

For instance, the **Animals Act 1971** imposes strict liability for damage caused by animals under the care of another. The Act applies in addition to ordinary common law principles. Therefore, an owner of a dog may still find themselves liable under occupiers' liability for injuries caused, liable in nuisance (for example, for the smell caused by their pigs), or liable in trespass (for example, for allowing hounds to stray onto another's land). An action for breach of statutory duty is an appropriate description for civil actions brought under statutes of this sort. The ordinary rules of negligence will also be applicable for the owners where they have failed to exercise reasonable care to prevent their pet causing foreseeable harm to another.

The main period of development of the tort of a breach of statutory duty was the nineteenth century, when a large amount of statute law was passed in the field of industrial safety, with a view to improving conditions in factories and other places of work.

Example 2.27

Section 41(1A) of the **Highways Act 1980** provides that the highway authority for a particular highway owes the highway's users a statutory duty to maintain it. It states: 'In particular, a highway authority is under a duty to ensure, so far as is reasonably practicable, that safe passage along a highway is not endangered by snow or ice.' A breach of these duties gives rise to an action for breach of statutory duty.



However, s.58(1) of the Act provides a defence for the highway authority if it proves that it took reasonable steps to see that the highway would be reasonably safe to travel. Therefore, a claim by a user of a highway who is injured or whose property has been harmed because the highway authority failed to ensure that the highway was properly maintained may be met by this defence.

Moreover, s.41(1A) is limited to doing what is reasonably practicable to clear the highway of snow or ice.

Breach of statutory duty, therefore, developed as a tort in its own right, distinct from negligence.

To succeed in an action for breach of statutory duty the claimant must establish the following:

1. That the statute was intended by Parliament to allow a civil remedy.

There is no automatic right to claim compensation if one is harmed as a result of someone else's failure to comply with a statute or regulation. To succeed in an action the claimant must prove that Parliament intended to give people the right to sue for damages.

2. The statute must impose a duty on the defendant and not merely a power.

The statute must impose a positive obligation on the defendant to do something (such as to fence dangerous machinery). No action can be brought where the statute merely gives the defendant permission or a power to do a particular thing.

3. The claimant must prove that the statutory duty was owed to them.

Statutes are often passed for the benefit of particular classes of person, for example, workers in factories or mines. In this case, the claimant must prove that they belong to the class of person which the statute was intended to protect.

4. There must be a breach of the duty by the defendant.

In some cases, the duty will be strict and no negligence on the part of the defendant need be proved.

5. The damage suffered by the claimant must be caused by the breach and be of a kind which was contemplated by the statute.

H Employers' liability

This part of the law of torts is concerned with the liability of the employer for injuries suffered by employees in the course of their employment. Because employment injuries are very common, there is a large body of case and statute law on the subject.



Be aware

You should understand, however, that the general principles of the law of torts apply to accidents at work and the rules in this field are not essentially different from those which apply to other sorts of injury outside of an employment relationship.

H1 Liability in negligence at common law

Employers' liability for injuries to their employees can arise in a number of ways. First, an employee may have a claim for negligence under common law. However, where employment injuries are concerned the general duty of care which an employer owes to their employees is usually broken down into more specific duties.

The employer must take reasonable care to:

- select competent staff;
- provide and maintain proper plant, premises and equipment; and
- provide a safe system of work.

As we have suggested, the duties described above are best regarded as a distinct branch of the tort of negligence. The employer's duty at common law is, therefore, not strict but rather a duty to take reasonable care for the safety of their employees. However, the standard of care demanded of employers by the law is high, much as it is for those who drive motor vehicles.

H2 Health and safety at work

The **Health and Safety at Work etc. Act 1974** takes the general common law duties of the employer mentioned above and makes them subject to the criminal law.

Substantial criminal penalties, including unlimited fines and imprisonment of up to two years, can be imposed under the Act, and both employers and employees may be subject to its sanctions. The Act applies to all places of work, all employees and some persons who are not employees.

Section 2(1) of the Act provides:



It shall be the duty of every employer to ensure, so far as is reasonably practicable, the health, safety and welfare at work of all their employees.

Section 47(1)(a) of the 1974 Act makes it clear that breach of the duty under s.2(1) will not be civilly actionable. As a result, an employer cannot be sued for breach of statutory duty if they breach the general duty that they owe their employees under s.2 of the Act.

Section 15 of the 1974 Act gives the Government power to create statutory regulations governing health and safety in the workplace. Previously, s.47(2) provided that a breach of a duty arising under these regulations would be civilly actionable unless the regulations provide otherwise. However, this has now been reversed by s.69 of the **Enterprise and Regulatory Reform Act 2013**. This amends s.47(2) so that a breach of duty under health and safety regulations will not be civilly actionable unless those regulations expressly provide that it should be.

As all the health and safety regulations passed between 1974 and 2013 were created in the expectation that their breach would automatically be civilly actionable, it is unlikely that any of them expressly provide this. As a result, virtually none of these regulations can now be relied on to bring a claim against an employer.

One set of regulations which seems to be unaffected by s.69 of the 2013 Act is the **Management of Health and Safety at Work Regulations 1999/3242**. This states that an employer may be sued if an accident at work is attributable to an employer's failure to implement a suitable and sufficient risk assessment.

H3 Vicarious liability

This is an appropriate point at which to introduce the concept of the common law doctrine of **vicarious liability**, which is of particular importance in the field of employers' liability.

Liability is said to be 'vicarious' when one person is held liable for wrongs committed by another. Vicarious liability is, therefore, not a tort or a wrong in itself but a way in which liability may be imposed: a person may be directly liable for their own torts or vicariously liable for torts committed by others.



Example 2.28

The key (but not the only) example of vicarious liability in tort arises from the relationship of 'master and servant', which effectively means employer and employee.

The rule is that an employer is vicariously liable for the torts committed by an employee in the course of their employment.

This means that where a worker injures a fellow employee in the course of their job or injures somebody who is not a fellow employee (such as a visitor to the premises), the victim can claim compensation from the employer, who is vicariously liable. In other words, the employer is made liable for the negligent actions of the worker that they were responsible for.

Consider this...

Why has liability for their employees' actions been imposed upon the employer?



One reason for imposing liability on the employer is apparent. The employer (a firm or corporation in most cases) is much more likely to have the financial means to pay the claim than the individual employee. Furthermore, the employer is likely to have insurance cover for accidents of this sort. In the case of injury to an employee, insurance is (in most cases) compulsory under the **Employers' Liability (Compulsory Insurance) Act 1969**.

Be aware

In **Barclays Bank v. Various Claimants (2020)** the Supreme Court confirmed that the correct approach to determining whether there was a relationship giving rise to vicarious liability between two persons is a question of whether the tortfeasor was carrying on business on their own account or whether they were in a relationship akin to employment with the defendant.



In the Barclays case the employer bank had instructed a doctor to perform pre-employment medical assessment on job applicants as part of its recruitment process. Barclays arranged the appointments with the doctor, communicated the details to the job applicants and supplied the doctor with a pro-forma report for completion. The examinations were unchaperoned at a consulting room in the doctor's home and he was paid a fee for each report. The issue arose in respect of Barclays' vicarious liability, for sexual assaults committed by an independently contracted doctor.

As laid down in **Cox v. Ministry of Justice (2016)**, whether a person could be made vicariously liable for the torts committed by another involved a two-stage test:

1. Is the relevant relationship one of employment or 'akin to employment'?
2. Is the tort sufficiently closely connected with that employment or quasi employment?

In Cox it was confirmed that a relationship other than one of employment was, in principle, capable of giving rise to vicarious liability where harm was wrongfully done by an individual who carried on activities as an integral part of the defendant's business activities and for the defendant's benefit, rather than their activities being entirely attributable to the conduct of a recognisably independent business of their own or a third party.

In doubtful cases, the five policy reasons (identified by Lord Phillips in **Catholic Child Welfare Society and Others v. Various claimants and Others (2012)**) are relevant. The five criteria are:

1. The employer is more likely to have the means to compensate the victim than the employee and can be expected to have insurance against that liability.
2. The tort will have been committed as a result of activity being taken by the employee on behalf of the employer.
3. The employee's activity is likely to be part of the business activity of the employer.
4. The employer, by employing the employee to carry on the activity, will have created the risk of the tort committed by the employee.
5. The employee will, to a greater or lesser degree, have been under the control of the employer.

However, where it was clear that the tortfeasor was carrying on their own independent business, it would not be necessary to consider the five policy reasons. In Barclays, the Supreme Court decided that the doctor had been in business on his own account with a portfolio of patients and clients and the ruling was therefore in favour of the employer.

Barclays Bank v. Various Claimants was followed in **Hughes v. Rattan (2022)** where R, who owned his own dental practice, had entered into British Dental Association standard template contracts with 'associate dentists' to grant them non-exclusive licences to practice

dentistry at his premises. Each treating dentist held professional indemnity cover for negligence claims, was responsible for their own work and clinical audits, had clinical control over the dental treatment they provided, paid their own tax and national insurance contributions and received no sick pay or pension.

A professional negligence claim was made against R in respect of dental treatment which the claimant had received at R's dental practice by three self-employed associate dentists. The court held that R was under a non-delegable duty of care to the patient who was, in law, a patient of R's practice. It was not necessary for the Court of Appeal to decide whether R was vicariously liable for any negligence by the associate dentists. The court nevertheless expressed that had it been required to decide this ground, it would have held that R was not vicariously liable for the acts and omissions of the treating dentists.

Here, the Barclays test was not met. The critical question was whether the dentists' relationship with R could properly be described as being 'akin' to employment, with the focus being on the contractual arrangements between them. The associate dentists were free to work at the practice for as many or as few hours as they wished, and were free to work for other practices and business owners.

As referred to in *Personal performance* on page 4/10, a producing broker may be held liable for the negligence of a placing broker. While at first sight the producing broker's liability seems to be a type of vicarious liability, Mr Justice Leggatt rejected this proposal in *Involnert Management Inc v. Aprilgrange Ltd (2015)* and held that it was a basic principle that a person is not vicariously liable for the negligence or other wrongful act or omission of an independent contractor. According to Leggatt J, as he then was, the producing broker may be held liable for the assured's loss (although the negligent act is that of the placing broker) under duties of a 'non-delegable' kind, and liability would be co-extensive with what was contractually agreed.

I Liability for defective or dangerous premises



Consider this...

What is the legal position if someone is injured while visiting your office premises? Who is responsible? Would the position be different if they were an invited guest, or a contractor mending equipment or someone who entered without permission?

People are quite frequently injured when visiting unsafe or badly maintained premises. Even where the building itself is safe, the visitor may come into contact with unexpected hazards, such as dangerous machinery, vicious animals or toxic materials.

Under the old common law there were special rules governing the liability of occupiers of land or buildings towards visitors who suffered injury because of defects in the premises or dangers which were present there. The rules were complicated because the duty of care owed by the occupier depended on the status of the person who was injured. A high standard of care had to be exercised with regard to guests who were invited onto the premises, but a lower standard applied to other people, such as contractors or officials who entered as of right. No positive duty was owed to trespassers although the occupier could not set traps (such as guns activated by trip wires or mantraps) which were deliberately intended to injure them.

I1 Occupiers' Liability Act 1957

The Occupiers' Liability Act 1957 was passed to simplify the old common law rules. Under the 1957 Act a 'common duty of care' (i.e. the same duty of care) is owed to all visitors present on the land of another, that is all persons who are not trespassers.

The duty is:

... a duty to take such care as in all the circumstances of the case is reasonable to see that the visitor will be reasonably safe in using the premises for the purposes for which he is invited or permitted by the occupier to be there.

In most cases, this duty will be much the same as the general duty of care imposed by the law of negligence.

I2 Trespassers

The 1957 Act did not change the law concerning trespassers to whom no positive duty was owed. However, in ***British Railways Board v. Herrington (1972)***, British Rail were found liable when a child trespasser, in an area where children were known to play, climbed through a gap in their fence and was severely injured upon coming into contact with a live electrified rail. The House of Lords held, for the first time, that occupiers of land owed a duty of 'common humanity' to trespassers.

I3 Occupiers' Liability Act 1984

The principles established in the *Herrington* case were put into statutory form in the Occupiers' Liability Act 1984. Accordingly, the 1984 Act extends a duty of care to trespassers and other 'uninvited entrants'. There are, however, limitations on this duty when compared to the broader duty to visitors under OLA 1957.

- A duty is owed only if the occupier knows or has reasonable grounds to believe that the danger exists and the trespasser has come/may come into its vicinity.
- The risk must also be one against which the occupier may reasonably be expected to offer a trespasser some protection.
- The only protected forms of damage are death and personal injury, with no duty in relation to property.

It should be noted that visitors and trespassers are owed only a duty to take such steps as will make them reasonably safe. Trespassers, for their part, are owed duties only in respect of hazards of which occupiers are or should be aware, and only if the occupier should be aware of their presence.

In summary, under the Occupiers' Liability Act 1984, a duty will be owed to trespassers if the occupier knew trespassers may be in the vicinity, that there was a danger to them and it was a risk against which the occupier should offer some protection.

Finally, we should stress that under English law liability for dangerous or defective premises is generally placed on the occupier rather than the owner of premises. Persons who own but do not occupy the land in question are liable only in exceptional cases.

J Liability for defective products

Product liability is also an important area of law because defective products are another common source of injury and damage.

Example 2.29

- Defective electrical equipment is a frequent cause of fire or bodily injury.
- Products made for direct human consumption, such as foodstuffs or pharmaceuticals, can result in serious illness if they are unsafe.



Where a person suffers harm from goods supplied by another there may be more than one legal remedy. This will depend upon whether the person who suffered the injury was the buyer of the product which caused the injury.

If the victim was the buyer of the goods, they will usually be able to sue the seller for breach of contract. This branch of civil law is considered in chapter 3.

If the victim was NOT the buyer of the goods:

- an action in contract will not be possible; and
- their only legal remedy will be an action in tort.

An action in tort may be based either on negligence or under the **Consumer Protection Act 1987**.

J1 Negligence

Refer to

Refer to [Negligence](#) on page 2/9 for negligence

If the action is based on simple negligence the ordinary rules governing this tort will apply. The parties need not be buyer and seller.

Any person who suffers harm as a result of a defect in the goods can sue. Any person whose negligence caused the defect, or allowed the defect to harm the claimant can be held liable. Liability may, therefore, be attached to a manufacturer, wholesaler, carrier, retailer or any other person in the chain of supply who acted negligently.

J2 Consumer Protection Act 1987

Negligence arises from a failure to take reasonable care: it goes without saying that an action cannot succeed when the defendant is not at fault. However, proving negligence can sometimes be difficult and may involve prolonged litigation. It has frequently been argued that a person who suffers injury from a defective product should be entitled to damages without the need to establish fault. Tragic cases, such as the birth defects arising from the use of the drug Thalidomide in the 1960s, and the difficulty which claimants faced in establishing liability on the part of the manufacturers, created pressure for a change in the law which would make it easier for victims to recover compensation. It was argued that liability for defective products should operate on a no-fault basis – in other words that there should be strict liability.

Eventually a form of strict liability for defective products was introduced in the Consumer Protection Act 1987. The immediate source was an EC Directive on liability for defective products which the Act carried into English law. Under the Act a producer is liable for personal injury, or damage in excess of £275 to property used for private purposes caused by a defect in their product.

Who is the producer?	The producer is defined as the manufacturer, or the person who has won or abstracted materials (such as a company which extracts oil or mines minerals) or who has processed material which has not been manufactured or abstracted (such as a processor of agricultural products). Liability is also imposed on a person who puts their 'own brand' on a product made by somebody else or imports it from outside the EU.
What is the product?	A product is defined as any goods or electricity including property comprised in another product as a component or raw material. A house or other building is probably not a product within the meaning of the Act, although components in a house are included, as are vehicles and components of vehicles. The product must be intended for private use.
When is the product defective?	According to the Act a product is defective when 'the safety of the product is not such as persons generally are entitled to expect', a definition which obviously leaves considerable scope for judicial interpretation.
The 'state of the art' defence	Although the Act imposes strict liability, the effect is weakened by what is known as the 'state of the art' defence, which is contained in the Act. By virtue of this defence, the producer will escape liability if the state of scientific or technical knowledge at the relevant time was not such that a producer of products of that sort might be expected to have discovered the defect. It seems, therefore, that if a product has a design defect the producer will not be liable if the defect could not have been detected or prevented with the scientific knowledge and technology available at the time. However, the burden of proof will lie with the producer in such a case.

K Defamation

The purpose of this tort is to protect a person's interest in their reputation. **Defamation** is, essentially, a false statement about a person which causes injury to that person's reputation.

The tort of defamation takes two forms:

- **Libel:** the defamatory statement is in a permanent form, e.g. an email, text, posting on social media or in a written publication.
- **Slander:** the statement is in a transient (non-permanent) form. Slander will usually take the form of defamatory speech or possibly defamatory gestures.

K1 Defamatory statement

According to the classic definition, a statement is defamatory if it is false and exposes the claimant to 'hatred, ridicule or contempt or lowers them in the eyes of right-thinking members of society generally'.

An alleged defamation can give rise to a claim for damages and so businesses and independent professionals may obtain liability cover for defamation claims as part of their professional indemnity insurance. In terms of what qualifies as defamation, a distinction must be made between statements which are defamatory and ones which amount only to vulgar abuse. The former harm a person's reputation whereas the latter merely hurt their dignity. Defamation may be by way of innuendo, which is where an apparently innocent statement about another has a hidden and defamatory meaning. In such a case, the claimant must 'prove the innuendo', i.e. establish that persons to whom the statement was published understood it in a defamatory sense.

The claimant must establish that they were the one identified by the statement. If they are not mentioned by name, then they must prove that a reasonable person reading the statement, and knowing the claimant, would assume that it referred to them.

Be aware

The reference to the claimant need not be intentional.



A defamatory statement is not actionable unless it is published, i.e. communicated to some person other than the claimant.

K2 Damage

This must be a material loss having some financial value, such as loss of employment, or loss of financial benefits through the refusal of persons to contract with the claimant. Slander is not generally actionable by itself and damage must be proved. There are two exceptions to this rule. These are cases in which the defendant falsely alleges or implies that the claimant:

1. is guilty of a crime punishable by imprisonment; and
2. is unfit to carry out their profession, calling, trade or business.

K3 Defences

A number of special defences are available in the tort of defamation. They include the following:

- **Truth:** in which the alleged defamation arises from factual statement.
- **Honest opinion:** in which the statements are a matter of comment or opinion. The defendant must prove the statements were honest, relevant and made without malice.
- **Publication on a matter of public interest:** this will succeed provided the subject matter of the publication is a public interest matter and the publisher 'reasonably believed' the publication was in the public interest whether the allegation was true or false.
- **Innocent defamation:** in which the statement was published unintentionally. This usually requires an offer to publish a correction and apology, together with appropriate damages.
- **Privilege:** this applies in judicial and parliamentary proceedings and applies to statements made to the police by members of the public.

L General defences in tort

In this chapter we have examined a number of special defences which apply to particular torts. In addition to these, there are a number of general defences – defences which apply to more than one tort, and in some cases, to several. We will look briefly at the more common examples and discuss their application.

L1 Self-defence

The law allows people to use reasonable force to defend themselves, their property and to defend other persons, such as members of their family or employees. Reasonable force can also be used to prevent crime. Self-defence is a good (legal) defence to intentional torts against the person, such as battery or false imprisonment.

L2 Necessity

Necessity is another possible defence to intentional torts such as trespass. Essentially it is a plea that the act which is alleged to be a tort was carried out in order to avoid a greater evil.

L3 Statutory authority

Statutory authority is a plea that the action which is alleged to be a tort is permitted by statute law (meaning Acts of Parliament and written rules and regulations).

It is a common defence because, in the interest of society as a whole, Parliament often allows firms and individuals to engage in activities which have some harmful effect on others. We have seen, for example, that statute law permits civil aircraft to fly over private land (which would otherwise be a trespass). Statutory authority may also be a defence in nuisance.

Again, statutory authority may be a defence to claims under the rule in *Rylands v. Fletcher*.



Be aware

Statutory authority will not be a defence in negligence, because it is most unlikely that Parliament would ever intend to authorise negligent behaviour.

L4 Consent and volenti non fit injuria

These are two separate defences but are dealt with together because of their similarity.

Consent

The defence of consent applies where the claimant agrees to a deliberate act by the defendant which would be a tort if no consent had been given.



Example 2.30

- The participants in a boxing match consent to being punched by each other.
- Customers in a hairdresser's salon agree to have their hair cut or treated.

If no consent was given each of these actions would amount to a battery.

You should note that in the case of sportsmen who engage in contact sports consent to physical contact is implied: it does not have to be expressly granted. Equally, however, sportsmen do not consent to foul play or breaches of the rules of the game: there have been many cases where football players and others have successfully sued for injuries inflicted in such circumstances.

You will appreciate that consent is primarily a defence to deliberate torts, and particularly to trespass to the person. However, it may also be a defence to other torts, such as libel or nuisance.

Volenti non fit injuria

The expression '*volenti non fit injuria*' literally means 'no legal wrong is done to a person who consents'. In this case, however, the defence is based on the proposition that the claimant consented not to a deliberate act but to the risk of negligence by the defendant. For this reason, the defence is sometimes known as 'assumption of risk'.

In the last century the defence was often used to defeat claims by workmen who were injured in the course of their employment. The employer would point out that the employee was aware of the dangers which their job entailed and, in continuing to come to work, clearly consented to run the risk of injury. Similarly, in this century the defence has often been used to defeat claims by passengers who were injured in car accidents but knew that the driver was drunk and, therefore, likely to drive in a negligent way.

This defence will hardly ever apply to an employment injury. It is also clear that *volenti* is generally no defence to claims by employees based on breach of statutory duty.

Volenti does not apply in 'rescue' cases, e.g. cases where a rescuer voluntarily risks their own safety to save others and the rescue is reasonable, necessary and foreseeable (the defence may apply where there was no real need to rescue).

Courts have tended to favour the concept of **contributory negligence** which is more flexible than *volenti*.

Volenti non fit injuria is primarily a defence to negligence. However, it may also operate as a defence to certain other torts. In particular, it is specifically stated to be a defence to a breach of the 'common duty of care' owed by an occupier under the Occupiers' Liability Act 1957.

L5 Contributory negligence

Contributory negligence (or contributory fault) arises where the claimant is partly to blame for the injuries which they have suffered at the hands of another. An example, would be a motorcyclist who is weaving between motorway lanes and is hit by a car.

Previously under common law, contributory negligence like *volenti* was a complete defence. This meant that the defendant would escape liability completely if they could establish that the claimant was in any way to blame for their own injury.

However, as a result of the **Law Reform (Contributory Negligence) Act 1945**, contributory negligence is no longer a complete defence: it merely reduces the damages awarded to the claimant to the extent that the claimant was to blame for the injury. Contributory negligence is, therefore, a 'plea in mitigation' (reduction) of liability rather than a true defence.

Section 1(1) of the Act reads:

Where any person suffers damage as the result partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reasons of the fault of the person suffering the damage, but the damages recoverable thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage.

Under the Act deduction will be appropriate where:

- the cause of the accident was, in some part, the claimant's own behaviour;
- their behaviour made the results of the accident more serious; or
- both of the above.

A common example of the second situation is where a person is injured in a motor vehicle accident caused wholly by the negligence of another person, but suffers a more serious injury than would normally be expected as a result of their failure to wear a seat belt.

Here the claimant in no way causes the accident but suffers a greater injury through their own fault.

Be aware

Contributory negligence on the part of the claimant will reduce damages in any tort action: its operation is by no means restricted to negligence claims.



L6 Reduction of liability

Contributory negligence focuses on whether the defendant can attribute some responsibility to the claimant, but it may sometimes be open to the defendant to reduce their liability by claiming that someone else should share responsibility for the losses.

Under s.1 of the **Civil Liability (Contribution) Act 1978**:

Any person liable in respect of any damage suffered by another person may recover contribution from any other person liable in respect of the same damage (whether jointly with him or otherwise).

The amount of the contribution will be such as the court finds to be 'just and equitable having regard to the extent of that person's responsibility for the damage in question' (s.2) and may amount to a complete indemnity. It should also be noted that this provision applies whether the liability arises in tort or contract.

The greatest restriction on the usefulness of s.1 arises from the need for both wrongdoers to have caused the 'same damage'. This phrase has been narrowly interpreted by the courts.

Section 1 is not a defence in the true sense, as it does not involve a reduction in liability to the claimant (as contributory negligence does) but the ability to pass liability on to another party. If the other party is unable to pay their contribution, the defendant remains liable in full to the claimant.

M Limitation of actions

The law allows a person who is the victim of a civil wrong only a limited period of time in which to begin their action against the wrongdoer.



Consider this...

Why should the law limit the time allowed for an action to be brought?

To allow unlimited time would be unfair to the defendant since the possibility of legal action could hang over them indefinitely. A very long delay would also make a fair hearing difficult since evidence tends to become less clear and less easily available with the passage of time.

The time periods allowed are governed by legislation and for this reason a claim which is made too late is described as being 'statute-barred'.

Claims based on tort are governed by the **Limitation Act 1980** as amended by the **Latent Damage Act 1986**. The main limitation periods are:

- one year where the claim is for libel or slander;
- three years for personal injury claims; and
- six years for most other tort actions (mainly property damage claims).

M1 When time begins to run

The limitation period begins on the date on which the cause of action accrues. The 'cause of action' means the situation which gives rise to the claimant's right to sue the defendant, and in the law of torts the date in question is usually the date when the damage or injury was sustained by the claimant.

In some cases, however, the duration of the normal limitation period may be modified.



Example 2.31

If, at the time when the cause of action accrues, the injured party is 'under a disability' for the purpose of the Limitation Act 1980 – such as situations in which they are a minor or are of unsound mind – time does not begin to run until this 'disability' ceases. For example, when they reach the age of majority, regain their mental capacity or in the event of their death.

Special rules apply also in the case of latent (i.e. hidden) injuries or damage. The rules are complex and only a brief and simplified description is given here.

M1A Latent bodily injuries

Consider this...

Asbestos related illnesses have resulted in thousands of claims against the insurance industry. Typically, the victims only become ill years after they were exposed to asbestos – sometimes decades later. When does the injured person's cause of action accrue?



Some forms of illness or injury remain hidden for a long time and many years may pass before the first symptoms begin to show. Asbestos-related diseases, which may take 30 or more years to develop, are a good example. For instance, a ship worker may have constructed ships in the 1940s but only develop symptoms of asbestosis in 1975.

If the claim is for an illness or injury of this sort, the time period (three years) begins to run not from the date when the illness began but from the date of knowledge, which in most cases means the date when the claimant first realised that they were suffering from a significant injury attributable to the tortious act/omission of the defendant.

M1B Latent property damage

More recently the principle described above has been applied to latent property damage. Latent property damage includes damage to a building caused by the defendant's negligence which is not immediately visible, such as deterioration of the foundations or cracks at the top of a high chimney.

In this case, the claimant has six years to sue, beginning from the date when the damage first began, or three years from the date when it was discovered, if this produces a longer period. There is also a 'long-stop' (or cut-off date) of fifteen years from the date of the alleged negligence or wrongful act by the defendant.

N Remedies in tort

You will recall from the definition of a tort given at the beginning of this chapter that the principal remedy in the law of torts is an award of damages, that is, monetary compensation to the claimant. Damages is a common law remedy but, as we shall see, certain equitable remedies are also available.

Equity relies less on precedent and more on the sense that justice should be served. It is used where what is sought by the claimant is not money – that is, where there is no adequate legal remedy. In equity a person may get a judge to order the breaching party to deliver some actual property, or to stop doing something that they should not be doing.

N1 Damages

The object of an award of damages is to compensate the claimant by paying for the loss which the defendant has caused by their wrongful act.

When assessing damages, the court will attempt to arrive at a sum of money which will, as far as possible, put the claimant in the financial position they would have enjoyed if the wrong had not been committed. The principles governing the assessment of damages are complex – particularly in personal injury cases.

Damages may fall into the following categories:

- Special damages and general damages.
- Aggravated damages.
- Exemplary (or punitive) damages.
- Nominal damages.
- Contemptuous damages.

We will look at each of these in more detail below.

N1A Special damages and general damages

Special damages are those of which the claimant is required to give notice when they make their claim against the defendant and which they must prove strictly at trial.



General damages do not require such strict pleading and proof because they relate to losses which the law automatically presumes to result from the tort; for example, pain and suffering following an injury. The term 'special damages' is also used to describe damages which are capable of precise financial assessment, as distinct from general damages, which cannot be precisely quantified but only assessed on the basis of what a 'reasonable person' would deem appropriate to compensate for the loss.

N1B Aggravated damages

As already stated, the purpose of general damages is to compensate the claimant for the injury/loss sustained.

In certain torts (for example, assault or trespass) the court may award additional damages to reflect the fact that the motives and conduct of the defendant have aggravated the injury suffered, by injuring the claimant's sense of dignity or pride.

N1C Exemplary (or punitive) damages

The object of an award of damages is not to punish the wrongdoers but to compensate the claimant, punishment being a function of the criminal law rather than the civil law.

Exemplary damages – awards which exceed the loss which has actually been suffered – intended to punish the defendant for their conduct, are nonetheless occasionally awarded in tort actions.



Be aware

Exemplary damages are not available in negligence claims.

Although rare in the United Kingdom today, awards of punitive damages are quite common in other jurisdictions, such as the United States. Such damages are meant to teach the wrongdoer a lesson (and are a warning to others).

N1D Nominal damages

Where a person has committed a tort which is actionable per se (such as libel or trespass) but no real loss has been caused to the claimant, the court may award a nominal (i.e. token) sum to mark the fact that the defendant was in the wrong.

N1E Contemptuous damages

This is the award of a tiny sum (traditionally the smallest coin of the realm) to mark the court's low opinion of the claim of the claimant or record their disapproval of the claimant's conduct. Contemptuous damages may be awarded for any tort, whether actionable per se or not.

N2 Injunctions

An injunction is a type of equitable remedy. In some cases, an award of damages will be inappropriate or inadequate. In many cases, the claimant's main wish will be to prevent in advance the commission of a tort or stop the defendant from continuing to commit one.



Example 2.32

The claimant may wish to:

- prevent the defendant from publishing a libellous book;
- stop them trespassing on private land; or
- cease an activity which is creating a nuisance.

In all these cases an *injunction* will be appropriate.

An injunction is a court order commanding the defendant:

1. to do a particular thing (such as knock down a wall which is blocking a right of way) – a mandatory injunction.
2. to refrain from doing a particular thing (such as publish a libellous book) – a prohibitory injunction.

An injunction may be awarded instead of, or in addition to, damages. However, because it is an equitable remedy then, unlike the common law remedy of damages, it cannot be claimed as of right. The decision to grant an injunction is at the discretion of the court and it may be refused if damages are deemed by the court to be more appropriate, or on a number of other grounds.

Where the claimant is seeking an injunction, it may be necessary to apply for an injunction at the outset of proceedings to protect their position until the trial of the claim. Such injunctions are generally only available if they are prohibitory.

O Scenario 2.1

O1 Scenario 2.1: Question

Apply the law of tort to practical situations (LO2.5)

Your colleague tells you that her 19-year-old son, Ben, was caught stealing car parts from a scrapyard. The police are not taking any further action and the car parts have been returned to the owner of the scrapyard. The owner of the scrapyard has said that he will sue Ben in the civil courts. Ben was injured while in the scrapyard and says that he wants to sue the scrapyard owner.

1. Do you think the scrapyard owner will be successful in suing Ben?
2. Do you think Ben will be successful in suing the scrapyard owner?

When planning your answer, use the following four-step IRAC approach:

- provide an **introduction** that identifies the focus of the question;
- look at the **relevant** areas of law;
- **apply** the principles of the law to the scenario; and
- provide a **conclusion** to your answer.

Note: the M05 study text is based on English law. All scenarios included are set in England; therefore English law applies.

O2 Scenario 2.1: How to approach your answer

Aim

This fictional case study tests the reader's ability to apply the law of tort to practical situations (learning outcome 2.5).

It is recommended that you use the following four-step IRAC approach when planning your answer.

Provide an introduction that identifies the focus of the question

The first step is to identify the torts that may apply. They are as follows:

1. Ben has trespassed and has taken goods.
2. Ben has been injured while trespassing so the scrapyard owner/occupier may owe a duty of care to him which has been breached causing him damage or injury.

Look at the relevant areas of law

These are as follows:

1. The tort of trespass both to land and to goods.
2. The Occupiers' Liability Act 1984 (OLA 1984) will apply as Ben is not a lawful visitor.

Apply the principles of the law to the scenario

1. Ben may be liable for trespass to land and to goods. However, the tort of conversion may not apply as it appears that no loss has been established because the goods were returned.

The scrapyard owner may be successful if he sues Ben in relation to trespass to land and goods but conversion may not apply as no loss has been established.

2. Ben will only be owed a duty of care by the occupier of the scrapyard (who may or may not be the owner) if the requirements set out in the OLA 1984 are satisfied. Under the OLA 1984, much depends on the occupier's knowledge – a duty may be owed but that duty has then to be breached and damage proved.

Therefore, a duty will be owed to Ben if the occupier knew trespassers may be in the vicinity, that there was a danger to them and it was a risk against which the occupier should offer some protection. Based on the facts, it is unclear if a duty is owed to Ben by the scrapyard owner/occupier under OLA 1984. If a duty is owed to Ben, it then needs to be established whether it has been breached. As a result, Ben may not be successful if he sues the scrapyard owner.

Remember to provide a conclusion to your answer that directly links back to the question and relevant area(s) of the law.

Note: the provisions of the OLA 1984 can be set out in full or paraphrased but, if paraphrased, the meaning must not be changed. The Occupiers' Liability Act 1957 does not need to be mentioned in relation to this scenario as it does not apply.

Key points



The main ideas covered in this chapter can be summarised as follows:

Torts

- A tort or legal wrong arises from a breach of duty fixed by law; the duty is towards persons generally and the victim can bring an action in tort against the wrongdoer.
- The same behaviour can amount to a tort and a crime.
- The remedy in tort is an action for unliquidated damages. Unliquidated means that the amount of damages is not fixed in advance but decided by the court.
- The general purpose of the law of torts is to protect people's rights by allowing them to sue if their interests are invaded, threatened or harmed.
- Torts can be classified by looking at the interests that they protect:
 - Defamation (libel and slander) protects a person's interests in their reputation.
 - Trespass to the person protects a person against deliberate physical harm.
 - Private nuisance and trespass to land protect a person's interest in the land they occupy.
 - Breach of copyright or patent design protects a person's interest in their intellectual property.
- Torts can also be classified by the type of behaviour that the wrongdoer must exhibit and the degree of fault (if any) which is necessary.
- Torts can be intentional; or require negligence or other fault.
- Torts can also impose strict liability where no intent or fault is required.

Trespass

- Trespass is actionable per se and requires:
 - Direct act by defendant.
 - Intentional act by defendant.
- Trespass takes three forms: to the person, to goods and to land.
- Trespass to the person can be assault, battery or false imprisonment.
- Trespass to goods occurs when the defendant directly and intentionally interferes with goods in the possession of another.
- If they then deliberately deal with the goods in a way inconsistent with the rights of the owner then they can be sued for conversion.
- Trespass to land is the direct interference with land which is in the possession of another and can take three forms; unlawful entry onto the land of another; unlawfully remaining on the land of another; and unlawfully placing or throwing any material object upon the land of another.

Negligence

- Negligence is the most important tort today.
- Negligence is a failure to take care in circumstances where the law demands that care should be taken, giving rise to a claim for damages by the person who suffers harm as a result.
- For an action in negligence to succeed the claimant must show a duty of care is owed to them by the defendant; that the defendant breached that duty; and that the claimant has suffered damage as a result of the breach.
- The leading case on duty of care is *Donoghue v. Stevenson* (the case involving the snail in the bottle of ginger beer).
- *Donoghue v. Stevenson* introduced the neighbour principle which is one of reasonable foreseeability – a duty of care is owed to another person if it is reasonably foreseeable that they will be affected by one's acts or omissions.
- A breach of duty occurs when the defendant fails to do what a reasonable person would have done in the circumstances; or does what a reasonable person would not

Key points

have done. The standard is objective. In other words, it is the response of a reasonable person to a foreseeable risk.

- The defendant will only be liable for damage that is not too remote.
- Where the chain of causation is broken by a 'novus actus interveniens' ('new intervening cause') the defendant will not be liable for subsequent damage.
- The Hedley Byrne case established liability for negligent misstatement where there is a special relationship between the parties; it is reasonably foreseeable that advice will be acted upon and loss will be suffered if the advice is inaccurate; the advice is indeed acted upon and the claimant sustains loss.
- The courts will not normally allow claims for pure economic loss i.e. claims for financial loss which are not accompanied by any physical damage to the claimant or their property.
- A person who suffers bodily injury will always be able to recover damages for any psychiatric injury that accompanies it.
- A person who suffers psychiatric illness following the shock of witnessing a terrible accident caused by the negligence of another will have to establish that they fall within a class of persons to whom a duty is owed in order to recover damages.
- There are two main categories; primary victims and secondary victims.
- Primary victims suffer shock through fear for their own safety; secondary victims suffer shock through fear for the safety of others.
- The Hillsborough cases confirmed that secondary victims have to establish proximity in order to recover damages.

Nuisance

- Nuisance can take two forms: private and public.
- Public nuisance is the carrying on of an activity likely to cause inconvenience or annoyance to the public. Private nuisance is an unlawful interference with a person's use or enjoyment of their land.

Rylands v. Fletcher

- The *Rylands v. Fletcher* rule is an example of strict liability for escapes of a damage-causing thing arising from non-natural use of land, and gives rise to a form of nuisance claim.

Liability for defective or dangerous premises

- Vicarious liability is where one person is held liable for wrongs committed by another – the most common example is employer/employees.
- The Occupiers' Liability Act 1957, which codified the common law position, places a duty on occupiers to take care to ensure that visitors will be 'reasonably safe' in using the premises.
- This principle was extended to trespassers, firstly in the case of a child trespasser in *British Railways Board v. Herrington* (1972), then more widely under the Occupiers' Liability Act 1984.
- It should be noted that visitors and trespassers are owed only a duty to take such steps as will make them reasonably safe. Trespassers, for their part, are owed duties only in respect of hazards of which occupiers are or should be aware, and only if the occupier should be aware of their presence.

Liability for defective products

- Liability for defective products can be strict under the Consumer Protection Act.

Defamation

- Defamation can take two forms: libel and slander.

Key points

General defences in tort

- General defences in tort include self-defence; necessity; statutory authority; consent and *volenti*; and contributory negligence.

Limitation of actions

- The law allows a person who is the victim of a civil wrong only a limited period of time in which to bring their action against the wrongdoer – three years for cases involving personal injury, one year for libel and slander, and six years for all other claims.

Remedies in tort

- The main remedies in tort are damages and injunctions.

Self-test questions

1. How would you distinguish a tort from breach of contract?
2. Why is contributory negligence, strictly, not a defence?
3. What are the key characteristics of the tort of trespass?
4. What must a claimant prove in order to succeed in an action for negligence?
5. What is the 'neighbour test' (or neighbour principle)?
6. What two forms may private nuisance take?
7. What is vicarious liability? Give an example.
8. What are the defences available in defamation?
9. What are the main limitation periods in the law of torts?
10. How does the law treat trespassers and non-trespassers differently, with respect to occupiers' liability for injuries incurred on the property?

You will find the answers at the back of the book

3

Law of contract

Contents	Syllabus learning outcomes
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Learning objectives

After studying this chapter, you should be able to:

- explain the nature of contractual liability;
- identify the rules relating to the formation of a contract;
- understand how contract terms are classified;
- describe the elements which affect the validity of contracts;
- distinguish between void, voidable and illegal insurance contracts;
- explain the circumstances in which a contract may be discharged;
- describe the remedies for breach of contract;
- understand the basic principles of assignment; and
- understand the rules which govern the assignment of insurance contracts.

Introduction

A contract is a legally binding agreement. That means it is one which the courts will recognise and enforce. An insurance policy (the contract of insurance) is, therefore, a legally binding agreement to insure.

It is the binding nature of an insurance contract which provides a solid foundation for the business of insurance and enables people to buy policies with confidence that obligations will be fulfilled by the insurers. This is important, because an insurance contract can be regarded as a promise to pay claims (with upfront payment of the premium).



Consider this...

Why is some knowledge of contract law essential for those working in the insurance industry?

The law of contract ('contract law') is central to insurance.

Contracts are of course made for many purposes besides insurance. There are contracts for the sale of goods; for the sale of houses; for employment; and for many other things.

In this chapter we examine the general law of contract; that is, the body of rules and principles which applies to all types of contract, including insurance.

First, we will examine how contracts are classified and how a contract is formed. Next, we analyse the contents of a contract and classify the various terms which make up the agreement. We also consider various factors which may destroy or affect the validity of a contract. We will then consider the discharge (the ending) of contracts, including the rules governing performance and breach of contract, and the remedies which are available for breach of contract. Finally, we will look at the subject of assignment – how rights under a contract may be transferred to another person.

Most of the detailed rules of the law of contract were developed in the nineteenth century, and you will find that a number of the leading cases date from this period.

Insurance contracts may differ to other types of contract. Such differences will be analysed in the following chapters.



Key terms

This chapter features explanations of the following ideas:

Agreement	Breach	Conditions and warranties	Consideration
Contracts under seal	Contractual capacity	Defective contracts	Equitable assignment
Illegality	Improper pressure	Misrepresentation	'Posting rule'
Privity of contract	Promissory estoppel	Restitution	Restraint of trade
Specified time	Termination	Time limit	Unilateral and bilateral contracts

A Types of contract

Contracts can be grouped according to their subject matter (e.g. insurance, sale of goods or land, employment, hire etc.). We will examine various classifications of contract below.

A1 Contracts under seal and simple contracts

A **contract under seal** (also known as a special contract or a contract by deed) is a formal contract which is signed, has the (wax) seal of the signer attached and is witnessed.

Certain contracts must be in this form to be valid. This will be discussed later.

All other contracts are known as simple contracts (or informal contracts).

Consider this...

If you verbally agree with your friend that you will buy their car from them but nothing is put in writing, has a contract been formed? In other words, is an oral contract valid?



Contracts can generally be in any form (including that of an oral agreement) although sometimes they must be in writing or be evidenced in writing. Details will be found in *Formation of a contract* on page 3/4 on the formal requirements of contracts. The main problem with a verbal contract is that there is no written evidence that it was formed between the parties or the terms of the agreement. Consequently, it is very difficult to enforce the contract. It is often the word of one person versus the word of another as to whether a verbal agreement was formed, and the terms thereof.

A2 Unilateral and bilateral contracts

A **unilateral contract** is primarily a one-sided, legally binding agreement where one party agrees to pay for a specified act. Such contracts only require a pre-arranged commitment from the offeror, unlike a bilateral agreement where a commitment is required from two or more parties.

A **bilateral contract** is legally binding between two or more parties, where the offer by the promisor is accepted by the promisee.

Whereas a unilateral contract is enforceable when someone chooses to begin fulfilling the act demanded by the offeror, a bilateral contract is enforceable from the time when the contract is signed. The word 'unilateral' reflects the nature of the offer that is open to be accepted and once it is accepted, a contract is formed. Once their offer is accepted (no one has to accept the offer but they may choose to accept it), the offeror is bound by their promise.



Example 3.1

One common example of a unilateral contract is when someone posts a reward for their lost pet. By offering the reward, the offeror sets up a unilateral contract that stipulates that the reward will be issued once the lost pet is found. It is legally binding only on the party who offers the reward. No one is legally obliged to find the property and hand it in, but the owner must pay the reward if somebody does so. Technically speaking, it is a unilateral offer until the offer is accepted, at which point it becomes a unilateral contract.

Under a **bilateral contract** each party makes a promise to the other and both are legally bound.



Consider this...

We have seen above that an insurance policy is a contract, a legally binding agreement. What are the promises made by the insured and by the insurer which bring about this agreement?



Example 3.2

Under an insurance contract the insured is bound to pay the premium and the insurers are legally bound to pay valid claims in return.

We will see examples of both types of contract later.

A3 Void and voidable contracts

A **void contract** is a formal agreement that is unenforceable (often, but not always, from the moment it is created). For example, an agreement between a drug dealer and a buyer is void because the terms of the contract are illegal. As such, neither party can go to court to enforce the contract. Void contracts often occur when there is lack of capacity to contract and by the operation in some instances of the doctrine of mistake.

A **voidable contract** is a formal agreement between two parties that, though valid when made, is liable to be subsequently set aside on a number of different grounds.

In summary, there are various reasons why a contract may not be fully valid in law:

A void contract: has no binding effect on either party:	A voidable contract is binding:
because a void contract is no contract at all, the expression is really a contradiction in terms	but one (or possibly both) of the parties will have the right, if they wish, to set it aside
however, the expression is useful to describe agreements which neither party can enforce	contracts may be voidable on a number of different grounds, such as <i>misrepresentation</i> , drunkenness or insanity and we will examine these and various other examples in this chapter

We will explore defective contracts and void and illegal insurance contracts more fully in [Defective contracts](#) on page 3/20.

B Formation of a contract

The following are the five essentials for the formation of a valid contract under English law:

1. there must be an *agreement*, which in English law is generally shown by offer and acceptance;
2. there must be the intention to create legal relations;
3. there must be *consideration* (in the case of simple contracts) e.g. a promise to pay the agreed premium;
4. the agreement must be in the form required by law (if any); and
5. the parties must have capacity to contract.



Be aware

The contract must also not be illegal or contrary to public policy.

This is dealt with later.

B1 Agreement

In English law, agreement is usually established by a process of offer and acceptance:

- The party who makes the offer is the offeror.
- The party who receives it is the offeree.

Offer and acceptance are dealt with in turn in the following sections.

B1A The offer

In this section we will look at offers and invitations to treat.

An offer may be made:

- in writing;
- orally;
- by conduct;
- to one person;
- to a group of people; or
- to the public as a whole.

Where there is a true offer, the offeror intends to be immediately bound if their offer is accepted as it stands.

We must, therefore, distinguish between true offers and statements which are made when negotiations are still in progress. These include invitations to treat.

An invitation to treat is a statement made when negotiations are still in progress, and not an offer. It is, effectively, an invitation to make an offer. Circulars, advertisements and the like often fall in this category and it is generally accepted via case law that the display of price-marked goods in a shop is merely an invitation to treat rather than an offer (which is capable of acceptance).

Example 3.3

In *Pharmaceutical Society of Great Britain v. Boots Cash Chemists* (1953), it was held that a customer did not accept an offer when he took items from the shelves of a self-service store. Taking the goods to the cashier was the offer to buy, which the cashier accepted when money was taken in payment.



You will appreciate that the dividing line between true offers and invitations to treat is often a fine one. In difficult cases, it is for the court to decide whether the offeror intended that the other party should be able to accept their offer without further negotiation.

Communication of the offer

Consider this...

Imagine that you find a wallet and return it to the owner, but only then find out that a reward of £100 had been advertised for the wallet. Are you legally entitled to the reward?



An offer must be communicated to the other party, since a person cannot accept an offer unless they are aware of it. Therefore, strictly speaking, a person has no legal entitlement to a reward for returning lost goods if they only learn of the reward after returning them to the owner.

Duration of the offer

An offer does not remain open indefinitely and, once it comes to an end, it can no longer be accepted.

It can end in the following ways:

- **A time limit or a 'reasonable time'**

An offer will lapse if the offeror imposes a *time limit* for acceptance and the other party does not accept within that time.

For example, an offer to buy shares may remain open for a limited number of days only. If no time limit is given, the offer lapses after a reasonable time. What is reasonable will depend on the circumstances.

Consider this...

In what situation would an offer lapse after only a short time?

An offer to sell a ton of fresh fish would probably lapse quite quickly!



• **Death**

The death of either party before acceptance will usually terminate the offer. Death after acceptance will not affect most contracts, except contracts for personal services (such as an agreement to sing in a show).

• **Acceptance**

Acceptance of an offer will complete the contract and bring the offer to an end. If an offer is made to a group of people but can be accepted by one person only (such as an offer to sell one bicycle for £100), the offer ceases to exist for the rest of the group when one person accepts.

• **Revocation**

The offeror may revoke (withdraw) their offer at any time before acceptance. They may do this even if they have promised to keep the offer open for a definite period of time.



Be aware

The situation is different if the offeree has paid a sum of money or given something of value in return for the promise to keep the offer open (sometimes known as 'buying the option'). If the offer is withdrawn in these circumstances, the offeror will be in *breach* of what is, in effect, a subsidiary contract to keep negotiations open, and may have to pay damages (meaning money damages to compensate for harm suffered).

Revocation must be communicated to the offeree, by either words or conduct. Selling goods to a person other than the original offeree would be an example of such conduct although the offer to the first offeree ends only when they learn of the sale. Communication may be made by the offeror themselves or by any other reliable source.

• **Rejection, counter-offer**

If the offeree rejects the offer, it then terminates. If they afterwards change their mind they cannot complete the contract, since there is now no offer to accept. All they can do is make an offer themselves which the other party can either accept or reject.

A counter-offer will also operate as a rejection. A counter-offer overrides the original offer.

We will return to the subject of counter-offers in the following section on acceptance.

B2 Acceptance

If an offer has been made, a contract will come into existence when the offer is accepted, provided all the essential terms of the contract are agreed.

The first key point to make is that acceptance must be unqualified; in other words it must exactly match the terms of the offer. If the offeree tries to vary the offer or to add *conditions* of their own, it is ineffective as an acceptance.

You will remember that a qualified acceptance of this sort also operates as a rejection of the original offer. Furthermore, it will probably take effect as a counter-offer (which in turn can be accepted or rejected by the other party).



Be aware

Trivial variations from the terms of the offer will not affect the validity of an acceptance. This is merely the application of a broad legal rule: '*de minimis non curat lex*' ('the law does not concern itself with trifles'), often referred to as the 'de minimis' principle.

B2A Manner of acceptance

An acceptance, like an offer, can generally be made in any form. It may be through words, either written or spoken, or may be implied by conduct.

However, if the offeror states that the offer must be accepted in a particular way (for example, in writing) then the offeree must generally use that method. An acceptance made in a different manner will, however, be valid if it is just as effective as the method requested, from the offeror's point of view: a request for acceptance by post might, for example, be satisfied by a message sent by email.

B2B Positive act of acceptance

Whatever form it takes, there must be some positive act of acceptance: an offer cannot be accepted by silence or by doing nothing.

B2C Communication of acceptance

As a general rule, acceptance is not effective until it is communicated by the offeree themselves or by an agent authorised by them. (Unlike revocation, acceptance cannot be communicated by 'any reliable source'.)

There are two main exceptions to the rule concerning communication.

Where the offer dispenses with communication

The terms of the offer may indicate that the other party can accept simply by carrying out their part of the agreement, without bothering to tell the offeror.

Where the 'posting rule' applies

Consider this...

A makes B an offer to sell a car to B; B accepts in writing, posting the letter two days after the offer was made. Before receiving the acceptance letter, but after it was posted, A sells the car to someone else. What effect does B's letter have, if any?



Under the '**posting rule**', a letter of acceptance is effective the moment it is posted and not only when it is received, as in the case of an offer. A contract can be made by posting even if the letter of acceptance never arrives. For the rule to apply, however, the letter must be properly addressed, stamped and posted and it must be reasonable to use the post. This would not be the case where the offeror had made it clear that an instant or urgent response was required. Furthermore, the offeror can prevent the rule from applying by making it clear that acceptance must be actually communicated to them or, of course, can state that acceptance must be made by some means other than the post.

The posting rule applies only to acceptance: a letter containing an offer, revocation or rejection will only take effect when it is received.

The posting rule applies to telegrams or telemessages but not to instantaneous methods of communication such as telephone or email where the party accepting will generally know that the communication has not arrived and could be expected to try again. In such cases, actual communication of acceptance is necessary and there is no contract if, say, the telephone line 'goes dead' and the message is not received.

The posting rule could possibly apply to an acceptance sent by fax: a contract might come into existence when the message was transmitted, even though it was illegible when received. On the other hand, there would probably be no contract if the sender knew that the transmission had failed. The same principles might apply to email, EDI (electronic data interchange) and other forms of online communication (e.g. webchat or messages sent on social media platforms).

B3 Intention to create legal relations

Even when two parties have reached an agreement, there may be no contract if they did not intend their arrangement to be legally binding.

In the case of non-consumer (business) agreements, however, proof of this intention is usually unnecessary because contractual intention is assumed to be present. However, there are one or two exceptions, discussed below.

B3A Express term of the agreement

The parties can expressly state in the agreement that it is not to be legally binding.

B3B Social and domestic agreements

Consider this...

Imagine you agree to cook dinner for some friends, but you later change your mind and decide to go to a restaurant instead. Did your agreement form a contract?



In contrast with non-consumer (business) transactions, it is assumed that social arrangements and day-to-day family matters are not intended to have legal consequences. No one supposes that accepting an invitation to a party creates a contract or that an agreement to cook the dinner is binding in law. Domestic arrangements are not legally binding, unless very strong evidence of contractual intention can be found.

B4 Consideration

It is helpful to think of contracts in terms of promises. In a contract of sale, for example, the seller promises to supply certain property to the other party. The law, however, will not generally enforce a promise unless it is supported by consideration; that is, unless the person to whom the promise is made agrees to provide something of value in return. If something is provided in return, a mere promise then becomes a bargain and the law will enforce it.

Consideration can, thus, be described as 'the price which supports the promise'.



Be aware

Very often the consideration which supports a promise is a further promise made in return, e.g. the buyer promises to pay for the property. The contract then takes the form of a mutual exchange of promises, each promise providing consideration for the other. To talk of consideration for the contract in such cases is incorrect: the consideration is given for the promise.

Consideration may be either a 'profit or benefit to the promisor' or a 'detiment to the promisee'.

However, in the vast majority of cases, the detriment to the promisee is also a benefit to the promisor and, since in most cases the contract is in the form of an exchange of promises, each party gains a benefit and suffers a detriment.

It is important to understand that a legally binding contract can come into force before the 'benefit' of the consideration is actually conferred on the other party, provided there is a firm promise to do so.



Example 3.4

For example, a promise to pay the agreed premium for insurance cover is good 'consideration' and the contract can come into force before any payment is actually made.

Contracts under seal

Refer to

Refer to [Contracts which must be under seal \(contracts by deed\)](#) on page 3/10 for contracts under seal

Since the central idea behind the doctrine of consideration is the provision of something in exchange, it follows that a bare or gratuitous promise, such as a promise to make a donation to charity for no return, is not supported by consideration. Although in English law such a promise is not generally enforceable, it becomes binding if it is made under seal, in the form of a deed.

B4A Rules of consideration

There are five main rules:

- Consideration must be real or genuine.**

The courts will not enforce vague promises, or ones in which there is no real benefit or detriment at all.

- Consideration need not be adequate.**

Although consideration must have some value, the value does not have to be adequate, i.e. worth what is given in exchange for it. If one party makes a bad bargain, the courts will not step in to help.

One result of this rule is the device of nominal consideration which enables valuable property such as a house or land to be validly 'sold' for a few pence or exchanged for a peppercorn or some other item of minimal value. This provides a second means (in addition to a promise in the form of a deed) by which a gratuitous promise or gift can be made legally binding.

- **Consideration must not be past.**

Consideration must be given in exchange for the promise which it supports; in other words, the two must be linked from the beginning. It follows that when services have already been given for nothing, a promise to pay for them made afterwards is not good consideration.

If an act is done for which no payment was fixed, a promise to pay which is made afterwards will be binding if the act was done at the request of the promisor and the understanding between the parties was that payment was to be made. Here, there is an implied promise to pay a reasonable sum for the work. This rule covers the common situation when a job is done on a non-consumer (business) basis but the price is agreed afterwards.

- **Consideration must move from the promisee.**

A person cannot enforce a promise (even though it is made to them) if the consideration for it was supplied wholly by some other person.

Example 3.5

If A promised to give B £5 if C washes A's car, B cannot enforce the promise because the whole of the consideration comes from C. If B provided some of the consideration (perhaps by finding C and arranging for them to do the job) they would be able to sue.



- Since the essence of consideration is a 'benefit to the promisor or detriment to the promisee', a promise to do something which the promisee is already bound to do gives the promisor nothing beyond what they already are entitled to and imposes no extra duty on the promisee.

The pre-existing duty may be a public duty imposed by the general law rather than by a contract with the promisor. Therefore, a promise to pay the police for protecting one's property is not enforceable unless the degree of protection granted is greater than normal. For example, as is the case when football clubs pay police to provide officers inside their grounds.

B5 Promissory estoppel

The essence of the doctrine of promissory estoppel is to hold a party who makes a promise to another accountable for the detriment suffered by the counter party who relied on that promise (notwithstanding an absence of consideration – such a promise, unsupported by consideration, is not enforceable as a contract of course).

Although a promise made without consideration cannot be enforced and will not complete a contract, it may be used as a defence to a legal action by the counterparty.

For example, if X promises not to enforce their strict contractual rights against Y, and the promise is intended to be binding and intended to be acted upon, X may be 'estopped' (that is, prevented) from going back on this promise if Y has in fact acted on the strength of it.

Example 3.6

In *Central London Property Trust v. High Trees House* (1947) (referred to as 'The High Trees' case), the landlords of a block of flats had let them to the defendants at a rental of £2,500 a year.



Owing to the outbreak of war, the defendants could not find tenants for the flats and considered ending the lease. The claimants then agreed in writing to reduce the rental to £1,250 a year, with effect from 1941.

The defendants continued with the lease under these circumstances but in 1945, the claimants claimed again the original rent from 1941 on the basis that no consideration had been given for their agreement to reduce it.

The judge held that the claimants were entitled to the full rent from 1945 (since the agreement implied that the full rent should be payable when the abnormal war-time situation ended), but that it would be inequitable to allow them to go back on their promise and recover the full rent from 1941.

The defendants had relied on the promise to accept a lower rent and had acted upon it by reducing the rent payable by their own tenants during the period in question. They had therefore relied upon it to their own detriment.

This principle operates only 'as a shield and not a sword': in other words – as a defence to the party sued rather than as a weapon of attack enabling the other party to sue on a gratuitous promise.

Promissory estoppel is an equitable principle and the defendant will not be allowed to claim relief unless they themselves have acted fairly ('he who comes into equity must come with clean hands').

In the insurance context the above requirements may materialise where the insurer leads the assured to believe that the insurer will not exercise his right to reject liability, say, for a breach of contract. If the assured relies on the insurer's representation in this context and if it is inequitable for the insurer to go back on what was represented to the assured, the assured may argue that the insurer should be stopped from rejecting liability for the breach of contract.

B6 Form

In some cases, the law requires a contract to be in a particular form and this will always involve some type of written documentation. There are, in effect, four categories:

Writing obviously makes for greater certainty as to what has been agreed and may warn people against entering into a contract too lightly. Nevertheless, the general rule is that most contracts can be made without any writing or other formality and only a limited number of contracts are subject to formal rules.

Although formal requirements always involve writing, the necessary documentation varies from case to case.

- contracts which must be under seal;
- contracts which must be in writing;
- contracts which must be evidenced in writing by a 'note or memorandum'; and
- contracts where one party must give certain written particulars to the other.

B6A Contracts which must be under seal (contracts by deed)

A deed must be signed and witnessed. Furthermore, the face of the document must make it clear that it is intended to be a deed.

A lease for more than three years must be made by deed, and if not by deed, is void for the purpose of creating a legal estate. We have already mentioned that gratuitous promises (i.e. those not supported by consideration) are not generally enforceable but become so if made by deed.

B6B Contracts which must be in writing

Contracts in this group include:

- bills of exchange;
- cheques and promissory notes;
- the transfer of shares in a registered company;
- some consumer credit ('hire-purchase') transactions; and
- contracts of marine insurance.

Since 1989, all contracts for the sale or other disposition of land must also be in writing and signed by the parties.

B6C Contracts which must be evidenced in writing

In this case, there must be a 'note or memorandum' of the contract in writing although, unlike contracts which must be in writing, the document(s) may come into existence after the time when the contract was made. These requirements apply to contracts of guarantee (contracts in which one party agrees to answer for the debt, default or miscarriage of another).

B6D Contracts where one party must supply certain written particulars to the other

A requirement of this sort applies in many cases: an employer may, for instance, have to set out the main terms of their employees' contracts in writing; and a landlord may have to give their tenant a rent-book containing certain particulars.

B7 Contractual capacity

Some people and bodies are subject to special rules which restrict their *contractual capacity*. The main categories are minors, people who are mentally ill or drunk, and corporations.

B7A Minors

Under English law a minor is a person below the age of 18 (**Family Law Reform Act 1969**).

The main purpose of the special legal rules which govern contracts made by minors is to protect them from their own inexperience, which may lead them into agreements which are disadvantageous to them. The law also tries to avoid causing too much hardship or inconvenience to adults who deal with minors.



We will briefly summarise these categories:

Contracts which are binding

A minor is bound by contracts for 'necessaries' and liable to pay for necessities which they have bought. Necessaries are the basic products and services of everyday life. They include foodstuffs and clothing appropriate to the minor's 'station in life', and can also include services such as the provision of education. They do not include items which are mere luxuries. A minor is also bound by contracts of employment or similar agreements such as a contract of apprenticeship. The contract is binding provided it is, on the whole, for their benefit.

Contracts which are binding unless they are repudiated

Certain contracts of a continuing nature are binding on both parties. However, the minor (though not the other party) can avoid liability by repudiating the contract, discharging them from any further liability. These include leases, partnerships and shareholder agreements.

Contracts which are not binding on the minor

All contracts other than those in the two sections above fall in this category. They include contracts to buy goods which are not necessities and contracts to borrow money.

Be aware

Although these contracts do not bind the minor, they do bind the other party. As such, the minor can sue if that other party does not keep to the agreement.



These contracts differ from those discussed above in that the minor does not have to repudiate the contract to avoid liability. If, however, the minor ratifies the contract when they reach their majority, they will be bound by it. Ratification can be by words or by conduct which shows that the minor regards themselves as bound. For example, if a minor paid for goods which are not necessities, they cannot claim their money back on the grounds of minority.

Restitution

The law of *restitution* is concerned with those situations where a person is liable to restore property to another. As we have seen above, a minor may acquire property from another under a contract which the other party cannot enforce.



Example 3.7

A minor who acquires goods which are not necessaries on credit cannot be made to pay for them. This can obviously create difficulties for those who trade with minors and the law, therefore, gives such persons remedies in restitution.

The main remedy is now provided by s.3(1) of the **Minors' Contracts Act 1987**. The Act provides that the court may, 'if it is just and equitable to do so', require the minor to transfer to the other party any property acquired by the minor under the contract or any property representing it.



Example 3.8

If a minor buys a motorcycle (which we will assume is not a necessary) on credit for £1,000 but does not pay for it, the court can order the minor to return the machine to the seller. If the minor has sold the motorcycle to someone else for £800, the court can order them to transfer the £800 to the seller. If the minor has spent the £800 on a hi-fi system, the court can order them to transfer the hi-fi.

If, however, the minor has spent the £800 on a holiday, no court order can be made since the minor no longer has the original property or 'any property representing it'. Even if the minor has other assets worth £800, this is irrelevant since the remedy is in respect of a particular piece of property only: the minor has no personal liability to pay.

B7B Persons with a mental health condition

Contracts made by persons with a mental health condition are generally valid, although the contract can be avoided by such a person if they were unable to understand the nature of the agreement and the other party was aware of this inability.



Again, if the person's mental health issues are so serious that their property has been made subject to the control of the court, contracts where they attempt to dispose of the property do not bind them, though they bind the other party.

B7C Drunken persons

The rules affecting drunken persons are similar to those governing persons with a mental health condition. A drunken person can avoid a contract only if they were so confused at the time that they did not understand what they were doing and the other party knew this.

Again, such a contract becomes binding if ratified when the effects of drink have worn off and a reasonable price must, in any case, be paid for necessaries.

B8 Corporations

Corporations, in general, were discussed in [Corporations](#) on page 1/41. Here we are concerned only with contracts made by them.

B8A Chartered corporations

A contract which is not authorised, or is prohibited, by the charter of a chartered corporation remains valid.

If the corporation engages in activities which fall outside the terms of its charter, there is also a risk that the charter may be revoked.

B8B Statutory corporations and registered companies

Refer to

Refer to *Corporations* on page 1/41 for the Companies Acts

Corporations created either directly by Act of Parliament or indirectly by registration under the **Companies Acts** are subject to the *ultra vires* doctrine. Under the *ultra vires* doctrine, a contract may be invalid if it is '*ultra vires*' ('beyond the powers of') the corporation.

In the case of a statutory corporation, these powers are expressed in the Act of Parliament which created it. In the case of a company formed by registration under the Companies Acts, they will be found in its memorandum of association.

The effect of the *ultra vires* rule has changed greatly as a result of European legislation which is now incorporated in the Companies Acts. In order to protect people and organisations which deal with companies in good faith, the law now provides that acts performed by companies cannot be called into question by reason of anything in the company's memorandum of association.



In simple terms, this means that contracts made by companies will be valid even if they are outside the powers expressed in the memorandum. However, a member of a company can bring an action to restrain proposed activities which are outside a company's powers and directors may be in breach of their duty to the company if they engage in such activities.

C Terms of a contract

In this section, we begin by considering the terms of a contract: the detailed provisions contained in the agreement. In England, the law was originally based on a theory of 'freedom of contract'; the theory being that people should be allowed to make agreements on any terms they liked. Even if a contract was particularly disadvantageous to one of the parties, the court should not interfere or try to make it fairer, but should, if necessary, merely rule on what the parties had, in fact, agreed.

Consider this...

If a consumer has entered into a disadvantageous contract with a large company, should the consumer be protected by the law? If so, what should this protection look like?



The courts and Parliament have increasingly stepped in to regulate and control contracts made by firms and individuals. They have done so in order to protect consumers and those whose bargaining position may be weak. The **Sale of Goods Act 1979** and, subsequently, the **Consumer Rights Act 2015** are both good examples of this and are discussed later in this section.

The result is that the parties to a contract are now not wholly free to agree what terms they like. The law may imply terms into the contract which the parties did not expressly agree and may refuse to enforce other terms which the parties did actually agree upon.

The courts may also have to decide which parts of a contract are vital to it and which are less important. This may be necessary if one of the parties breaks some term of the contract and the court has to rule on how the agreement has been affected and the remedy to which the other party is entitled.

As such, the law has developed ways of classifying the terms of a contract according to their importance and the effect on the contract if they are broken.

C1 Certainty of terms

The terms of a contract must be certain and no contract is formed if a vital term is missing or if the meaning of an essential term is uncertain.

This rule is subject to some qualifications. For example, if a very minor term is meaningless it can simply be ignored, provided the remaining parts of the agreement still make sense. Again, if the price or some other detail has not been fixed but the parties have had similar dealings in the past, it will often be assumed that the terms of the previous agreements apply.

C2 Classification of terms

One way of classifying the terms of a contract is into **express terms** and **implied terms**. A contract may contain both kinds of term.

Express terms arise from the words used by the parties in reaching or recording their agreement. In other words, express terms are specifically stated, either orally or in writing.

Implied terms are not expressly or explicitly stated. Despite this, implied terms form part of the agreement.

C2A Express terms

Express terms of a contract are based on the words spoken by the parties or written down by them.

Oral contracts sometimes present problems of proof. However, where the contract is in writing there is usually no dispute as to the words used – although disputes may arise as to their meaning. The rules governing the construction of contracts (often referred to as 'interpretation') are dealt with in chapter 7.

A term may be implied into a contract by a statute or the courts, and only if it does not conflict with the express terms of the contract.

C2B Implied terms

Terms may be implied in one of three ways:

- in fact;
- by custom or usage; or
- by law.

Terms implied in fact

A term implied in fact is implied into a particular contract. The term implied is one which is not actually stated but is presumed to be intended by the parties.

In some cases, the term in question may be implied because it relates to something which is so obvious that 'it goes without saying'. In other cases, the implied term may be necessary to give 'business efficacy' to the contract. In other words, because the contract would not make business sense without the implied term. However, the courts will only imply a term where it is necessary to do so.

Terms implied by custom or usage

Terms can be implied by the custom of the market in which the parties to the contract operate, or the usages of a particular locality or trade. For example, in a tenancy agreement between a farmer and a landowner a term may be implied allowing compensation for the farmer's work and expenses undertaken in growing crops if it is common practice for farming tenancies to contain such a clause. Without such a clause, the landowner could terminate the contract with no compensation the day before the field was due to be harvested.

The implied term must not be unreasonable or inconsistent with the rest of the contract.

Terms implied in law

There are terms which are implied into a class of contractual relationship. The rights and duties of the parties may be based on terms which the law automatically applies to the agreement.

Such an outcome may be reached through:

- Statutory implied terms.
- The courts sometimes imply terms as a matter of policy in order to fill gaps in contracts of common occurrence. In other words, the court may imply a term as a necessary incident of a particular relationship unless the parties have expressly excluded it.

Example 3.9

Perhaps the best known examples of the terms implied by statute are those created by the Consumer Rights Act 2015 (which, where consumer protection is concerned, has largely replaced the Sale of Goods Act 1979). Some of the provisions of the Act are as follows:

- There is implied in every contract for the sale of goods a condition that the seller has a right to sell the goods (s.17).
- Where goods are sold by description, there is an implied condition that the goods will correspond with the description (s.11).
- When the seller sells goods in the course of business, there is an implied condition that the goods supplied under the contract are of satisfactory quality and are reasonably fit (suitable) for the purpose supplied (s.9–10).
- Where goods are sold by sample there is an implied condition that the bulk will correspond with the sample in quality (s.13).



'Conditions', as we shall see, are important terms in the general law of contract.

Insurance contracts are also subject to some implied terms.

Example 3.10

Section 39 of the **Marine Insurance Act 1906** implies into every contract of marine insurance a term to the effect that the vessel must be seaworthy.



Where the court implies a term in law two conditions need to be satisfied:

- the contract has to be of a sufficiently common type (e.g. landlord/tenant, owner/hirer) that is possible to identify the typical obligations of such a contract; and
- the matter to which the implied term relates must be one which the parties have not in any way addressed in their contract.

Example 3.11

In *Liverpool City Council v Irwin* (1977) the tenancy agreement in relation to a block of flats said nothing about who was to be responsible for the maintenance of the common parts of the block and, in particular, the lifts and rubbish chutes. The House of Lords held that it was possible to imply a term to the effect that the landlord should take reasonable steps to keep the common parts in repair.



C3 Standard terms and exemption clauses

Activity

Find one of your own personal insurance policies (motor or household). What part of it is personalised? Are there standard pre-printed terms which will apply to all customers for that type of policy?



Contracts are often made on standard terms drawn up by one of the parties. The terms are usually contained in printed forms which are used in dealings with all customers who want the same type of goods or services. Insurance policies (especially 'personal lines' such as motor and home insurance) are often standard term contracts.

The use of standard term contracts is obviously necessary to save time and to simplify dealings of a day-to-day nature.



Consider this...

Look again at the policy you found in the activity above. Have you read the entire contract? Did you read it all before taking out the insurance contract?

However, there is also the risk of abuse, because the consumer usually has little chance of negotiating any changes in the written contract presented, and often does not bother to read what is often described as 'the small print'. If the supplier of goods or services has included exemption clauses (also known as exclusion clauses) which exclude its liability to the customer, or limitation clauses which reduce it, the latter may find that they have little redress when things go wrong.

Refer to

Refer to *Consumer Rights Act 2015* on page 3/18 for the 2015 Act

In view of their possible abuse, the courts have developed rules to control the use of these restrictive clauses and Parliament has limited their effectiveness by a number of statutes, including the Consumer Rights Act 2015.



Be aware

You should note that most of the principles discussed here apply not only to clauses that restrict a person's right to sue in contract but also notices or other words that restrict the right to sue in tort (often called 'disclaimers').

We will look first at the rules which the courts have developed to deal with these issues – the 'common law' rules.

C3A Common law rules

The person who seeks to rely on an exclusion clause must show that it has been incorporated in the contract – which means that the other party must have agreed to it either before or at the time that the contract was concluded.

Incorporation can be achieved in a number of ways:

Signing of written documents	Where the contract is formed by signing a written document, the general rule is that the signer is bound by all the terms of the document which they have signed, including any exemption clauses, even if they have not read it.
Notice	If there is no signed contract, the exemption clause may be incorporated in a notice displayed at the premises where the contract is made, or in a document (such as a ticket or receipt) which is simply handed or posted to one party by another.



Activity

The next time you pay for a car park ticket, look for the sign which limits the liability of the car park owner for damage to vehicles and so on. Is it on the board near the payment machine, or referred to on the back of the ticket? How has it been incorporated in your contract with the car park? You could also observe exclusion clauses in the gym you are a member of or at a hotel you are staying in. Pay attention to the location at which such clauses are written and consider if they should appear at a different place which can be seen earlier.

The document may refer to conditions which can be found elsewhere.

In order to rely on an exemption clause in such a case, the party who seeks its protection must:

- First establish that the document was a 'contractual' one which could reasonably be expected to contain terms.
- Also prove that they took reasonable steps to bring the terms to the attention of the other party by the use of clear words communicated in an appropriate way.

The steps to notify the other party of the terms must be taken before or at the time that the contract is made.

Example 3.12

In the case of *Olley v. Marlborough Court Ltd (1949)*, the claimant's property was stolen when she stayed at the defendant's hotel. Although there was a notice in the bedroom stating that the proprietors were not liable for any such loss, it was held to be ineffective because she saw it only after the contract was made at the reception desk.



In the case of *Thornton v. Shoe Lane Parking (1971)*, the claimant completed a contract when he put a coin in the automatic ticket machine outside the defendant's car park. The ticket referred to conditions displayed inside the car park, one of which sought to exempt the defendants from liability for injury to persons using the car park. It was held that the claimant (who was severely injured in an accident on the premises) was not bound by the conditions since they were brought to his attention after the contract was made.

Course of dealing

Exceptionally, the courts may allow an exclusion clause to be incorporated in a contract as a result of past dealings between the parties in which the exclusion clause was regularly used.

In such cases the party which alleges that it is prejudiced by the clause may be held to be 'fixed with knowledge' of it even though it was not included in the transaction in question.

To bring this rule into operation there must be a regular and consistent course of dealing.

C3B Unfair Contract Terms Act 1977

The **Unfair Contract Terms Act 1977 (UCTA)** and the Consumer Rights Act 2015 contain the most important restrictions on the effectiveness of exemption clauses for commercial and consumer contracts respectively.

Refer to

Refer to [Consumer Rights Act 2015](#) on page 3/18 for the Consumer Rights Act 2015

Until the enactment of the Consumer Rights Act 2015, UCTA applied to certain contracts entered into by consumers. Contracts concluded between a trader and a consumer have now been removed from the scope of UCTA; as a result, this Act only applies to contracts concluded between parties acting in the course of business.

Some of the key provisions are summarised below.

Section 2 – negligence liability

Under s.2 of the Act, no one acting in the course of business can by means of contractual terms or by any notice given or displayed, exclude their liability for death or bodily injury arising from negligence.

A person may exclude liability for other forms of loss caused by their negligence (such as property damage), but only if they can prove that the exclusion is reasonable.

Section 3 – contractual liability

Where one party deals on the other party's written standard terms of business, then the other party cannot exclude or restrict their liability for breach of contract, except subject to a requirement of reasonableness.

The requirement of reasonableness also extends to terms that purport to entitle the other party to render performance substantially different from that reasonably expected or render no performance at all.

Section 6 – sale of goods and hire-purchase

Refer to

Refer to [Implied terms](#) on page 3/14 for implied terms

In these contracts, implied terms as to title cannot be excluded or restricted by a contract term. The other important implied terms (as to correspondence with description or sample,

fitness for purpose and satisfactory quality) can only be excluded in a non-consumer (business) sale where the test of reasonableness is satisfied.

For a term to satisfy the requirement of reasonableness mentioned above, it must, in the view of the court, be:

a fair or reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.

It is interesting to note that in some cases the court is required to take into account the availability of insurance cover in deciding whether or not it is reasonable for one party to limit their liability.



Consider this...

The implication here is that it may be reasonable for one party to restrict their liability for loss or damage in a case where they cannot easily insure against liability for such loss, especially when the other party can insure the risk more easily. Do you agree that this is fair?



Be aware

UCTA applies mainly to 'business liability' and does not cover private transactions in which neither party is acting in the course of business (with the exception of implied terms in sale of goods and hire-purchase contracts).

Most types of contract are covered by the Act but some, including insurance contracts, are excluded. The insurance industry sought to have insurance contracts exempted from the Act, since it would have made the practice of insurance very uncertain.

Insurance policy wordings which had been established and accepted for many years would have been laid open to continual challenge and premium levels would be very difficult to set for insurers.

C3C Consumer Rights Act 2015

As mentioned above, unfair terms in consumer contracts are now governed by part 2 of the Consumer Rights Act 2015. This Act came into force in October 2015 and revoked the provisions previously given in the **Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR)**.

UTCCR laid down a general requirement of fairness in consumer contracts and also required that such contracts should be in plain, intelligible language. The 2015 Act continues the requirement for fairness and applies it to consumer notices as well.

Section 62 of the 2015 Act provides that an unfair term of a consumer contract or notice is not binding on the consumer. It defines an unfair term or notice as that which, contrary to the requirement of good faith, causes a significant imbalance in the parties' rights and obligations to the detriment of the consumer. Where a term is not binding on the consumer, the contract continues, so far as practicable, to have effect in every other respect (s.67).



Be aware

Terms which define the main subject matter of the contract or which determine the price are excluded from review, as long as they are in plain, intelligible language.

The 2015 Act removes the requirement stated in UTCCR that 'a term must not have been individually negotiated before a term could be challenged on the ground that it was unfair'. The consumer is now entitled to claim the protection of part 2 of the 2015 Act even when a term of the contract has been individually negotiated with the trader.

Section 65 – exclusions

Under s.65, a trader cannot by a term of a consumer contract or a consumer notice exclude or restrict liability for death or personal injury resulting from negligence. Where a term or notice aims to do this, a person is not to be taken to have voluntarily accepted any risk because they agreed to or knew about the term or notice.

Section 65 does not apply to:

- any contract so far as it is a contract of insurance, including a contract to pay an annuity on human life; or
- any contract so far as it relates to the creation or transfer of an interest in land.

Section 31 – implied terms

Under s.31, a term that excludes implied terms relating to, for example, correspondence with description or sample, fitness for purpose and satisfactory quality is not binding on the consumer.

We will look at the Consumer Rights Act 2015 in more detail in [Consumer Rights Act 2015](#) on page 7/5.

C3D Summary

The following table compares the provisions of UCTA and the 2015 Act with regards to contract terms.

	Applies to:	Scope:	Effect:
The Unfair Contract Terms Act 1977 (UCTA)	Business-to-business contracts.	Restricted mainly to exclusion and limitation clauses.	Makes frequent reference to a 'reasonableness' test, with the burden of proof of reasonableness on the party seeking to rely on the restrictive term. Where a clause fails the test of reasonableness that cannot be relied upon by that party.
Consumer Rights Act 2015	Consumer contracts.	Cover all types of term.	This subjects terms to a 'fairness' test, with the burden of proof (of unfairness) on the consumer.

Example 3.13

In *Bates v. Post Office Ltd (No.3 Common Issues)* (2019) the Network Transformation Contract (NTC) between the Post Office and sub-postmasters was disputed.



The Post Office introduced an electronic point-of-sale and accounting system, which sub-postmasters were required to use. The sub-postmasters maintained that software defects resulted in unexplained shortfalls and accounting discrepancies.

The NTC stated that the sub-postmaster should be fully liable for any loss however that occurred and whether it occurred as a result of any negligence by the sub-postmaster, its personnel or otherwise. The sub-postmasters were to pay any shortfall in full. The Post Office maintained that individual sub-postmasters had to prove that the shortfalls were not their individual responsibility. NTC were standard terms of business, a number of terms in the NTC failed the test for reasonableness in s.11(1) of the UCTA 1977 and the Post Office was not entitled to rely upon them.

C4 Conditions and warranties

The terms of a contract can be further classified into conditions and *warranties*. This classification is largely based on the importance of the terms in question and the consequences if they are broken.

Under the general law of contract, a **warranty** is a term which affects only a minor aspect of the agreement. If it is broken, the injured party has a right to claim damages but not, in general, to terminate the contract. A **condition** is a term which relates to an important aspect of the agreement: it 'goes to the root' and if it is broken the victim has a right not only to claim damages but also to terminate the agreement.

General law of contract	Importance:	If broken:
Warranty	Affects only some relatively minor aspect of the agreement.	Injured party has a right to claim damages but not to terminate the contract.
Condition	Relates to an important aspect of the agreement: it 'goes to the root'.	Victim has a right not only to claim damages but also to terminate the agreement.

In fact, the parties to a contract will often expressly classify at least some of the terms of their agreement in advance and stipulate which are to be regarded as crucial and which are not.



Be aware

However, the words used by the parties will not always be conclusive and, even if a term in a contract is expressly described as a condition, the courts will not treat it as such if the parties plainly did not intend it to be an important part of the agreement.

In some cases such classification appears to exist as a matter of law.



Example 3.14

Prominent examples are found in the Sale of Goods Act 1979, discussed earlier. You will recall that the Act provides that a number of conditions (such as 'satisfactory quality' and 'fitness for purpose') will be implied into every contract for the sale of goods. The Act also creates two implied warranties (freedom from encumbrance and the right to quiet possession of the goods) in s.12(2).

There is a modern tendency of the courts to adopt a more flexible approach and focus on the effect of a breach on the injured party to ascertain whether a condition or warranty has been broken. This has led to the recognition of a third class, known as intermediate or innominate terms.

These cannot be classified as either conditions or warranties in advance and it is only when the effects of a breach are considered that the true nature of the term is revealed. A trivial breach will then give rise to an action for damages only whereas a serious breach will entitle the injured party to treat the contract as repudiated.



Be aware

Finally, we should note that the classification of terms in insurance contracts is quite different from that which is described above. In particular, the word 'warranty' is used in an entirely different sense in insurance and refers to a major term of the contract.

This is discussed in chapter 7.

D Defective contracts

There are a number of factors which may destroy the validity of an apparently sound contract, or make it partly ineffective.

Defective contracts may result from:

- illegality;
- improper pressure;
- mistake;
- misrepresentation; or
- non-disclosure (this concept needs care as it has only very limited exceptional application in general contract law and in the insurance context only in business insurance).

Each of these is now discussed in turn.

D1 Illegality

Although people are generally free to make whatever agreements they wish, contracts which directly involve the commission of a legal wrong should obviously be discouraged.

Such contracts are termed 'illegal' and are generally void in law.

In this section, however, we use the term 'illegality' in a broader sense to include those agreements which are against public policy, that is, agreements which do not involve the commission of a distinct legal wrong but which the courts refuse to enforce because of their tendency to harm society.

Illegal contracts fall into three categories:

- contracts which are contrary to law;
- contracts which are contrary to public policy; and
- contracts in restraint of trade.

We will consider each of these in turn and look at the effects of illegality (*Effects of illegality* on page 3/23) before focusing specifically on **illegality in insurance contracts** (*Illegality in insurance contracts* on page 3/23).

D1A Contracts which are contrary to law

These include contracts involving the commission of a crime or tort.

Such contracts include those to:

- forge banknotes;
- steal property; and/or
- kill or injure other people.

In some cases, merely making the contract will be forbidden by law:

Example 3.15

If two parties agree to break into a shop, for instance, the agreement alone is a criminal conspiracy.



In other cases, it may be the purpose of the contract which is illegal (for example, where a gun is sold lawfully but the seller knows that the buyer intends to commit murder with it).

In other cases, contracts are forbidden by statute but making such a contract is not a criminal act. The contract is illegal but there is no criminal penalty.

Example 3.16

The **Life Assurance Act 1774** states that 'no insurance shall be made' by a person who has no insurable interest in the life or event in question.



Be aware

If a contract is not prohibited by statute, but simply declared void, voidable or unenforceable, it is not illegal. This is the case with a marine insurance policy which lacks the insurable interest required by the Marine Insurance Act 1906. The question of *insurable interest* is discussed in *Insurable interest* on page 5/10.



D1B Contracts which are contrary to public policy

A contract may not involve the commission of a legal wrong, or be forbidden by any statute, but may still tend to bring about results which are in some way harmful to the public or socially undesirable.

A considerable number of examples exist, including those which follow:

Contracts tending to sexual immorality

Although prostitution, as such, is not illegal in the UK, contracts in furtherance of prostitution or other immoral purposes have been held contrary to good morals and so illegal.

Contracts affecting the freedom of marriage

A contract in absolute restraint of marriage (where a person agrees not to marry at all) is void. A partial restraint (as in an agreement not to marry an Englishman or an insurance executive) may be upheld if it is reasonable.

Contracts of trade with an enemy

A contract which involves trading in wartime with an 'enemy' (a person voluntarily resident or carrying on business in enemy occupied territory) is illegal under common law.

Contracts to break the law of a friendly foreign state

Contracts of this sort are likely to harm good foreign relations and may, therefore, be held contrary to public policy.

Contracts to deceive public authorities

An agreement between an employer and employee where part of the salary was concealed or disguised as 'expenses' in order to defraud the tax authorities provides an example.

Contracts to corrupt public life

Contracts to bribe officials or to sell public honours fall in this category.

Contracts which pervert the course of justice

These include contracts to hinder prosecutions, for example, by paying the victim not to report a crime or not to cooperate in the prosecution.

D1C Contracts in restraint of trade

Although these fall under the general heading of agreements which are contrary to public policy, they form a particularly important group and are, therefore, treated separately.

For centuries the prosperity of the United Kingdom has depended on trade and for that reason, there is a long tradition of the common law that agreements which tend to hinder or restrain trade are to be discouraged.

The general rule is that contracts in **restraint of trade** are '*prima facie*' ('on the face of it') void but will be upheld if they are reasonable.

Restraint can take many forms and the following are simply examples of two of the main types.

Restraints on contracts of employment

Contracts of employment sometimes state that the employee, if they terminate their employment, may not compete against their present employer by working for a rival firm or setting up a competing business of their own.

The courts are not sympathetic to restraints of this kind, especially where the effect would be to prevent the employee from earning their living through the use of some general skill or knowledge which they have acquired. However, the courts are more willing to allow the employer to protect themselves from misuse by the employee of trade secrets, confidential information and lists of customers and trade connections.

In each case the courts will have to decide whether the restraint is reasonable in the interests of the parties and of the public and will take into account the nature of the interest protected and the extent of the restraint clause.



Example 3.17

In **Attwood v. Lamont (1920)**, a tailor and draper at Kidderminster employed the defendant (Lamont) under a contract stating that Lamont could not, on leaving his employment, carry on a business as a tailor within ten miles of Kidderminster. It was held that this restriction was merely to prevent the defendant from using his skill in competition with the claimant and was, therefore, void.

However, in **Forster & Sons Ltd v. Suggett (1918)**, the works manager of a glass-making company had agreed not to work for a rival firm for five years after leaving his present job. Here, the restraint was held to be valid because the manager knew of a secret manufacturing process which would be valuable to a rival.

Restraints on the seller of a business

When a business is sold, the buyer will often require the seller to agree that in future they will not carry on a similar business in competition (which, if established nearby, might attract all their old customers away from the buyer). The courts are far more ready to uphold restraints of this sort.

Here the buyer pays for, among other things, the 'goodwill' of the business which is a form of property which the law will protect. Again, when a business is sold the parties are normally in an equal bargaining position and there is no danger of exploitation which sometimes exists in the relationship between employer and employee. Only occasionally will the courts need to step in to protect the buyer.

In deciding whether the restraint is reasonable, the courts will also bear in mind the adequacy of the payment received by the seller.

D2 Effects of illegality

An illegal contract is generally void, and the court will not assist a party to the agreement in any way.

The contract cannot be enforced and, furthermore, money or goods delivered under it cannot usually be recovered by an action in court. (A person who has transferred money or property under a void contract that is not illegal will generally be able to recover it).

Where money or goods have changed hands under an illegal contract, the defendant is, therefore, in a stronger position than the claimant who seeks the aid of the court to recover it, since the help of the court will be denied once the illegality of the agreement is discovered. This is expressed in the legal maxim in '*pari delicto potior est defendantis*' ('where there is equal wrongdoing the position of the defendant is stronger').

However, there are some exceptions to this rule, when it may be possible for the claimant to recover property transferred under an illegal contract:

- when the parties are not *in pari delicto* (equal in wrongdoing) because, for example, one party entered the contract through **improper pressure**, fraud or mistake;
- when one party 'repents', i.e. voluntarily abandons the illegal purpose; and
- when the illegality arises under a statute passed to protect a particular class of people (such as tenants or people who borrow from moneylenders), in which case a member of that class will be able to recover their property.

Be aware

You should note that if a contract is illegal in part only, the court may in some cases be willing to enforce the valid portion of the contract and refuse assistance only with regard to the illegal part. This is called 'severance'.



D3 Illegality in insurance contracts

As we have seen, contracts generally will be void if they are illegal or against public policy and the same is true in the case of insurance contracts.

Consider this...

In what situations might **illegality** arise in an insurance contract?



- **No insurable interest.**

- **Purpose of contract is illegal.**

- **Unlawful use of insured property.**

- **Close connection with a crime.**

No insurable interest	This will be discussed in Insurable interest on page 5/10. For now, take note that an insurance contract may be illegal and void because the would-be insured lacks the insurable interest required by statute.
Purpose of contract is illegal	The purpose of the contract may be illegal or against public policy. Contracts of insurance with enemies or on enemy property may fall in this category and there are a number of similar decisions to this effect. For instance, taking out a motor insurance policy on a vehicle which is intended to be used to commit a crime.
Unlawful use of insured property	If insured property is used unlawfully, the contract may be rendered illegal. In marine insurance law there are decisions which suggest that policies of insurance on illegal adventures are themselves illegal.

Close connection with a crime	<p>In any case where there is a close connection between the loss for which the insured seeks compensation and a criminal act, the policy may well be invalidated (motor insurance cover is excepted, even criminal use is covered – see <i>Hardy v. Motor Insurers' Bureau (1964)</i>). Two principles may be involved here:</p>
	<p>First, there is a basic requirement in insurance that losses should be accidental or fortuitous, so that the insured is not entitled to recover losses caused by their own 'wilful misconduct'.</p>
	<p>Second, public policy may prevent the insured from claiming where allowing them to do so might encourage other people to break the law.</p>

We will now look at some examples from different classes of insurance to help illustrate the above points.

D3A Life insurance



Example 3.18

The leading case is *Beresford v. Royal Insurance Co. Ltd (1938)*. Here the insured committed suicide, intending that the policy money be used to pay off his heavy debts, at a time when suicide was a criminal offence. It was held that the policy did cover suicide and that the insurers could extend the policy to cover acts of wilful misconduct if they wished (the first principle mentioned above). Nevertheless, the court held that public policy (the second principle) would prevent a recovery being made, because payment would allow the insured a 'benefit' from his criminal act in the sense that his estate would be freed from debts.

Refer to

For more on insurable interest, see *Insurable interest* on page 5/10

There is no doubt that the courts would now reach a different conclusion, because suicide is no longer a crime.

D3B Property insurance

An insurance on property which has been acquired illegally by the policyholder (such as stolen goods) will certainly be illegal.



Example 3.19

In *Geismar v. Sun Alliance (1977)*, the insured had not stolen the insured property (some items of jewellery) but had smuggled it into the UK without declaring it and paying the necessary excise duty: this made them liable to forfeiture. The items were subsequently stolen, but the court held that the claimant could not claim for the theft under his insurance as this would (at least indirectly) allow him to profit from his criminal act.

D3C Motor and liability insurance

The application of the general principles to motor vehicle insurance is varied due to the nature and prevailing objective of compulsory motor vehicle liability insurance. A third party is normally an innocent victim of an insured driver's wrongdoing, and the courts are of the view that the third party's right to be compensated for an injury that they suffer as a result of criminal conduct by the insured driver should not be invalidated because of the driver's criminal act. The insured driver is not entitled to claim under the insurance contract if they deliberately caused the loss. However, if there is insurance, the insurer and – in the case of the driver being uninsured or untraced – the Motor Insurers' Bureau (MIB) will be obliged to compensate the victim's loss (*Hardy v. Motor Insurers' Bureau (1964)*). The insurer or the MIB – whoever pays the third party for their loss – may recoup against the driver who caused the loss.

If the act involves only negligence (as in the case of some road traffic offences), the validity of the insurance will not be affected. In the context of liability insurance other than motor vehicle insurance, the general principle is that a deliberate or even reckless course of

conduct is enough to invalidate the claim even if the result is accidental and the insured is not convicted of any crime.

Example 3.20

The leading case is **Gray v. Barr (1971)** in which a man shot and killed his wife's lover. He had deliberately taken a loaded gun with the intention of frightening his rival, who was killed when the gun accidentally went off in a scuffle. He was acquitted of murder and manslaughter in the criminal trial but was successfully sued for damages by the wife of the dead man. He claimed indemnity under the personal liability part of his household policy, but the court rejected this because of deliberate and dangerous use of the loaded gun. Claiming on insurance would be against public policy to allow him an indemnity against the consequences of his conduct.



In motor insurance, however, disallowing the victim to claim against either the insurer or the MIB where the insured's conduct was either deliberate or reckless is in conflict with the purpose of motor insurance as set out in the **Road Traffic Act 1930 (RTA 1930)**. In summary, the victim of a traffic accident is not prejudiced by the fact that the insured has no claim against the insurers. Where the wrongdoer has no insurance, the victim has a similar claim against the MIB.

Activity

To find out more about claims made to the MIB, visit: www.mib.org.uk.



D4 Improper pressure

A contract is voidable by a person who has been led into it by improper pressure. The coerced person may feel that they have no choice but to enter into the agreement as a result of the improper pressure.

Be aware

However, a contract is not voidable merely because one party was in a position to drive a hard bargain or used hard selling techniques.



The pressure must be 'improper' and may take the form of either duress or undue influence.

D4A Duress

Originally, duress only arose when a contract was achieved through force or threats of force against the person of the other contracting party. Later cases recognised duress by means other than physical violence and accepted that unlawful threats to the claimant's property or business interests might also have the same effect.

It is now recognised that any threat to commit a legal wrong can amount to duress if the other party is forced to agree against their will.

In some cases the threat may amount to duress even when what is threatened is not in itself illegal, such as where a blackmailer threatens to expose the truth about his victim.

D4B Undue influence

The concept of undue influence is a product of equity which recognised more subtle forms of 'persuasion' than those of duress.

In particular, it is presumed that certain relationships, such as solicitor and client or doctor and patient, will give rise to improper pressure unless the contrary is proved. This will occur when one party holds a dominant position over the other or is able to take advantage of a relationship of trust and confidence between them.

If such a relationship exists, the person seeking to have the agreement set aside need only show that the arrangement was manifestly to their disadvantage. This can be done by showing that the transaction is 'not readily explicable on ordinary motives'. It is then up to the other party to rebut the presumption of undue influence. This, if it can be done, is usually achieved by showing that the other party had proper independent advice. The right to avoid the contract must be exercised within a reasonable time.



Be aware

An insurance contract could, in theory, be obtained by duress or undue influence but you should note that even high pressure selling will not in itself amount to improper pressure.

D5 Mistake

In exceptional cases, the validity of a contract may be affected by mistake. This will normally make the contract void.

Both parties may make the same mistake.



Example 3.21

For instance, they may both believe that something which one party proposes to buy from the other exists, when, in fact, it has been destroyed.

Alternatively, the parties may effectively make different mistakes:



Example 3.22

One party believes they are contracting about one thing and the other party thinks they are contracting about another.

In the first case, there is an agreement although it will not have the effect that the parties intended. In the second, there is really no agreement at all because the parties are at cross purposes.

In either case, the contract will be affected only if the mistake is fundamental: in other words, so important that its effect is to undermine the whole contract. If it does not 'go to the root' of the contract, it will have no effect on it.

If this were not the case, anyone who had made a bad bargain would be able to escape by relying on some trivial misunderstanding. The mistake may be a common one of law rather than fact.

A mistake which makes a contract void is likely to fall into one of three main categories.

The principles governing mistakes also apply to insurance contracts in the ordinary way although, in practice, examples of fundamental mistakes are common. There is little case law on the subject concerning insurance but a contract to purchase annuity or life insurance would be void for mistake if the proposer died before the date of purchase.

D5A Mistake concerning the subject matter of the contract

First, the mistake may concern the existence of the subject matter. This is the sort of case where the parties are at cross purposes and there is no '*consensus ad idem*' ('meeting of minds') at all. Both parties to the contract must have a *consensus ad idem* for the contract to be valid.

In terms of insurance contracts, there are occasional instances where the insured and insurer have been at complete cross-purposes.



Example 3.23

In *Beach v. Pearl Assurance Co. Ltd* (1938), the proposer wished to insure the life of her mother, Mary Ellen Ince, but the company's agent thought that the policy was to be on the life of her grandmother, Mary Ann Ince. The policy was issued in the name of Mary Ellen Ince but the details were appropriate to the grandmother and the premium was calculated on the basis of the grandmother's age. The Industrial Assurance Commissioner dismissed a claim for payment on the death of the mother because there was no *consensus ad idem* between the parties and a valid contract was never made. The company agreed to return the premiums paid.

Other mistakes about the subject matter are possible.

Where there is a mistake as to the quality of the subject matter, the contract will not be void unless the mistake rendered the subject matter of the contract essentially different from the

subject matter that the parties had believed to exist. The mistake must be such as to render the performance of the contract impossible.

D5B Mistake as to the identity of the other party

Example 3.24

A may enter into a contract for the sale of goods with B, but believe that they are, in fact, dealing with C. Often B will have deliberately led A to believe that they are C, in order to persuade A to contract with them. In many cases, B is a confidence trickster who pretends to be a wealthy and respectable person in order to persuade A to part with their goods in exchange for a cheque which turns out to be worthless. By the time A discovers that they have been cheated, the confidence trickster will usually have disappeared.

If, before disappearing, B has cashed in on their fraud by selling the goods to someone else (D), an interesting legal question arises as to the ownership of the goods.

Do they belong to A, who was cheated by the fraudster, or do they belong to D, who bought them from the rogue in good faith?



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Do they belong to A, who was cheated by the fraudster, or do they belong to D, who bought them from the rogue in good faith?

The answer depends on the status of the original contract between A and B. If the contract is void for mistake, title to the goods (ownership) does not pass to B and so B cannot pass a good title to D. A, therefore, remains the owner and can recover their property from D.

This remains, however, a very difficult area of law and the position may be different where parties who deal face to face enter into an oral contract.

D5C Mistakes in recording agreements – rectification

If the parties put their contract in writing but make an error in recording what they have agreed, the court may rectify the document to make it accurately reflect the true agreement.



Be aware

The mistake must, however, be that of both parties.

If the written instrument does accurately express the prior agreement, it cannot be corrected on the ground that the agreement itself was based on some mistake: the court can only rectify documents, not contracts.

If rectification were not available, the court would have to either declare the whole contract void for mistake or enforce it in its uncorrected form. In many cases neither would achieve a just result.

Cases where one of the parties applies to the court for the rectification of an insurance policy are not uncommon.

D6 Misrepresentation

Before a contract is made there are often negotiations in which one party makes statements (known as representations) which are intended to persuade the other to enter into the contract or to accept particular terms.

Example 3.25

The seller of a car may persuade the purchaser to buy, or pay a good price, by saying that the vehicle has been regularly serviced, is totally reliable and so forth.



Sometimes both parties make representations. Representations as such are not part of the contract itself (unlike conditions and warranties which are, of course, terms of the contract) but are statements which induce (i.e. persuade) the other party to enter into the agreement.

A misrepresentation is, thus, a false statement of fact which induces the other party to enter into the contract. It may be:

- fraudulent;
- innocent; or
- negligent.

To have a damaging effect on the contract, the following requirements must be met:

- **The misrepresentation must be one of fact.**

Statements of existing fact are to be contrasted with statements of opinion or belief.

A statement of fact must be true. A statement of opinion or belief, on the other hand, although not true may be excused if, at the time of the representation, the representor had reasonable grounds to believe that their statement was true.

- **The misrepresentation must be made by a party to the contract.**

A statement by a third party (such as a bystander at the time of negotiations) is not actionable. On the same principle, a misleading advertisement by the manufacturer of goods cannot upset a contract between the seller and buyer from a retail shop.

- **The misrepresentation must induce the contract.**

The person seeking redress must have relied and acted upon the statement in question.

D6A Remedies for misrepresentation

The broad effect of misrepresentation is to make the contract voidable rather than void as in most cases of mistake. In voidable contracts, the party who wishes to avoid is required to take positive steps to avoid the contract. Until the contract is avoided this way, it is a valid contract between the parties.

Remedy for misrepresentations differs depending on the misrepresentation being fraudulent, innocent or negligent.

- A representation is fraudulent if the person who makes it knows it is false, has no belief in its truth or makes it recklessly, not caring if it is true or false.
- An innocent misrepresentation is a false statement which the maker honestly believes to be true.

There is a further category of negligent misrepresentation. See ***Hedley Byrne v. Heller and Partners (1963)*** in [Negligent misstatement](#) on page 2/13 for an example of it.

The claimant's remedies are as follows:

1. Rescission (avoidance)

The claimant may bring an action to rescind (avoid) the contract.

Rescission is available for any type of misrepresentation but s.2(2) of the **Misrepresentation Act 1967** allows the court to award damages in lieu of (instead of) rescission at its discretion where misrepresentation is innocent.



Be aware

The right to avoid will, however, be lost if the parties cannot be restored to their original position before the contract: for example, where the goods have been re-sold by the buyer. Since rescission is an equitable remedy, the right will also be lost if it is not exercised reasonably promptly. In either case, the claimant will be left with a claim for damages only.

2. Damages

In the case of fraud, the action for damages is based on the tort of deceit rather than on the contract. Where there is fraud, the action for damages can be in addition to the action for rescission.

A purely innocent misrepresentation may result in an award of damages if they are awarded in lieu of rescission (see above). Damages and rescission are, thus, effectively alternatives where misrepresentation is innocent. The court can choose which remedy is appropriate but will not award both.

Section 2(1) of the Misrepresentation Act 1967 gives the right to claim damages for negligent misrepresentation.

3. Refusal of further performance

Avoidance of the contract puts the parties back to the positions they were in before they made the contract. The injured party can refuse to perform their part of the contract if they have not already performed it. In effect, they do nothing. If they are then sued, they can raise the misrepresentation as a defence.

4. Affirmation

Since the contract is voidable rather than void, the injured party may choose to affirm the contract (treat it as binding) if they wish.

Be aware

If they affirm the contract by their conduct or by express words, however, they cannot later elect to avoid.



D7 Non-disclosure

As a general rule, the parties to a contract are under no positive duty of disclosure, namely volunteering information.

We have seen above that a false representation will harm the contract but there is no general obligation to make any disclosure at all.

In relation to contracts for the sale of goods, the position has often been summarised in the expression '*caveat emptor*' ('let the buyer beware').

In some circumstances, however, a positive duty of disclosure does exist. If, for instance, a representation made in the course of negotiations afterwards becomes untrue because of a major change in circumstances, there is a duty to correct the original statement if the change takes place before the contract is concluded.

Example 3.26

When a company is 'floated' on the stock exchange and the public is invited to buy shares, a prospectus (now known as 'listing particulars') must be issued. This document must contain all the information which investors would reasonably require in deciding whether to buy shares. An omission to disclose material facts relating to the company or share offer may make those responsible for the prospectus liable for damages.



D8 Duty of fair presentation in insurance contracts

The subject of non-disclosure and misrepresentation in the context of insurance is a major topic of this book which is discussed fully in chapter 6.

It suffices here to state that the duty is analysed differently in consumer and in non-consumer insurance.

Under the **Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA)**, consumers are obliged to take reasonable care not to misrepresent facts before the insurance contract is concluded. Due to the nature of the duty (to take reasonable care not to misrepresent), the Act does not allow a remedy for insurers in the case of an innocent misrepresentation. However, where the duty is either deliberate, reckless or careless, the insurer is entitled to a remedy. Such a remedy may be avoidance of the contract or deduction from the insured indemnity or treating the contract as if it were made under different terms – depending on the seriousness of the breach and depending on what the insurer proves in terms of inducement to enter into the contract.

A duty of disclosure, as well as the duty not to misrepresent material facts, exists as part of the duty of fair presentation of the risk in relation to non-consumer insurance contracts. The relevant statutory provisions are to be found under the Insurance Act 2015.

E Discharge of contracts

In this section we look at the ways in which a contract may be discharged; that is, how the rights and obligations of the parties come to an end.

A contract may be discharged by:

- performance;
- breach;
- frustration;
- agreement; or
- operation of law.

E1 Performance

A contract is performed when each party has carried out their side of the bargain.



Consider this...

How would a contract for sale of goods be performed?



Example 3.27

A seller of goods will fulfil their duties by delivering goods of the agreed type and quality and the buyer by accepting the goods and paying for them.

Failure to perform the contract will usually amount to a breach of contract. A breach of contract occurs when one party fails to fulfil its obligations as outlined in the contract.

E1A The duty to perform

Each party must do completely and exactly what they have agreed to do: doing anything different will generally amount to a breach of contract.

However, tiny deviations may be disregarded under the *de minimis* principle discussed earlier.

Again, there may be no breach where partial performance is accepted by the other party (provided they have the choice whether to accept or reject) or where the other party refuses an offer to perform or actually prevents performance.

As we stated in *Strict liabilities* on page 2/6, liability in contract is often strict, so that when a party fails to perform it will usually be no defence that the breach was not their fault.

On the other hand, sometimes a party to a contract will promise only to take reasonable care in carrying out their contractual duties. In this case, liability will not be strict and the party in question will be liable only if they have been negligent in carrying out their work.



Example 3.28

When professional people and firms contract with their clients, they usually promise only to provide advice or treatment of a high professional standard: doctors, for example, do not usually promise to cure people.

Accordingly, if the advice or treatment does not bring about the results that are desired, the client must usually prove negligence if the professional is to be held liable.

Non-performance may be pardoned if there is a clause in the contract excusing non-performance owing to factors which are beyond the party's control. In other cases (including many insurance contracts), a clause may simply allow one or both parties to cancel or terminate the contract prematurely.

Finally, if performance of the contract becomes illegal, impossible or futile, both parties may be discharged from their obligations under the doctrine of frustration, which is discussed later.

E1B Time for performance

The time for performance may be agreed in the contract and, where time is 'of the essence' of the contract, failure to perform within that time will amount to a breach of condition, allowing repudiation of the contract (see below).

Time is of the essence when the parties have expressly stated that this is so or where it can be implied from the circumstances: a contract to supply a wedding dress obviously implies that it will be delivered before the wedding rather than afterwards.

Where time is not 'of the essence', a failure to abide by a time limit in a contract will result in liability for damages.

Where no time limit for performance of the contract has been agreed, performance must take place within a reasonable time, to be decided by the court if necessary.

E2 Breach of contract

If a breach of contract is sufficiently serious, the injured party will have the option of treating the contract as discharged.

A contractual breach may take the following forms:

E2A Breach by failure to perform

This is the most common form of breach and occurs when one party fails to carry out what they have agreed to do. Their performance may be inadequate or they may provide no performance at all.

Example 3.29

A seller may, for instance, deliver goods which are not in accordance with the agreement or simply fail to deliver anything.



E2B Anticipatory breach

Before the time for performance of the contract arrives, one party may indicate that they will not fulfil their part of the bargain. They may expressly renounce (or repudiate) the contract by stating that they will not perform or they may disable themselves from performing by doing something which makes performance impossible.

Example 3.30

A seller who has agreed to deliver goods to one person may disable themselves by selling them to someone else before the date of delivery has come.



A breach which takes place before the date for performance has arrived is known as an anticipatory breach. Where there is an anticipatory breach, the right to sue for breach arises at once.

Instead of 'accepting' the anticipatory breach and suing immediately, the injured party can ignore the breach and wait until the time for performance arrives. Keeping the contract alive in this way may be worthwhile if there is a chance that the other party may, in fact, perform their obligations. However, there is a risk that the right to sue will be lost if the contract is subsequently discharged by some unexpected turn of events.

E2C Effects of breach

A breach of contract will always give the injured party a right to claim damages. In some cases, it will also give the right to terminate the contract and bring it to an end.

You will remember that the terms of a contract can be classified into conditions, breach of which entitles the innocent party to terminate the contract. The breach of a warranty, or minor term, gives rise to an action for damages only.



Be aware

We have stated already that in insurance law, the term 'warranty' is given a different meaning and refers to a major term of the contract. Under the current law, the breach of a warranty in an insurance policy suspends the insurance cover until the insured remedies the breach. This is discussed in chapter 7.

There are a number of possible remedies for breach of contract in addition to the ones already mentioned. Remedies are discussed later in this chapter.

E3 Frustration

We stated earlier that liability in contract is often strict, in the sense that a person can be liable even when a breach is not their fault.

In some cases, however, a contract may become impossible to perform or illegal or futile because of some unexpected turn of events after the contract was made. In this case, the contract may be 'frustrated'.

Broadly speaking, the effect of the doctrine of frustration is to release both parties from their obligations.

A contract may be ended by frustration due to:

- change in law or operation of law;
- destruction of a thing necessary for performance of the contract;
- non-occurrence of an event on which the contract depends;
- commercial purpose of the contract being frustrated; and
- death or personal incapacity.

E3A Change in law or operation of law

Case law provides a good example of frustration by subsequent illegality. In a particular case, the outbreak of war with Russia made the performance of an existing chartering agreement illegal, thus discharging the contract.

Further, sanctions against Iran (due to Iran's nuclear activities) led to discussions on whether the contracts that had been entered into before the relevant sanctions were imposed either became illegal or frustrated, or both. For instance, see *Mamanechet Mining Ltd v. Aegis Managing Agency Ltd (2018)*.

E3B Destruction of a thing necessary for performance of the contract

An example of this is shown in case law – a hall was hired out to the claimant for a series of concerts on four named days but was accidentally burnt down before the date of the first concert. The claimant's claim for damages (based on wasted advertising expenses) failed as destruction of the hall had frustrated the contract.

E3C Non-occurrence of an event on which the contract depends

Good examples are found in the 'coronation cases' which resulted from the cancellation of events connected with the coronation of Edward VII, which was itself postponed owing to the King's illness.



Example 3.31

A defendant agreed to hire the claimant's rooms to watch the coronation procession but refused to pay the balance of rent due when the procession was cancelled. The court held that the cancellation of the procession effectively discharged the contract and the rent did not have to be paid.

E3D Commercial purpose of the contract frustrated

A contract may be discharged when a change in the circumstances is so fundamental that the duties involved become entirely different from those which were originally envisaged.

A contract will not be discharged simply because new circumstances make it more difficult to perform.

E3E Death or personal incapacity

Death or serious illness will discharge a contract where the person in question is required to provide personal services.

A contract to perform in a concert is an obvious example and contracts of employment can also be discharged in this way.

E3F Effects of frustration

Frustration automatically brings the contract to an end. Both parties are freed from their obligations and neither need take any steps to rescind the agreement. The law then attempts, as far as possible, to put the parties back to where they were before the contract was made.

E4 Discharge by agreement

Since a contract is formed by agreement, it follows that the parties can make a further agreement to release each other from their obligations. By releasing each other, the parties both give up a benefit and, thus, provide consideration. This form of release is known as waiver.

However, if one party has performed their duties under the contract, a subsequent promise to release the other will not be binding in itself because there is no consideration for it.

If the promise is to be binding it must be made in the form of a deed or the party to be released must give some fresh consideration for it. They can provide consideration by doing something different from that which was originally required of them, even if it is only a small favour.

This form of release is known as accord and satisfaction, the agreement to discharge being the accord and the fresh consideration being the satisfaction.

Example 3.32

If A has agreed to pay B £1,000 for the purchase of a motorcycle, the contract will be discharged if B accepts a pair of roller-skates instead of £1,000 in exchange for the cycle.



E4A Discharge of money debts

A debt cannot be discharged by the payment of a smaller sum unless there is a change in the time or mode of payment or something extra is added.

Example 3.33

If A owes B £1,000 (perhaps for the motorcycle mentioned above) an agreement by B to accept £500 instead would not be binding (and would not prevent B from later claiming the whole sum) unless the payment was made earlier than was previously agreed or in a different form or something else of value was given as well.



Finally, a discharge by agreement may take the form of the substitution of a new contract: this is known as novation.

E5 Discharge by operation of law

A contract may also be discharged by the operation of the law itself; for example by merger, death or bankruptcy.

F Remedies in contract



Consider this...

If a contract is breached, what remedies does the aggrieved party have?

The main remedies in the law of contract are:

- termination;
- an action for damages;
- an action for specific performance; and
- an action for an injunction.

Certain other remedies will also be considered briefly.



Be aware

Some of the remedies discussed are common law remedies (developed in the Common Law courts) and some are equitable remedies (developed by the Court of Chancery). The distinction is important because common law remedies are available as of right whereas equitable remedies are granted only at the discretion of the court and may be refused in some circumstances, such as where another remedy is more appropriate.

F1 Termination

We have seen that failure to perform a contract properly, or failure to perform at all, will generally amount to a breach of contract. If the breach is sufficiently serious, the injured party will be entitled to *termination* of the contract. Remember, however, that in the case of a breach of condition, the innocent party has the right to terminate the contract irrespective of the seriousness of the breach.

They can do so by refusing to perform their own obligations under the agreement, by refusing to accept further performance from the other party (e.g. by rejecting goods) (this is called repudiation).



Be aware

If the term breached in the contract is not a condition, the right to terminate arises where the breach is so serious as to 'go to the root' of the contract (remember innominate (intermediate) terms). You should bear in mind the classification of terms into conditions and warranties here. Again, if the situation can be adequately redressed by the payment of damages to the injured party, this will generally be the preferred option of the court.

F2 Damages

As in the law of torts, the main common law remedy for breach of contract is an award of damages; that is an award of financial compensation to the claimant.

As we have suggested, damages can be claimed as of right when a contract is broken. By contrast, equitable remedies (such as injunctions and specific performance) are awarded at the discretion of the court only.

The central purpose of an award of damages is to place the claimant in the financial position they would have enjoyed if the contract had been performed fully and properly.

To claim substantial damages, the claimant must have suffered loss.

If the claimant has suffered no loss at all, they are entitled to nominal damages only, e.g. a token amount. This may be the case, for example, if the defendant fails to deliver goods ordered by the claimant and the latter is able to obtain them elsewhere without extra cost or inconvenience.

Be aware

Damages in contract are intended to compensate the claimant and not to punish the defendant.

**F2A Types of loss**

When assessing damages in contract, the courts recognise various types of loss including personal injury, damage to property and financial loss.

Damages may also be awarded for distress or injury to feelings where the object of the contract was to provide comfort and pleasure and a breach of contract creates the opposite result. For example, a travel agent sells a holiday which promises a stay in a brand-new hotel. On arrival, the holidaymakers find the hotel is still under construction and are forced to relocate to another hotel which causes them stress. In this instance, the travel agent has breached their contract and the holidaymakers may potentially be awarded damages for distress or injured feelings. English courts, however, found that the purpose of insurance contracts is not pleasure or relaxation, and denied claims for damages of this nature. Therefore, if an insurer upsets the insured, the insured's claim for non-pecuniary losses is likely to be rejected.

F2B Measuring the loss

The measure of damages will vary according to the circumstances.

Consider this...

If you have a contract to buy goods and the seller fails to deliver them, how would your damages be calculated? What if the goods you ordered would now cost more to buy elsewhere?



The buyer will normally be entitled to damages based on the cost of substitute goods. If they have paid the seller, they will be entitled to the full market price of substitute goods.

If they have not paid, they will be entitled to damages based on the increased cost of the goods if the market price has risen in the meantime.

If a buyer wrongfully refuses to accept and pay for goods, the same general principles will apply and the seller will be entitled to the difference between the contract price and the market price if the market price has fallen. If the market price has risen, there will probably be no loss since the goods can now be sold to someone else for a higher sum.

In other cases, the appropriate basis of damages may be the cost of remedying the defective performance such as the cost of correcting mechanical faults in a car or defective work carried out by a builder.

F2C Mitigation of loss

The victim of a breach of contract is under a duty to mitigate (minimise) their loss and cannot recover damages for losses which they could reasonably have avoided by their own efforts. Students should be aware of the distinctions between mitigation of an insured loss (See chapter *Efforts to avoid or reduce loss* on page 8/16 and *Prevention costs* on page 8/17) under an insurance contract and mitigating damages under general contract law. In the former, if the contract provides that the insurer would pay for such costs, the insured might be able to claim the expenses incurred to prevent or minimise an insured loss. For instance, paying a ransom to pirates to save the ship and cargo hijacked by the pirates would be mitigating an insured loss if the insurance contract insured against the risk of piracy.

F2D Liquidated damages and penalties

Like an action in tort, an action for breach of contract is usually an action for unliquidated (also known as unspecified) damages, and the amount to be awarded is fixed by the court. However, the results of an action for breach of contract can be hard to predict and to remove uncertainty the parties sometimes agree in advance that a certain fixed sum or sums should be payable in the event of specified types of breach.



Example 3.34

A construction contract might stipulate that if the work is not completed on time the building contractor shall pay the employer the sum of, say, £1,000 for each day's delay in handing over the building.

If such provisions are a reasonable attempt to estimate and provide for anticipated losses in advance, they are valid in law and are known as liquidated damages clauses. If, however, the amounts concerned are excessive or unreasonable they are known as penalty clauses and are invalid.

F2E Remoteness of damage and causation

Refer to

Refer to [Causation and remoteness of damage](#) on page 2/11 for remoteness of damage

The doctrine of remoteness of damage applies to the law of contract as well as the law of torts. Accordingly, damages will not be awarded for losses that are too remote from the original breach of contract.

The general effect is that damage will not be too remote if it is reasonably foreseeable or if the defendant is aware of special circumstances that make a loss likely.

Remoteness draws the line between the defendant's breach and amongst the damages that the claimant can and cannot claim from the defendant. In the ordinary course of life events, one thing may lead to another. For instance, as a result of a breach of contract, the innocent party may suffer financial losses. Such financial losses may cause further losses, e.g. in the form of losing the opportunity to perform some other lucrative contracts. Moreover, they may suffer from depression as a result of the financial losses, following that, their marriage or some other personal relationships may break down. Naturally, this list can be extended further. The remoteness rule explains which of these losses may and may not be claimed from the contract breaker.

If the damages claimed by the innocent party against the contract breaker arose naturally as a result of the breach of the contract, that damage will not be regarded too remote and can be claimed.

If the damages in question arose because of some special circumstances, for the contract breaker to be liable for such loss, the contract breaker must have been informed of the special circumstances at the outset of the contract. If the parties enter into the contract by the knowledge of such special circumstances, it would be regarded that they contemplated the consequences of their breach of contract, and the consequences that might arise because of the special circumstances.

F3 Specific performance and injunctions

These remedies are means by which a contract can be specifically enforced. In other words, they are remedies which compel the defendant to honour their promise to the claimant rather than simply pay compensation for breaking it.

The court may	1	Positively order the defendant to do something which they have promised to do, such as transfer particular property to the claimant.
	2	Forbid the defendant to do something which they have promised not to do, such as set up a business in competition with the claimant.

In the first case, the order is one of specific performance. In the second, the order is an injunction (which we have met already when discussing the law of torts). Failure to obey either is a contempt of court for which the defendant can be punished, by prison if necessary.

Specific performance and injunctions are equitable remedies and are awarded only at the discretion of the court. You will recall that the common law remedy of damages is available, not at the court's direction, but as of right.

Specific performance will not be awarded where the claimant can be adequately compensated by an award of damages.

Be aware

The court will not order specific performance of contracts for personal services or, indeed, any contract where it would be difficult to supervise performance.



The remedy will also be refused if the claimant has not acted fairly. This requirement applies to all equitable remedies.

Where a contract contains a negative undertaking such as a promise not to work for another person or set up a rival business in competition, an injunction can be sought to prevent a breach of the promise. For obvious reasons, this is known as a prohibitory injunction.

A mandatory injunction is an order requiring the defendant to do something positive to end a wrongful state of affairs which they have brought about (such as an order requiring the defendant to demolish a structure which they have erected in breach of a promise not to build).

The restrictions on the availability of an injunction are broadly similar to those which apply to specific performance.

An injunction will not be granted if the effect would be to compel performance of a contract that could not be enforced by an order of specific performance. The breach of some part of a contract that is not specifically enforceable may, however, be restrained by injunction.

F4 Other remedies for breach of contract

Other remedies exist besides those mentioned above.

An action for an agreed sum (a common law remedy) may be brought when one of the parties has broken an undertaking to pay a specified sum of money.

Example 3.35

A buyer might agree to pay £1,000 for goods which are to be delivered at a later date but fail to actually pay. The seller in this case could sue for the sum in question.



A remedy in contract may also take the form of a claim for restitution, a claim for the return of money which has been paid or other property which has been transferred.

Example 3.36

Where there has been a total failure of consideration under a contract and the claimant has received nothing of value from the defendant by way of performance, they can sue to recover money or property which they have transferred under the agreement.



Finally, a person may bring an action on a '*quantum meruit*' ('as much as they have earned or deserved'). For example, if a contract is discharged by the defendant's breach, the claimant may claim on a *quantum meruit* as an alternative to damages.

The remedy may also be available when work has been done under a void contract (when, by definition, an action for breach of contract cannot be brought).

F5 Limitation of actions

In [Limitation of actions](#) on page 2/30, we saw that the law gives a person who is the victim of a civil wrong only a limited period of time in which to begin their action against the wrongdoer.

Consider this...

Why does the law limit the time in which a victim can bring an action?



To allow unlimited time would be unfair to the defendant since the possibility of legal action could hang over them indefinitely. A very long delay would also make a fair hearing difficult since evidence tends to become less clear and less easily available with the passage of time.

The time periods allowed are governed by legislation and, for this reason, a claim which is made too late is described as being 'statute-barred'.

Claims for breach of contract are governed by the **Limitation Act 1980**.

The main limitation periods are:

- six years in an action on a simple contract; but only
- three years where the claim is in respect of personal injuries; and
- twelve years in an action brought on a speciality contract (deed).

F5A When time begins to run

The limitation period begins on the date on which the cause of action accrues. The 'cause of action' means the situation which gives rise to the claimant's right to sue the defendant, so the date in question is normally the date of the breach of contract.

F5B Claims for specific performance, injunctions or other equitable remedies

The limitation rules discussed above do not apply, in general, to claims for equitable remedies.

F5C Specified time

Contracting parties frequently include an express term that a claim for breach may only be made within a *specified time*. In non-consumer (business) contracts these time limits may well be short (a matter of months rather than years) and the courts will generally uphold them.

G Privity of contract

Privity of contract is a doctrine which restricts the rights and duties created by a contract to the persons who originally made it.

Under this doctrine, a contract between A and B cannot confer any legally enforceable benefit on a third party and cannot impose any duties on the third party. 'Only a person who is a party to a contract can sue upon it'.

G1 Contracts (Rights of Third Parties) Act 1999

A strict application of the doctrine of privity of contract would often hinder useful and sensible non-consumer (business) arrangements. For this reason, a number of exceptions to the rule have become established over the years.

Some of these have been created by statute; others are common law exceptions (i.e., they have been developed by the courts). The **Contracts (Rights of Third Parties) Act 1999** applies to contracts entered into on or after 11 May 2000.

The Act provides that a third party (i.e. someone other than one of the original contracting parties) can enforce a contractual term if:

1. the contract provides that they may do so; or
2. the contract purports to confer a benefit on the third party, unless on a true construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.

The third party can only enforce the contractual term if they are expressly identified in the contract by name, or they belong to a general class of persons identified in the contract (e.g. 'all purchasers of products'). The third party need not be in existence when the contract is made.

The Act supplements the existing law and does not remove or replace any of the existing exceptions to the doctrine of privity.

A number of contracts are specifically excluded from the Act, including bills of exchange, terms in contracts of employment against an employee, and most terms in contracts for the carriage of goods by sea (and some other contracts of carriage).

Be aware

Insurance contracts are not excluded from the Act, but it is perfectly possible for the parties to an insurance contract (or any other contract) to exclude the operation of the Act altogether.

**Consider this...**

What types of third party do you think may want to enforce a contractual term in an insurance contract? What would their interests be in the operation of the policy, and why would an insurer want to take steps to prevent them from exercising their right to enforce the relevant term?



The doctrine of privity of contract, the exceptions to it, and the 1999 Act have important implications for the practice of insurance. This is so because insurance policies often appear to cover not one but several people or 'confer a benefit' on persons other than the policyholder (i.e. the person who originally entered into the contract with the insurer). The question then arises as to whether these 'additional insureds' or other third parties can claim on the insurance policy. There is another complicating factor, because one (or more) insured persons may break the terms of an insurance policy that covers several people, whereas other insureds may not. This raises a question as to whether the insurance cover is unavailable wholly for all insured persons or only for the person who breached the term of the insurance contract. We will return to these important questions in *Joint and composite insurance* on page 7/19.

H Assignment

We have seen that under the doctrine of privity of contract discussed earlier, only the parties to a contract may sue on it.

An original party to the contract may be able to assign (transfer) their rights under the contract to another who then stands in their place.

We will look at the general rules of assignment first and then, in *Insurance contracts* on page 3/41, we will look at assignment in relation to insurance contracts.

**Be aware**

This topic is important because in some classes of insurance (particularly life and marine) policies are quite frequently assigned. In fact, the assignment of policies in each of these two classes is governed by special legislation.

- In the case of **marine insurance**, it is governed by section 50 of the Marine Insurance Act 1906.
- In the case of **life insurance**, it is governed by the **Policies of Assurance Act 1867**.

Otherwise, the general rules of assignment apply to insurance contracts as we will now discuss.

H1 Transfer of rights

Example 3.37

If A owes B £100 for work which B has done, B may decide to transfer the right to receive the £100 to C, either as a gift or in exchange for something else. B is, therefore, the assignor (or creditor) and C is the assignee. The debtor (A) is not a party to the assignment and their consent, in general, is not required (although it will be advantageous to the other parties if they are given notice). As a result of the assignment, C will gain the right to enforce the debt against A.



A contractual right is a 'chose (thing) in action', a valuable but intangible piece of property. It is called a chose in action because it cannot be physically seized but only enforced through an action in court.

A 'chase in possession', in contrast, is a piece of tangible property which can be seized or physically controlled.

The most common types of assignment are as follows.

H1A Statutory assignment under the Law of Property Act 1925 s.136

Under this section, the assignment of a debt or chase in action transfers the underlying legal right to the assignee. Such an assignment must be:

- absolute, and not purport to be by way of charge only;
- in writing (although no particular form is necessary); and
- expressly made in writing to the debtor or trustee (although an assignment may be valid in equity without such notice).

Essentially, under s.136, an assignee can sue the debtor in their own name, which equitable assignees are not generally able to do (see *Equitable assignment* on page 3/40). There is no need for consideration to support a s.136 assignment (it can be by gift), and it can be used for a debt which is payable at a future point in time (such as future instalments of rent).

H1B Equitable assignment

If an assignment does not comply with all the requirements for a statutory assignment given above, it may still take effect as an **equitable assignment**, provided there is a clear intention to assign. This can take place in one of two main ways:

- the assignor informs the assignee that they transfer the chase to them; or
- the assignor instructs the debtor to discharge the obligation by payment to, or performance for, the assignee.

H2 Rights which cannot be assigned

Most rights can be assigned but there are a number of exceptions. In particular, there are restrictions on the assignment of rights under what are described as 'personal' contracts. These are contracts where it would be unreasonable to expect a party to perform their obligations towards any person other than the one with whom they originally contracted.

In *Insurance contracts* on page 3/41, we will discuss assignment of insurance contracts more fully but it is worth noting here that many insurance contracts are of a 'personal' character in the sense that the insurer agrees to provide cover on the basis of the insured's personal characteristics and would not necessarily offer the same terms to another.

Insurance contracts are of a 'personal' character in the sense that the insurer agrees to provide cover on the basis of the insured's personal characteristics and would not necessarily offer the same terms to another.



Example 3.38

Motor policies are not freely assignable because an insurer's willingness to offer cover depends not only on the vehicle but also on many factors personal to the insured, such as age and driving record.

H3 Transfer of obligations

Rights can often be transferred. However, a person cannot generally transfer their obligations under a contract to another without the consent of the other party and the assignee. Everybody has a right to choose with whom they will contract, and no one is obliged without their consent to accept the liability of a person other than the person with whom they made their contract. Consequently, the burden of a contract cannot in principle be transferred without the consent of the other party to discharge the original contractor.



Example 3.39

If A owes B £100 and B owes C £100, they can agree between them that B's debt should be extinguished and that C should be allowed to recover the money from A instead.

This is known as a 'novation'. In this case, nothing is transferred – rather one debt is cancelled by agreement and a new debt is created in its place.

It is not unusual for one person to delegate their contractual duties to another.

This would not, however, be assignment as the original contracting party will continue to be liable for any breach committed by the person to whom the duties have been delegated.

Example 3.40

A builder who undertakes to build a house will normally sub-contract much of the work to plumbers, electricians and other specialist tradesmen. In this case, there is no transfer of liability by the contractor since they retain full responsibility and are answerable to the other party for any defects in the work.



Alternatively, we can see that there is no privity of contract between the customer for whom the work is done and the sub-contractor employed by the builder.

H4 Insurance contracts

There are three types of assignment that are relevant to insurance contracts:

- assignment of the subject matter of the contract;
- assignment of the benefit of the contract; and
- assignment of the contract itself.

Assignment of the subject matter does not usually transfer any rights under the policy and, indeed, will normally terminate the contract automatically. Again, while the benefit of an insurance contract can be freely assigned, the contract itself usually cannot.

H4A Assignment of the subject matter

Consider this...

In what situations would the subject matter of an insurance contract often be transferred from one person to another?



Example 3.41

A motor policyholder may, for instance, sell their car to another, or the insured under a household buildings policy may sell the house.



Assignment of the subject matter does not, however, carry with it any automatic assignment of the policy in question.

So the person who buys a car or a house from another does not automatically take the place of the insured under the seller's policy. In fact, if the insured disposes of the subject matter of the insurance, the usual effect will be to bring the contract to an end. This is because they will no longer have any insurable interest in the property which they have disposed of and can suffer no loss.

To read more on insurable interest, see *Insurable interest* on page 5/10.

H4B Assignment of the benefit of the contract

Refer to

Refer to *Transfer of rights* on page 3/39 for transfer of rights

The right to recover money under an insurance contract is a chose in action which can be assigned to another person. The key point is that the entire contract is not assigned, but merely the benefit of it.

There is no change in the subject matter of the contract (such as the property which the policy covers), or in any other aspect of the risk; the insurance money is payable on exactly the same event or events.

The assignor is simply saying that the proceeds of any valid claim they may have should go to the assignee in question rather than to themselves.

As we noted in *Statutory assignment under the Law of Property Act 1925 s.136* on page 3/40, there can be a statutory assignment of the benefit of the policy in line with s.136 of the Law of Property Act 1925 or an equitable assignment. Therefore:

- Notice must be given to the insurer if the insurer is to be liable directly to the assignee.
- If no notice is given, the assignee can only enforce their rights by bringing an action against the assignor.
- Although notice should be given to the insurer, the consent of the insurer is not necessary.
- The assignment can take place either before or after the loss.
- The assignee need have no insurable interest in the subject matter of the insurance.



Example 3.42

By way of example, an insured might assign the benefit of their household policy to a builder as a means of paying for the repair of storm damage which is covered by the policy. The insurer must be notified of this arrangement and is under no legal obligation to pay the builder directly unless this is done. If the insurer is not notified the builder can enforce the agreement only against the insured. The insurers do not have to consent to the arrangement, but merely have notice of it. The arrangement could be made before any damage occurs (which would be a little unusual!) or afterwards. Finally, the builder need have no insurable interest in the house.

H4C Assignment of the contract itself

The assignment of an entire insurance contract is subject to some limiting factors.

'Personal' contracts are not freely assignable

Many insurance contracts are of a 'personal' character, in the sense that the terms of the cover granted to the insured by the insurer will often depend, to some extent, on the insured's own personal characteristics.



Example 3.43

An insurer's willingness to provide motor insurance cover and the terms of the cover granted (including the premium payable) will depend not only on the vehicle to be insured but also on the age, occupation, experience and driving record of the insured and any other persons who may drive the vehicle.

Most property insurances will also be 'personal' contracts, because the risk is likely to depend partly on the nature of the person who controls and manages the property and the particular use they make of it.



Example 3.44

If the ownership of a factory changes, the standard of 'housekeeping' may decline, making the fire risk worse.

Again, liability insurance is very much of a personal character because most claims arise from the actions of the insured.

Since the risk depends on the identity of the insured in these cases, the policy cannot be assigned without the consent of the insurer.



Be aware

In practice, insurers are unlikely to grant such consent and will usually provide insurance only under a new contract.

So, if A sells their car, house, or business to B, A's insurers will usually ask B to submit a new proposal if A wishes them to cover the risk, and a new contract will be formed involving a fresh offer, acceptance and consideration. Where, exceptionally, the policy expressly states that assignment is permitted, it may also impose contractual terms as to how and/or when notice of assignment must be given.

Consider this...

What types of insurance contract are likely to allow for assignment? What factors specific to insurance are likely to make assignment more complex?



Assignment must take place at the time when property is transferred

If a policy is assigned when the property it covers is sold, the assignment must take place at the same time as the sale. This is because the policy will normally lapse automatically if the subject matter is disposed of and, therefore, there will be no contract to assign once the sale has taken place. On the other hand, if assignment is attempted before the sale the assignee may not yet have sufficient insurable interest in the property to make the insurance valid.

Marine insurance

Because of the limitations mentioned above, few insurance contracts are freely assignable in practice.

Be aware

However, marine cargo policies are an exception.



The ownership of cargo may change several times in the course of a voyage, and it is obviously convenient if the insurance cover can be easily transferred at the same time. Normally, the risk will not alter as a result of a change in the ownership of the goods, because they will usually remain on the same ship. A cargo policy is not a 'personal' contract and there is no reason why such assignments should not take place. Marine hull policies, however, are not freely assignable because the ownership of a vessel will obviously affect the risk.

Assignment of marine policies is governed by section 50 of the Marine Insurance Act 1906.

H4D Assignment of life policies

Life insurance provides a means of investment as well as a source of protection, and many life policies acquire a cash (or surrender) value once a certain number of premiums have been paid. The insured then has a useful and valuable piece of property which they may wish to sell or transfer to another, or use as security.

Life policies are freely assignable because, provided the identity of the life insured does not change on assignment, there is no change in risk.

In this sense, life policies are **not** personal contracts.

Example 3.45

To illustrate this, let us suppose that A has a policy on their own life.



- A is the insured – the policyholder who will benefit from the policy money when it matures, or whose estate will benefit if A dies.
- A is also the life insured – in other words A's life is the subject matter of the contract and the death of A is an event on which the sum insured is payable.
- If A assigns the policy to B the life of A remains the subject of the contract and the policy money is still payable on the death of A, and not of B. When the policy is assigned, B may become the insured under the policy and entitled to the policy money: A, however, remains the life insured.



Be aware

The key point, which we already have made above, is that the risk does not change when the contract is assigned.

Our example (with a further assignment to C) is represented in table 3.1.

Table 3.1:

	Insured	Life Insured
Own policy in the name of A	A	A
A assigns policy to B	B	A
B assigns policy to C	C	A

The assignment of a life policy may be conditional or absolute.



Example 3.46

An example of a conditional assignment is by way of mortgage. In this case, the policy is assigned as security for a loan or other debt, but the mortgage can be redeemed and the policy recovered once the debt is repaid.

Types of assignment

- An equitable assignment of a life policy has always been possible. This may be done, for instance, simply by handing the policy to another – provided the intention to assign is clear.
- Statutory assignment became possible as a result of the Policies of Assurance Act 1867. This Act allows legal assignment of life policies, with the result that an assignee can enforce the policy in their own name as long as the requirements of the Act are complied with. The Act indicates the form of words which must be used for the assignment, requires these words to be endorsed on the policy or contained in a separate instrument, and requires that written notice of the assignment be given to the insurer at its principal place of business.
- Alternatively, a life policy may be assigned by the procedure laid down in s.136 of the Law of Property Act 1925 (as outlined earlier in this chapter).

Refer to

Refer to [Statutory assignment under the Law of Property Act 1925 s.136](#) on page 3/40 for the Law of Property Act

H4E Assignment of insurance contracts by operation of law

On the death or bankruptcy of a person, their property generally, including any rights under insurance policies, passes to their personal representatives or trustee in bankruptcy, as the case may be. Policies often specifically provide that cover will continue following this sort of involuntary assignment, even though they may expressly prohibit any voluntary assignment by the insured.

I Scenario 3.1

I1 Scenario 3.1: Question

Apply the law of contract to practical situations (LO3.10)

An insurance firm advertises its products on television. In its advertisement, the firm states that there is a discount for travel insurance for those over 65 years of age for one month only. A potential customer has been refused the discount and makes a complaint. He claims that, because he responded to the advertisement, there is a contract in law. He is threatening to take the firm to court.

Explain with justification whether you think the potential customer is correct in what he says.

When planning your answer, use the following four-step IRAC approach:

- provide an **introduction** that identifies the focus of the question;
- look at the **relevant** areas of law;
- **apply** the principles of the law to the scenario; and
- provide a **conclusion** to your answer.

Note: the M05 study text is based on English law. All scenarios included are set in England; therefore English law applies.

I2 Scenario 3.1: How to approach your answer

Aim

This fictional case study tests the reader's ability to apply the law of contract to practical situations (learning outcome 3.10).

It is recommended that you use the following four-step IRAC approach when planning your answer.

Provide an introduction that identifies the focus of the question

Contract law is a wide-ranging subject so it is important to identify what the issues are in this scenario. The starting point is whether there is a true offer made via the advertisement. If there is a true offer, the issue is whether the offer has been accepted. If no offer has been made, the issue is whether the advertisement has any legal effect or is merely an invitation to treat.

Look at the relevant areas of law

The relevant law is on offers which, if accepted, bind the parties. Offers can be made to the public as a whole so the insurance firm's advertisement may be considered as a unilateral offer which, once accepted, binds the parties.

However, in *Pharmaceutical Society of Great Britain v. Boots Cash Chemists* (1953), it was held that offers to sell were not made by placing goods on shelves in a shop. Similarly, an advertisement may not be a true offer, it may simply be an 'invitation to treat'. If this is the case, it is the customer who makes the offer when responding to the advertisement.

Apply the principles of the law to the scenario

If the television advertisement is a unilateral offer, the customer may be accepting the offer by responding to the advertisement. As long as the customer satisfies the conditions attached to the offer (i.e. they are over 65 years of age and respond within the one month time period mentioned), they may claim that an offer and acceptance has taken place. They will then be bound and there may be a contract (subject to the other elements of a valid contract being in place). One reason the discount may have been refused is that the offer may have lapsed through passage of time, or if there are some other limitations such as only the first 1,000 customers will be eligible and it will be on a first come, first served basis.

If the television advertisement is not a true offer but an invitation to treat then it is the customer that is making the offer and it is up to the insurance firm to decide if they wish to accept it. It may be for the courts to decide if there is an offer made by the insurance company or by the customer in this scenario.

Remember to provide a conclusion to your answer that directly links back to the question and relevant area(s) of the law.



Key points

The main ideas covered in this chapter can be summarised as follows:

Types of contract

- Contracts can be either contracts under seal (a formal contract in writing which must be witnessed) or simple contracts (all other contracts).
- Contracts can be either bilateral contracts or unilateral contracts – there must always be two persons to make a contract. A unilateral contract usually starts with a unilateral offer which may or may not be accepted. However, once accepted, the offeror cannot reject the acceptance but is bound by it.
- A contract may not be fully valid in law for a number of reasons; it can be void or voidable.

Formation of a contract

- There are five essentials for the formation of a valid contract:
 - An agreement (offer and acceptance).
 - Intention to create legal relations.
 - Consideration (for simple contracts).
 - In the form required by law (if any).
 - The parties must have capacity to contract.
- The contract also must not be illegal or contrary to public policy.
- Special rules restrict the capacity to contract of minors, mental patients and drunken persons.

Terms of a contract

- Terms in a contract can be classified into express and implied terms; implied terms can be implied in fact, by custom or in law.
- Exclusion clauses must be incorporated into the contract in order to be valid. Those in commercial contracts are governed by the Unfair Contract Terms Act 1977 and those in consumer contracts by the Consumer Rights Act 2015.
- Terms in a contract can further be classified into conditions and warranties. This classification largely depends upon the importance of the term and the consequence if broken. In general contracts a condition goes to the root of the contract; a warranty affects only some minor element of the contract. (This is different in insurance law, and will be covered later in the text.)

Defective contracts

- Contracts can be defective as a result of:
 - illegality;
 - improper pressure;
 - mistake;
 - misrepresentation; or
 - non-disclosure.

Discharge of contracts

- A contract may be discharged by: performance; breach; frustration; agreement; or operation of law.

Remedies in contracts

- The main remedies in the law of contract are termination; an action for damages; an action for specific performance and an action for an injunction.

Key points

- Claims for breach of contract are governed by the Limitation Act 1980; the claimant has six years to bring a claim on a simple contract.

Privity of contract

- Privity of contract is a doctrine which restricts the rights and duties created by a contract to the persons who originally made it.

Assignment

- Rights under a contract may be assigned by an original party to the contract to another who stands in their place. Assignment can be statutory or equitable.
- Assignment of insurance contracts can occur in the following three ways:
 - Assignment of the subject matter of the contract – this does not carry with it any automatic assignment of the policy in question.
 - Assignment of the benefit of the contract – this can be statutory or equitable assignment.
 - Assignment of the contract itself – personal contracts are not freely assignable; life policies are freely assignable because, provided the identity of the life insured does not change on assignment, there is no change in risk; and marine cargo policies are also assignable.

Self-test questions

1. What are the essentials for the formation of a valid contract?
2. A person goes to a supermarket, picks up a bar of chocolate from the shelf and pays at the cash desk. At what point is the contract of sale concluded?
3. What is an 'invitation to treat'?
4. Acceptance must generally be communicated to the offeror. How can this be done?
5. Give two examples of contracts which must be by deed.
6. What are 'necessaries'?
7. Distinguish between a warranty and a condition in the general law of contract.
8. When may a contract become frustrated?
9. How may a contract be discharged?
10. Under what circumstances may an insurance policy be illegal?
11. How does the assignment of the benefit of an insurance contract differ from the assignment of the contract itself?
12. Under what circumstances might there be an equitable assignment of a life insurance policy, and what is the main disadvantage to the assignee of a life insurance policy if the assignment is only an equitable one?
13. Why are motor insurance policies not freely assignable?

You will find the answers at the back of the book

4

Law of agency

Contents	Syllabus learning outcomes
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Learning objectives

After studying this chapter, you should be able to:

- explain the nature of agency;
- describe the relationships between principal agent and third parties;
- describe the creation of agency;
- discuss the nature of an agent's rights, responsibilities, authority and duties;
- discuss the role of agents in insurance contracts and how an agency relationship can be created;
- understand an agent's role in disclosure of material facts;
- understand and apply knowledge of agency to the relationship between insurer, insured and intermediary; and
- explain the termination of agency and the effects of termination.

Introduction

Insurance policies are often arranged through an agent (usually, a professional insurance broker or a ‘part-time’ agent who arranges insurance policies in addition to their other activities). For this reason, some knowledge of the law of agency is important for insurance students.

In this chapter, we will introduce the general principles of the law of agency and look at the topic in the context of insurance. We will first examine how the relationship of the principal and agent is created. We will then look at the rights and duties of agents and the nature of the authority or power which they have. We will then consider how the exercise of this authority affects the principal and third parties. Finally, we will examine the way in which an agency relationship may come to an end.



Key terms

This chapter features explanations of the following ideas:

Agency by ratification	Apparent authority	Appointment by express or implied agreement	Broker
Disclosed and undisclosed principle	Express and implied actual authority	Good faith	Imputed knowledge
Law of agency	Personal performance	Remuneration	Renunciation
Termination of agency			

A Law of agency

The law of agency is an area of commercial law dealing with relationships that involve a person (**the agent**), who is authorised to act on behalf of another (**the principal**) to create legal relations with a third party.

Common examples of the principal-agent relationship include a private person (principal) hiring a contractor (agent) to complete a repair on a home or a corporation (principal) retaining an attorney (agent) to perform legal work.

Often, the task of the agent is to bring about a contract between their principal and a third person, referred to as a third party.



Example 4.1

- Estate agents are employed by sellers to arrange contracts of sale between buyers and sellers of property.
- Employment agencies are engaged by employers to attract potential employees, with a view to the formation of a contract of employment.

Agents are essentially intermediaries or ‘middlemen’. Their roles are not limited to arranging contracts. They may undertake duties at the post-contractual stage in relation to the performance of the contractual obligations.

In the context of insurance, the most straightforward insurance transaction involves just two parties – the buyer of insurance and the seller of insurance. However, the buyer of insurance may not be so knowledgeable about the options available to them either in terms of the product or the market so will seek help from an expert advisor – an insurance intermediary. This is especially the case for more complex types of insurance.



Consider this...

Insurance intermediaries such as brokers do not simply arrange insurance contracts. What other services do they provide for their clients?

Example 4.2

Insurance intermediaries provide many additional services other than simply arranging insurance contracts for their clients. These include providing general advice on risk management and loss prevention as well as assistance in negotiating claims.



Be aware

In some cases, a person or firm described as an agent or agency may not be an agent in the strict legal sense of the word.



On the other hand, people who are agents may be described by another word; for example, insurance intermediaries may go under the name of **insurance brokers** (or in some cases 'insurance consultants', or use some other title).

You may recall from [Legal personality](#) on page 1/37, that corporate bodies (e.g. companies) have no physical existence and, therefore, can only operate through agents, such as their employees.

Questions of agency law often arise when an insurance intermediary makes a mistake or is generally negligent in carrying out their duties. A typical example would be where in non-consumer (business) insurance, the intermediary fails to pass on to the insurers important information about the risk that has been given to them by the proposer (the future insured). As a result, depending on the circumstances, the insurers might be able to avoid the policy for non-disclosure, perhaps leaving the insured with a large uninsured loss.

Example 4.3

An insurance broker may arrange an insurance contract for a period which is shorter than what the insured instructed them to do, or may arrange for an insurance contract with a lower deductible than requested.



We will start our review of the general principles of the *law of agency* by considering how the relationship of principal and agent is created.

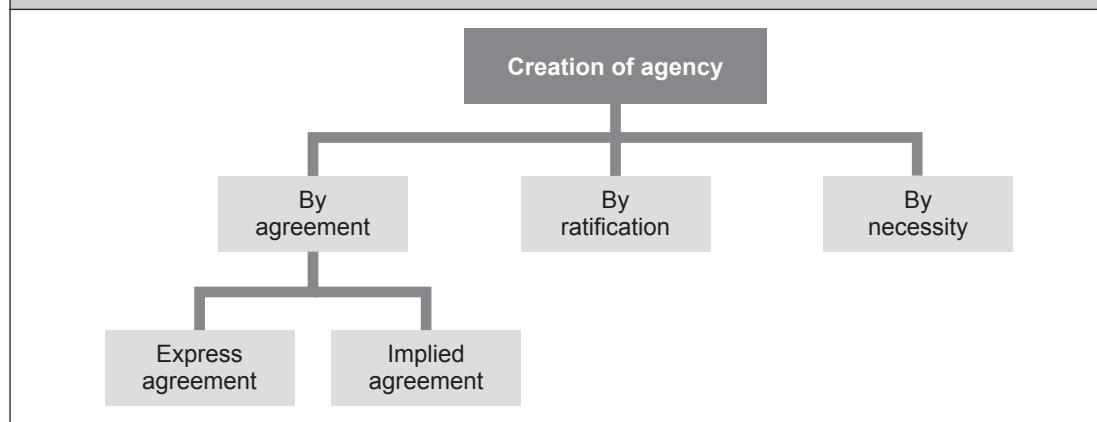
A1 Creation of agency

The relationship of principal and agent may come about in three main ways:

- by agreement (or consent);
- by ratification; and
- by necessity.

A summary of the ways an agency relationship may be created is given in figure 4.1.

Figure 4.1: Creation of agency – summary



A2 Agency by agreement (or consent)

In almost every case the agency relationship is created through an agreement between the principal and agent. This agreement will often be a contract in itself, described as a contract of agency.

However, in some instances the agreement will not amount to a legal contract, particularly when the agent receives no commission, fee or other payment for their work.



Example 4.4

A person may ask a friend or a family member to do some shopping on their behalf without a contract being formed between the two.



Consider this...

If you buy your insurance cover through an agent such as a broker, will they be a party to the insurance contract between you and the insurer?

It is important to understand that when an agent is employed to buy or sell or arrange some other contract between the principal and third person, the agent is not usually a party to the contract arranged. Although the agent has the authority or power to bind the principal in a contract, the agent simply 'drops out' of the picture once the contract is made.



Be aware

For this reason, it is not necessary for the agent to have full contractual capacity, provided the principal and third party have such capacity. A minor (i.e. a person under the age of 18 years in the UK) may, therefore, act as an agent and bring about a contract between others which would not be fully binding if made for themselves, such as a contract for the purchase of goods which are not 'necessaries'.

The agreement by which the agent is appointed may be express or implied.

A2A Appointment by express agreement

Most agencies, including insurance agencies, are created in this way. The agreement may be a formal one, in writing, or an informal oral agreement.

In the case of a formal agreement, the terms of the agency will usually be set out in detail. The terms include the:

- authority and powers of the agent;
- duties to be performed;
- commission or other *remuneration*; and
- period of the agreement.

In some cases, the appointment may be in the form of a deed. If an agent is appointed by a deed, the deed is known as a power of attorney. If the agent is to be given the power to sign deeds on the principal's behalf, the agent must be appointed in this way.

A2B Appointment by implied agreement

An agency agreement may be implied by the conduct of the parties and the relationship between them.

An agency is likely to be implied where one person acts on behalf of and at the request of another, particularly if commission or some other payment is made for the work.

As we shall see later, the authority of an agent may, in turn, be either express or implied. Where the appointment of the agent is by implied agreement, all the agent's authority will be implied. Where there is an express agreement, at least some of the agent's authority will be express.

A3 Agency by ratification

In some cases, the relationship of principal and agent can be created retrospectively (i.e. after the 'agent' has carried out their task) under the doctrine of ratification.

Example 4.5

If A purports to be the agent of B, without B's knowledge, and does something in B's name, such as agree the sale of B's car to C, B may afterwards accept the agreement as binding. In this case, B could sue C for breach of contract if the latter failed to go through with the purchase of the car, even though B had not authorised A.



A number of conditions must be satisfied for **agency by ratification** to be possible:

- The 'agent' doing the act must purport to do it on the principal's behalf and not on the agent's own behalf (e.g. the agent must make it clear that it is the principal's car and not the agent's own car that is being sold, although the principal need not be named).
- The principal must be the person whom the agent had in mind at the time of the act.
- At the time of ratification, the principal must have full knowledge of the circumstances relevant to the act, or must have waived further inquiry.
- The principal must have existed and have had the contractual capacity to do the act at the time it was done.
- Ratification must take place within a reasonable time.
- Void or illegal acts cannot be ratified.
- The whole contract must be ratified.

A valid ratification 'relates back', in other words it is retrospective to the date of the agent's original act.

Be aware

However, ratification validates only past acts of the agent and does not in itself give the agent any authority for the future.



Under the doctrine of ratification, a person may ratify an insurance contract which has been arranged on their behalf, even if the person was unaware that the insurance 'agent' had arranged the cover. In marine insurance, the contract may be ratified even after a loss has occurred.

A4 Agency by necessity

Agency by necessity arises where a person is entrusted with goods belonging to another and an emergency makes it necessary to do something to preserve them.

An agency of necessity will arise only in cases where it is impossible to obtain the owner's instructions in time. Such an agency will occur only rarely now when modern communication technology is available to most people.

B The principal of an insurance agent

This is a key topic in insurance. In most business transactions, an agent acts on behalf of one party only – for example, they may be the agent of the buyer or the seller of property, but not of both.



Be aware

However, in insurance an intermediary may, at different times, act on behalf of both the proposer/insured and the insurer in the following ways:

- Giving general advice.
- Granting cover.
- Collecting premiums.
- Completion of the proposal form.

B1 Giving general advice

When an agent advises the proposer (a person who proposes to enter an insurance policy contract with an insurance company) about the sort of insurance they need and recommends a general type of policy, the agent is clearly acting on behalf of the proposer who is the principal at this point.

B2 Granting cover

On the other hand, insurance intermediaries who are empowered by insurers to **grant cover** (particularly common in the case of ‘personal lines’ business such as motor and household) will obviously be acting on behalf of the insurer when doing so. This will be the case where the agent has actual authority to grant cover or where they have apparent authority only.

B3 Collecting premiums

An agent may also be acting on behalf of the insurer when they collect insurance premiums for the latter.

B4 Completion of the proposal form

Insurance agents often assist proposers in the completion of proposal forms. Quite often the agent will complete the form on behalf of the proposer and then give it to the proposer to sign. Indeed, it has been known for proposers to sign a blank form and for agents to fill in the necessary details afterwards!

Sometimes an agent will act negligently in carrying out this task.



Example 4.6

- They may fail to record accurately on the form information which is given to them by the proposer.
- They may omit from the form information that was supplied by the proposer.
- They may fail to supply extra information about the risk which they know is material and should, therefore, be disclosed.

The consequences of such a failure will depend on whether the agent was acting for the proposer or for the insurer at the time.

If the agent was deemed to be acting for the insured at the time, the insurers may be able to avoid the policy for breach of the pre-contractual information duty because the agent's knowledge will be deemed to be known by the insured (subject to the exceptions under sections 4 and 6 of the **Insurance Act 2015 (IA 2015)**). If the insurers avoid the policy, the insured may then be able to sue the agent for breach of the duties arising out of the agency relationship.

If the agent was deemed to be acting for the insurer in handling the proposal form, the insurers will not be able to avoid the policy for breach of the duty of fair presentation of the risk because knowledge of the true facts will be imputed to the insurers (IA 2015, s.5). In other words, the law will assume that the insurers were aware of the true facts, even though

the agent did not actually pass them on. In this case the insurers may have a right to sue the agent (in reliance on the agency relationship and duties arising out of that).

B5 Consumer insurance

The **Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA)** sets out rules for determining whether an agent – through whom a consumer insurance contract is effected – is acting either as the agent of the consumer or of the insurer. Accordingly, the agent is to be taken as the insurer's agent where:

- the agent collects information from the consumer under the express authority of the insurer;
- the agent enters into the contract as the insurer's agent if the insurer has given the agent express authority to do so; or where
- the agent does something in their capacity, as the appointed representative of the insurer, for the purposes of the **Financial Services and Markets Act 2000** (section 39 of that Act).

In any other case, it is to be presumed that the agent is acting as the consumer's agent unless, in light of all the relevant circumstances, it appears that the agent is acting as the insurer's agent.

For instance, the agent may be considered as acting for the consumer if the consumer pays the agent a fee. The agent may be considered as the insurer's agent, for example, where the insurer permits the agent to use the insurer's name in providing the agent's services.

B6 Summary

The following is a detailed summary of the circumstances in which an insurance intermediary is deemed to be an agent of the proposer and those in which they are deemed to be acting for the insurer.

The agent is an agent of the proposer:

- when an agent gives general advice to the proposer as to the cover they require and the market in which they should place their business;
- if no authority is given by the insurers and the only recognition they receive from the insurers is the payment of commission;
- when they fill in, alter, or add to the answers in a proposal form, and the proposer knew or ought to have known of this;
- when they complete a form on the proposer's behalf and the form incorporates a wording to the effect that if the form is completed by someone other than the proposer, that person is deemed to be the agent of the proposer;
- when they and the proposer are in collusion to defraud the insurers; or
- when the agent gives the insured advice about how to formulate their claim.

The agent is an agent of the insurer:

- when they have express authority from the insurer to receive and handle proposal forms;
- when they handle the forms according to a previous course of business with the insurers and within an implied authority that has arisen;
- when they are instructed by the insurers to ask questions and fill in the answers on a proposal form – they are then the insurers' agent even when the proposal contains a declaration to the contrary;
- when they survey and describes the property on the insurers' behalf;
- when they act without express authority, and the company either ratifies their action or has ratified such action in the past; or
- when they have express or implied authority to collect premiums.

Consumer agency

Section 9 of the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) refers to schedule 2 of the Act in relation to determining whether an agent – through whom a consumer insurance contract is effected – is the agent of the consumer or of the insurer. The guidance stated in schedule 2 only applies to the determinations for the purpose of the 2012 Act.

According to schedule 2, the agent is to be taken as the insurer's agent:

1. When the agent does something in their capacity as the appointed representative of the insurer for the purposes of the Financial Services and Markets Act 2000.
2. When the agent collects information from the consumer, if the insurer had given the agent express authority to do so as the insurer's agent.
3. When the agent enters into the contract as the insurer's agent, if the insurer had given the agent express authority to do so.

The Act then states that in any other case it is to be presumed that the agent is acting as the consumer's agent.

The 2012 Act also provides some guidance which helps to confirm whether the agent is acting for the consumer or the insurer. The following circumstances may tend to confirm that the agent is acting for the consumer:

1. If the agent undertakes to give impartial advice to the consumer.
2. The agent undertakes to conduct a fair analysis of the market.
3. If the consumer pays the agent a fee.

On the other hand, the following examples may tend to confirm that the agent is acting for the insurer:

1. The agent places insurance of the type in question with only one of the insurers who provide insurance of that type.
2. The agent is under a contractual obligation which has the effect of restricting the number of insurers with whom the agent places insurance of the type in question.
3. The insurer only provides insurance of the type in question through a small proportion of the agents who deal in that type of insurance.
4. The insurer permits the agent to use the insurer's name in providing the agent's services.
5. The insurance in question is marketed under the name of the agent.
6. The insurer asks the agent to solicit the consumer's custom.

Conflicts of interest

The fact that an insurance intermediary can act for both parties in the same transaction can lead to some difficult situations. It could lead to a conflict of interest – this means a situation in which a person has a duty to more than one person or organisation, and serving one interest (e.g., for client A) could involve working against another interest (e.g., against client B).



In *HIH Casualty & General Insurance Limited v. JLT Risk Solutions Limited Lord (2007)* Justice Auld said:

'The role of an insurance broker is notoriously anomalous for its inherent scope for engendering conflict of interest in the otherwise relatively tidy legal world of agency. In its simplest form, the negotiation of insurance, the broker acts as agent for the insured, but normally receives his remuneration from the insurer in the form of commission; he may, in certain circumstances, act for both. Where there is reinsurance of an insured risk, the same broker may act on behalf of the insured in placing the insurance and on behalf of the insurer in placing the reinsurance.'



Example 4.7

In *North & South Trust Co. v. Berkeley (1970)*, a broker negotiating a claim settlement on behalf of the insured was held in the Court of Appeal to be the agent of the insurer when he was shown documents by the latter which were the basis of the repudiation of the claim. Therefore, the broker was not at liberty to disclose the contents of the documents to the insured.

In the case a conflict of interest arises, the broker's compliance with the duty of care towards one client may breach their duty of care towards the other client. It was stated in *HIH v. JLT (2007)* (referred to above) that this conflict of interest situation is of the broker's own making by accepting the appointment by both parties and the broker will be held liable for the breach where it occurred. In other words, the broker's duty of care towards their clients is not eroded by the conflict of interest that arises in the circumstances. The duty of care is explained below.

C Duties of an agent

The duties of an agent to the principal are as follows and apply equally to insurance agents as to other forms of agency:

- To obey the principal's instructions.
- To exercise proper care and skill.
- To perform duties personally.
- To act in good faith towards the principal.
- To account for monies received on behalf of the principal.

The agency agreement will normally take the form of a written contract, and so the agent's duties will usually be set out in the contractual terms. Whether the agreement is in writing or not, the duties of the agent – as established in common law – will apply to the contract.

C1 Obedience

An agent must obey the principal's instructions, provided they are lawful and reasonable, and may be liable in damages if the instructions are not carried out.

However, the agent is under no obligation to perform any act which is either illegal or void. Where an insurance intermediary has no instructions on a particular point, they may follow market usage where such practice is clear.

C2 Care and skill

Agents must exercise reasonable care and skill in the performance of their duties as agents.

The level of care and skill required will depend on the circumstances. Experts and professional people must exercise the level of care and skill which is expected in their trade or profession. Again, people who claim to have some special skill must be able to live up to their claims.

An insurance intermediary must exercise a level of care and skill appropriate to the class of agent they represent.

Example 4.8

The standard of care is assessed objectively. It is not a defence to say that the expectations of a junior broker should be lower than those which apply to an experienced broker. The standard of what is reasonably expected from a broker applies to any professional who undertakes the role of a broker in the circumstances.



Furthermore, if a broker purports to exercise a specialist skill (for example, in relation to a particular class of business) they must meet the standard of a reasonably competent specialist in that field.

The duty to exercise reasonable care and skill includes a duty to act in a timely manner and the intermediary will be liable for loss caused by their failure to act with appropriate speed – for example, in the placing of cover or the notification of claims.

Where the insured suffers loss as a result of the broker's negligence the general measure of damages is that which will place the insured in the position that they would have been in were it not for the negligence.



Example 4.9

Where there is a negligent failure to renew and the insured suffers a loss that would have been covered by the policy, the broker will be liable in damages for the amount which would have been payable under the policy.

A broker is under the duty to exercise reasonable skill and care to obtain the cover that the insured instructed the broker to obtain. For example, if the insured would like the insurance cover to last for four years, but the broker obtains cover for two years and the loss occurs in the third year, the insured will not have insurance to cover the loss.

Alternatively, if the insured would like insurance that covers all aspects of its business, but the policy obtained by the broker covers only some types of business that the insured deals with and excludes others, the broker will be in breach of its duty unless it obtains full coverage as requested by the insured. If it is not possible to obtain full coverage in the insurance market, the broker should inform the insured accordingly.

Similarly, if a broker fails to disclose material facts on behalf of their business with the insured, and the insurers discover this when investigating a claim and then seek remedy for breach of the duty of fair presentation of the risk, the broker will be liable to the insured for the amount that would have been payable had the breach not occurred.

C3 Personal performance

Generally, an agent may not delegate duties to a 'sub-agent'.

Delegation, however, may be allowed:

- where the principal expressly authorises the agent to delegate all or some of their duties;
- where the authority to delegate can be implied from the circumstances – such as the delegation of routine clerical and administrative tasks to employees;
- where the delegation is in accordance with trade custom; and
- in cases of necessity.

When delegation does take place, the sub-agent acts on behalf of the agent, not the principal. The agent is, therefore, liable to the principal for any fault on the part of the sub-agent and will be responsible for paying the sub-agent.

Where an insurance broker from overseas appoints a broker in the London insurance market to place the risk with the London insurers, the broker overseas is named as the 'producing broker' and the London broker is named as the 'placing broker'. The insured has an agency agreement with the producing broker and the producing broker has a sub-agency agreement with the placing broker. In *Involnert Management Inc v. Aprilgrange Ltd (The Galetea) (2015)*, Leggatt J held that the producing broker's duties towards the insured were non-delegable duties. Therefore, the producing broker is liable to the insured for the negligence of the placing broker, but such liability is not vicarious liability. See [Vicarious liability](#) on page 2/22.

The placing broker, in principle, does not owe a duty of care (in tort) to the insured and does not have a contract with the insured. As such, if there is liability for broker's negligence, the producing broker is liable to the insured (although it is the placing broker's negligence) and the placing broker is liable to the producing broker.

Example 4.10

In *Involnert Management Inc v. Aprilgrange Ltd (The Galetea) (2015)*, the claimant pursued legal action against the insurer for refusing to meet a claim for abandonment of their yacht after it caught fire. The claimant also brought in the producing broker and the placing broker, on the basis that the placing broker's negligence led to the insurer's refusal, and that one or both parties were responsible for this. It was held that the producing broker was liable to the claimant, because their duties were of a 'nondelegable' kind, and liability extends from what has been contractually agreed (vicarious liability was also considered, and ruled out on the basis this does not ordinarily extend to independent contractors). Where the producing broker does not agree to arrange insurance for its client but agrees to get another broker to do so, the duty of the producing broker, both in contract and in tort, is limited to taking care to choose a competent sub-broker and giving it appropriate instructions.



A duty of care between the placing broker and the insured may be established if the placing broker (sub-agent) assumes responsibility towards the insured as was established in *BP Plc v. AON Ltd (No.2) (2006)*.

C4 Good faith

An agent's relationship with their principal is a fiduciary one, which means that it is based on duties of *good faith*.

The agent must not allow personal interests to conflict with those of the principal. If such a conflict arises it must be disclosed to the principal. This means, for instance, that an agent is not entitled to personally buy from or sell personal property to the principal unless the agent fully discloses to the principal what is being done.

Example 4.11

In *Lucifero v. Castel (1887)* the principal engaged an agent to buy a yacht for him. The agent found a suitable yacht, bought it himself and then tried to sell it to the principal for a higher price. The court held that the principal was required to pay no more than the amount which the agent himself had paid for the boat.



The agent's duty of good faith to the principal requires full disclosure, not just of matters that relate to a possible conflict of interest, but of any information acquired in the course of the agent's duties that might affect the principal's position.

Be aware

Generally speaking, an agent may not act for both parties to a transaction. However, as we saw in *The principal of an insurance agent* on page 4/6, insurance provides an unusual example of a business where it is customary for the agent, at different times, to act on behalf of both the buyer and seller of insurance.



Conflict of interest arises when a broker acts for the insured as well as the insurer and the broker's commission is calculated proportionately to the premium charged.

Agents must not make any form of secret profit from their agency duties. Based on the same principle, an agent must not accept commission from both parties without full disclosure.

Sometimes a third party offers a person who is known to be acting as an agent a payment or gift to persuade the latter to act favourably towards them. If the agent accepts the gift or payment, the secret profit is in this case called a bribe. The taking of a bribe allows the principal to dismiss the agent, recover the bribe from the agent or the third party (or the amount of the actual loss, if this is greater), refuse all commission and repudiate any contract in respect of which the bribe was paid. Both agent and donor may also commit a criminal offence in such a case.

It is a custom of the business that insurance intermediaries are paid commission by insurers. This is a well-known fact but if for any reason the insured should be unaware of it, or appear to be unaware of it, it must be disclosed to them.



Be aware

In some fields, such as life insurance, specific disclosure of commission may be required by law.



Activity

There has been considerable debate about disclosure of commissions by insurance intermediaries. Look at the insurance trade press to read more about the regulatory investigation into this issue and the present position.

Finally, we should note that although the agent owes duties of disclosure to the principal, the agent must maintain secrecy towards others and not disclose any confidential information connected with the agent's work.

C5 Accounting for monies received

An agent has the **duty to account** to the principal for all money received in the course of agency duties. The principal's money and property must be kept separate from the agent's own money. An agent must not spend the money collected either from the insured to be paid to the insurer or from the insurer to be paid to the insured in order to run their agency offices.

For insurance brokers, there is a requirement in their professional code of practice to keep clients' money separate from their own, in separate insurance broking accounts.

Note: in marine insurance, a broker is personally liable for the payment of a premium under s.53(1) of the **Marine Insurance Act 1906 (MIA 1906)**. The insurer may claim a premium that has not been paid from the broker. As a result, the broker has a lien on the policy in case the insured does not reimburse the broker for the premium paid to the insurer by the broker. The parties to an insurance contract may, however, contract out of this liability as section 53(1) says 'unless otherwise agreed'.

C6 Remedies for breach of duty

A number of remedies may be available to the principal if an agent fails in their duties. For example, the principal may:

- sue the agent for damages for breach of contract;
- in certain cases, sue the agent in tort (for example, where the agent has refused to return the principal's property);
- for a serious breach (such as the taking of a bribe, as described above), dismiss the agent without notice or compensation;
- sue the agent (or the donor) to recover a bribe paid to the agent;
- if the breach is fraudulent, rescind any contract made through the agent and refuse commission; and
- sue for an account if the agent fails to disclose full financial details of their agency dealings.

D Imputed knowledge



Consider this...

If there is an agency agreement in place, what does this mean in terms of the principal's liability for the agent's actions?

We have already seen that an action carried out by an agent is treated in law as the principal's own action. Therefore, the principal becomes generally liable for their agent's deeds and can be bound in contract by the agent.

Under the law of agency, any knowledge which an agent possesses is imputed to the principal. In other words, the law assumes that the principal is aware of information which has been given to the agent. To put it another way, what is known by an agent is deemed to be known to the principal too. This is of particular importance in relation to the duty of disclosure in non-consumer (business) insurance.

The Insurance Act 2015 (IA 2015) introduced a detailed section clarifying 'knowledge of insured'. Accordingly, with regards to the insured's duty of disclosure, if the insured is an individual, the insured knows or ought to know what is known to their agents who are responsible for arranging their insurance (s.4(2)(b)). An insured is not taken to know confidential information known to the agent and information acquired by the agent through a business relationship with a person who is not connected with the contract of insurance (s.4(4)).

E Rights of an agent

Agents have two main rights in respect of their employment by a principal. These are:

- the right to remuneration; and
- the right to indemnity.

In some cases the agent may protect these rights through a lien on the principal's property.

E1 Remuneration

An agency may be gratuitous, without payment, but if there is an express or implied agreement to do so the principal must reward the agent for any work done, normally by paying commission. A right to payment will usually be implied where the agent is in business and does work which would not usually be done for nothing.

The amount to be paid or the scale on which commission is payable may be an express term of the contract. If no amount is set down but commission is clearly payable, the principal must pay normal non-consumer (business) or professional rates or, if there is no such guide, a reasonable sum, which can be fixed by a court if necessary.

In any case, the agent must have earned the commission. This means that the event on which the payment of commission depends must actually happen, and it must happen as a result of what the agent has done.

Example 4.12

An estate agent who is engaged to sell a house will not usually be entitled to a commission until a sale is completed. They may lose the right to a commission if the house is sold privately to a person who was not introduced by the agent.



This is subject to the terms of the agency agreement, which may vary from the usual rules.

When an agency is ended, the agent is generally entitled to payment for transactions which were brought about before termination. However, unless it is agreed otherwise, they are not entitled to payment for transactions which take place afterwards, even though the agent may have originally introduced the customers concerned.

The expenses of running an insurance agency or broking firm are normally funded by the agent or broker through the commission they receive. The level of commission for various lines of business will normally be set out in the agency agreement. Quite often, however, the agent or broker will 'return' this commission to the insurer and, instead, charge the insurer a fee (which is likely to be less than the commission they would otherwise receive). In either case, it is the insured who ultimately pays the agent.

E2 Indemnity

If agents reasonably incur expenses in the performance of their duties, they have a right to be indemnified (i.e. paid back) by the principal, unless the agency agreement provides otherwise. However, they lose the right to indemnity if:

- their act was not authorised (or ratified) by the principal;
- they are in breach of their duties as the agent (for example, by failing to obey instructions); and
- the act for which they claim indemnity is illegal or void by statute.

If an insurance broker pays premiums on behalf of their clients (which is common), they of course have the right to be repaid.

E3 Lien

A lien is the right to retain the goods of another as security for payment of a debt.

A lien may be a particular lien, which is a right to retain the particular goods in respect of which payment is due or a general lien, which is a right to retain any property as security. A general lien arises only by agreement between the parties or by trade usage. At various times, bankers, solicitors and stockbrokers have been held by the courts to have a general lien based on trade usage.



Be aware

In the context of agency, an agent may have the right to retain property belonging to the principal as security for commission or other monies owed to them.

It should be emphasised that a lienor (person with a lien) has the right to retain goods but, generally, not the right to sell them. If they wish to sell they must usually apply for a court order permitting them to do so. Finally, a lien comes to an end when the principal pays or offers to pay the sum due.



Example 4.13

In marine insurance, for example, an insurance broker has a lien over the policy and can retain it as security for payment of the premium by their principal, the insured.

F Authority of an agent

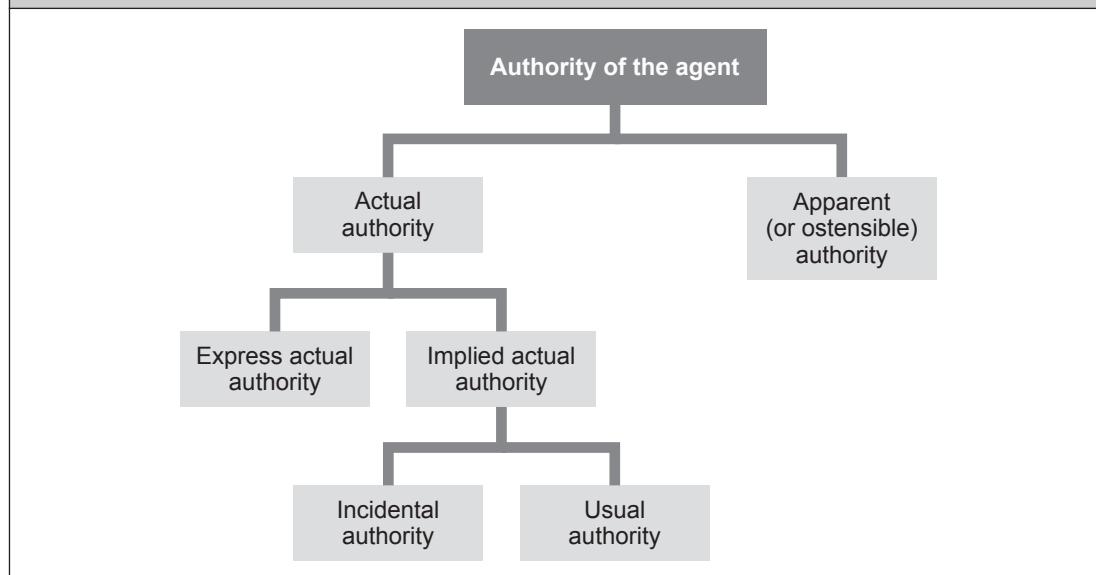
We have seen that the relationship of principal and agent can be created in various ways. Similarly, agents may have different types of authority.

The main distinction is between actual authority and apparent (or ostensible) authority:

Actual authority	The authority of the agent is real, in the sense that they have been given the right to act on behalf of the principal, either expressly or by implication.
Apparent authority	<p>The agent has no real authority to do the act in question.</p> <p>However, it appears, in the eyes of the third party, that they have such authority and are, therefore, able to bind their principal.</p>

A summary of the various types of authority which an agent may have given is shown in figure 4.2.

Figure 4.2: Authority of the agent – summary



F1 Actual authority

Actual authority can itself take two forms:

- express actual authority; and
- implied actual authority.

F1A Express actual authority

Express authority arises from the instructions which have been given to the agent, stating what is required and what is allowed.

These instructions form part of the agency agreement and may be oral or in writing. If the instructions are ambiguous, the agent should seek clarification from the principal. However, if the principal cannot be contacted, no liability will fall on the agent provided the agent acted in good faith and interpreted the instructions in a reasonable way, even if it was not the way the principal intended.

F1B Implied actual authority

First, agents have **implied authority** to do anything which is incidental to, or necessary for the carrying out of their express instructions.

Example 4.14

An agent may have implied authority to incur travel expenses or post and telephone charges.



Refer to

Refer to [Law of contract](#) on page 3/1 for the law of contract

The principles which apply here are the same as those which govern implied terms of contracts generally.

An agent may have implied authority to perform those acts which are usually performed by persons in the agent's position or usual in a particular trade or profession. This is known as **usual authority** (or **customary authority**).

Consider this...

What sort of acts would be covered by 'usual authority' in the case of an insurance agent? What are the acts usually performed in the insurance broking profession?



Be aware

A problem may arise, however, if the usual authority of the agent has been restricted by the principal, or if the agent abuses their position in some way. In this case the agent will be acting outside their actual authority, even though what they are doing is customary.



Refer to

Refer to [Apparent \(or ostensible\) authority](#) on page 4/16 for apparent authority

As we shall see, in such cases the principal may still be bound by the **apparent authority** of the agent.

You will appreciate that there is a link between the authority of the agent and the way in which the agency is created, even though the two are not the same thing.

So, where the agency has been created by express agreement the agent will have both:

- express actual authority; and
- implied actual authority.

However, where the agency agreement is implied, the agent will have no express actual authority, and all authority will be implied.

Finally, you should be aware that agents who go beyond their actual authority, express or implied, will generally be in breach of their agency duties and become liable to the principal for their actions.

F2 Apparent (or ostensible) authority

When a third party deals with an agent, often they will not know the exact limit of the agent's authority.



Example 4.15

A person cannot be expected to know the extent, if any, to which an insurance broker is entitled to give temporary cover.

They are, therefore, bound to rely on what appears to be the authority of the agent. The law recognises this by what is termed apparent authority.

A principal is bound, not only by acts which are within the actual authority of the agent, but also by acts which are within the authority they appear to have.

As we have suggested, this means that agents may have power to do things which they have no right to do and may be able to bind the principal even when failing to obey the principal's instructions.

Apparent authority arises only when the principal gives the agent the appearance of authority. The doctrine of apparent or ostensible authority is based on estoppel by representation.

For example: where P represented (or caused it to be represented) to T that A had authority to act on P's behalf, and T dealt with A as P's agent on the faith of that representation, P was bound by A's acts to the same extent as if A had the authority they were represented to have.

The principal must make some representation, by words or conduct, to the third party that the 'agent' is entitled to act on their behalf and the third party must rely upon the representation. In other words, the principal must in some way 'hold out' another as being their agent.

Apparent authority can arise in cases where:

- the principal has restricted the authority of a validly appointed agent;
- the apparent agent has never been appointed at all; and
- unknown to the third party, the authority of the agent has been terminated.

F2A Validly appointed agent with restricted authority



Example 4.16

In *Watteau v. Fenwick* (1893), the defendant appointed a manager of his public house. The licence was taken out in the name of the manager (a Mr Humble) whose name appeared over the door. The manager bought cigars on credit from Watteau. This transaction was within the usual authority of a public house manager, although Fenwick had, in fact, forbidden him to buy cigars. Watteau was successful in his claim against the defendant for the cost of the cigars because he had no knowledge that the usual authority of the agent had been restricted.

F2B Apparent agent who has never been appointed

Sometimes a person may 'hold out' another person as being their agent when the latter has no authority at all, with the result that the third party is deceived. This is sometimes known as an agency 'by estoppel'.

F2C Termination of authority

When an agency is terminated, the actual authority of the agent will also end. However, third parties who deal with the 'agent' may be unaware that their authority has ceased and continue to deal with them.

Although the agent will have no actual authority, the principal may still be bound by their apparent authority.

Be aware

For this reason, a principal who terminates an agency should inform third parties who have dealt with the agent in the past. In this way, both the agent's actual authority and their apparent authority will come to an end.



G Contract made by an agent

When agents are engaged to bring about contracts with third parties, the effect of their actions will depend on whether the existence of the principal is disclosed or undisclosed.

G1 Disclosed principal

A **disclosed principal** is one whose existence is known to the third party at the time the contract is made.

In some cases, the third party will know that the agent is contracting on behalf of someone else but not know the principal's name. In other cases, they will be aware of both the existence and the name of the principal. Whether the principal is named makes little difference, because in either case the third party will be aware that the person they are dealing with is an agent.

When an authorised agent contracts on behalf of a disclosed principal, as described above, the general rule is that the agent simply 'drops out' once the contract is made.

The principal and third party can enforce the contract against each other but the agent can neither sue nor be sued on it. There are, however, exceptions to this rule. For example:

- agents who sign a deed may be liable on it, even though they are known to be contracting as an agent;
- trade custom sometimes makes an agent personally liable on a contract; and
- agents who sign their name on a negotiable instrument (such as a cheque or bill of exchange) may be liable on it unless they indicate that they are signing on behalf of principal.

G2 Undisclosed principal

The position is different if the existence of the principal is undisclosed – i.e. the third party is unaware that they are dealing with an agent.

Two questions then arise:

- Can the **undisclosed principal** enforce the contract?
- Can the third party enforce the contract and, if so, against whom?

G2A Enforcement by the undisclosed principal

The general rule is that the undisclosed principal can enforce the contract against the third party.

It may seem strange that the third party can be sued by somebody with whom the third party did not know they were contracting. However, to protect the third party, some limitations are placed upon this right.

Example 4.17

An undisclosed principal cannot:

- sue if they did not exist or lacked capacity when the contract was made;
- ratify a contract;
- sue if the contract expressly provides that the person making it is the sole principal; and
- sue if the third party can prove that they had some good reason for dealing with the agent personally (e.g. because of their reputation or special skills).



G2B Enforcement by the third party

Where the principal is wholly undisclosed, the third party can enforce the contract and has the option of doing so either against the agent or against the principal: this is known as a right of election. However, the third party cannot sue both and, having elected to sue one (e.g. by commencing legal proceedings or demanding payment), they cannot then sue the other.

G3 Other actions against the agent by the third party

We have seen above that in certain exceptional cases an agent can be sued by the third party on the contract made. In addition to this, the third party may be able to sue the agent for breach of warranty of authority or in tort.

G3A Breach of warranty of authority

When a person acts as an agent, there is an implied promise on their part that they have the authority to act and to bind the principal.

If the agent has no authority, or exceeds their authority so that the principal is not bound, the third party may be able to sue the agent for damages for breach of warranty of authority.

In some cases, the agent may be liable even where they genuinely believed that their actions were authorised.

G3B Actions in tort

If an agent commits a tort when acting in the course of their authority, the principal will be liable.



Example 4.18

The principal will be liable if the agent makes fraudulent statements to a third party so as to commit the tort of deceit. However, if the agent knows the statement to be false or acts recklessly, they will be liable as well.

The agent will not be liable if they innocently pass on false information given to them by the principal.

G4 Payments made through an agent

In this section we will consider payments made through an agent, either by the principal or by the third party.

G4A Payment by the principal

If an agent commits a tort when acting in the course of their authority, the principal will be liable.

When the principal owes money to a third party, the debt cannot be discharged simply by paying money to the agent. If the agent fails to pass it on, the principal will still be liable to the third party.

The principal may not be liable, however, if the third party has induced the principal to pay the agent by suggesting, for example, that the agent has already paid over the money to them.

G4B Payment by the third party

If the third party owes a debt to the principal, this will not generally be discharged by payment to the agent. However, if the agent has authority to receive payment on their principal's behalf (which is often the case), the debt of the third party is discharged and the principal must sue the agent if the agent fails to hand over the money.

H Termination of agency

There are a number of ways in which an agency may come to an end:

Agreement between the parties	Just as an agency can be formed by agreement it can be dissolved by agreement – if both parties wish to terminate the relationship.
Performance	If an agent is employed to carry out a particular task, such as to secure a buyer for a house, the agent will have no further authority once the task has been completed and the agency will end.
Lapse of time	Where an agency has been created for a specified period of time (for example one year) it will end once the time has passed.
Withdrawal of authority	In general, a principal may revoke the agent's authority at any time. However, this may amount to a breach of contract in some cases, particularly when the agent is entitled under the agency agreement to a period of notice and is wrongfully dismissed without notice. The agent cannot force the principal to abide by the contract in such a case, because contracts for personal services cannot generally be enforced. However, the agent may be able to claim damages from the principal. In some cases the authority of the agent cannot be revoked.
Renunciation by the agent	Just as the principal may generally withdraw the agent's authority so may an agent renounce their duties. Once again, however, this may amount to a breach of contract in some cases and make the agent liable to the principal in damages.
Death of either principal or agent	The death of the principal or the agent terminates the agency.
Bankruptcy	The bankruptcy of the principal will end the agency relationship automatically. However, bankruptcy of the agent terminates the agency only where it prevents the agent from carrying out their duties.
Insanity	Insanity on the part of the principal will end the agency if it renders them incapable of entering into the contract or other transaction for which the agency was established. If the agent becomes insane the agency will end if, as is likely, the agent is unfit to carry out their duties.
Frustration	Frustration of contracts generally is discussed in <i>Frustration</i> on page 3/32.

Consider this...

How might a contract of agency be frustrated? Think about the example of an estate agent selling a house.



Frustration of a contract of agency might occur in a number of ways:

Example 4.19

- The subject matter of the agency (such as a house which is to be sold) might be destroyed.
- The task of the agent might become impossible to fulfil, illegal or futile.
- The agent becomes an enemy alien.
- Illness of either party might make the agency useless in non-consumer (business) terms.



H1 Effects of termination

Finally, we must consider how the relationship between the parties is affected when an agency is brought to an end. We will examine, first, the effect of termination on the relationship of principal and agent and, second, its effect on the position of the third party.

H1A Termination as regards principal and agent

Not all the consequences flowing from the principal/agent relationship will cease immediately when the agency is terminated.



Example 4.20

- If, at the time of termination, the agent has a right to commission already earned or to indemnity in respect of expenses previously incurred, these vested rights will remain.
- If an agent has been guilty of a breach of duty and has been dismissed for the breach, bringing the agency to an end, the principal's right to sue the agent in respect of the breach (perhaps for damages) will remain.

H1B Termination as regards the third party

We have suggested already that revocation by the principal may divest an agent of actual authority, but not necessarily deprive them of their apparent or ostensible authority.

If the principal has held out the agent as having authority, they remain liable so far as the third party is concerned until the third party has had notice that the agency is at an end or becomes aware of circumstances which make them suspect this.

On the other hand, where termination happens involuntarily, such as by death or insanity of the principal, the agent's authority may end automatically, regardless of whether the third party is aware of this or ought to be aware of it. In this case, the third party will have no remedy against the principal and can only sue the agent for breach of warranty of authority.

I Scenario 4.1

I1 Scenario 4.1: Question

Apply the principles of agency law to practical situations (LO4.6)

Carlos asks his neighbour, Priya, to help him sell his car. He tells her that he will give her 10% of the sale price following a completed sale. Priya finds him a buyer and the car is sold to that buyer. She gives Carlos the full purchase price. Carlos, however, now refuses to pay Priya the 10% he promised. The buyer has also contacted Priya to say that the car is not fit for purpose and that he wants his purchase money back.

1. Do you think Priya is entitled to payment from Carlos?
2. Do you think Priya is at risk of being sued by the buyer of the car?

When planning your answer, use the following four-step IRAC approach:

- provide an **introduction** that identifies the focus of the question;
- look at the **relevant** areas of law;
- **apply** the principles of the law to the scenario; and
- provide a **conclusion** to your answer.

Note: the M05 study text is based on English law. All scenarios included are set in England; therefore English law applies.

I2 Scenario 4.1: How to approach your answer

Aim

This fictional case study tests the reader's ability to apply the principles of agency law to practical situations (learning outcome 4.6).

It is recommended that you use the following four-step IRAC approach when planning your answer.

Provide an introduction that identifies the focus of the question

1. The scenario presents an agency situation with Carlos as the principal and Priya as the agent. The task of an agent is to bring about a contract between the principal and a third party. Here, the agent has been created by express agreement and Priya has actual authority.
2. The scenario also presents the issue of whether there is a disclosed or undisclosed principal and what impact this might have in terms of who may be liable for any breach alleged by the buyer.

Look at the relevant areas of law

1. The relevant areas of law are the general principles of agency with specific reference to the obligation to pay an agent. An agent has certain duties but so too does the principal, and one of these is to pay the agent. This means the agent has a right to be remunerated and, in this case, the sum of that payment is clear.
2. There is a possibility that Carlos is an undisclosed principal and this may be relevant to whom the buyer can seek compensation from.

Apply the principles of the law to the scenario

1. It seems as though Priya is entitled to the agreed payment (known as 'commission') as she has done what was asked of her, including handing over the purchase price – she has earned her commission. It does not appear that she has gone beyond her authority as an agent and therefore the principal, Carlos, should not withhold payment. Regardless of whether there was a disclosed or undisclosed principal, Priya is entitled to payment from Carlos because she has performed her required duties.
2. The facts suggest that the buyer may not have known Priya was an agent and so Carlos may be an undisclosed principal. Carlos being an undisclosed principal may have no effect unless the buyer wishes to enforce the contract (that is, to take some legal action based on the contract). If this is the case, the buyer may have the right of election (i.e. the buyer can elect to pursue a claim against the agent or the principal but not against both) so either Priya or Carlos could be sued. As the buyer is unhappy with the car, there is a risk of Priya being sued unless the existence of a principal is known to the buyer. If Priya disclosed the principal then any compensation sought by the buyer from her is unlikely to be successful.

Remember to provide a conclusion to your answer that directly links back to the question and relevant area(s) of the law.



Key points

The main ideas covered in this chapter can be summarised as follows:

Law of agency

- An agent is a person who has the authority or power to act on behalf of another person, known as the principal.
- Questions of agency law often arise when an insurance intermediary makes a mistake or is generally careless in carrying out their duties.
- Agency may be created by agreement or consent, by ratification and by necessity.

The principal of an insurance agent

- An insurance intermediary may, at different times, act on behalf of both the proposer/insured and the insurer.

Duties of an agent

- The duties of an agent are to obey the principal's instructions; to exercise proper care and skill; to perform duties personally; to act in good faith towards the principal and to account for monies received on behalf of the principal.
- An insurance intermediary must exercise a level of care and skill that is appropriate for the class of agent they represent.

Imputed knowledge

- Under the law of agency, any knowledge which an agent possesses is imputed to the principal. This is of particular importance in relation to the duty of disclosure in non-consumer (business) insurance.
- The Insurance Act 2015 introduced a detailed section clarifying 'knowledge of insured'.

Rights of an agent

- The rights of an agent are the right to remuneration and the right to indemnity.

Authority of an agent

- Agents can have different types of authority:
 - actual authority (express or implied); or
 - apparent or ostensible authority.

Contract made by an agent

- Contracts made by the agent with third parties can be for a disclosed or undisclosed principal.
- Agencies can be terminated by agreement, performance, lapse of time, withdrawal of authority, renunciation by the agent, death of principal or agent, bankruptcy, insanity or frustration.

Self-test questions

1. The concept of agency is tripartite. What are the three relationships?
2. What types of authority might an agent have?
3. State three ways in which an agency may be created.
4. What conditions need to be fulfilled to achieve a valid ratification?
5. What is meant by an agent by necessity?
6. What is meant by 'imputed knowledge' in the context of the law of agency?
7. When may the agent delegate their duties?
8. What are the duties of the agent?
9. Against whom may the third party enforce the contract when the principal is wholly undisclosed?
10. How may an agency be terminated?

You will find the answers at the back of the book



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5

Insurance contract formation and insurable interest

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C The law on insurable interest	5.3, 5.6
D Application of insurable interest	5.3, 5.6
Key points	
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Learning objectives

After studying this chapter, you should be able to:

- understand how the general principles of contract law apply to insurance;
- understand the concept of insurable interest;
- distinguish between insurance and gambling agreements;
- explain the common features of insurable interest; and
- apply the principle of insurable interest to the major types of insurance and reinsurance.

Introduction

Refer to

Refer to chapter 3 for the law of contract

Please note that in the first section of this chapter we are concerned only with the way in which the general principles of the law of contract affect insurance policies.

Some general principles of insurance law differ from the principles of contract law. Throughout the M05 study text we highlight those differences where necessary.



Key terms

This chapter features explanations of the following ideas:

Acceptance	Contractual intention	Current interest	Insurable interest
Legal interest	Offer	Reinsurance	Renewal
Statute	Unilateral offer	Unlicensed insurers	

A Formation of an insurance contract – general principles

A1 Offer and acceptance in insurance

The rules of *offer* and *acceptance* which we examined earlier apply to insurance policies in the same way as they do to other contracts.



Consider this...

When will an insurance contract come into existence?

An insurance contract will, therefore, come into existence once the offer made by one party is unconditionally accepted by the other.

A1A Invitations to treat

You will remember, however, that we need to distinguish between true offers and invitations to treat which are merely invitations to the other party to enter into negotiations.



Consider this...

Can you think of an example of an invitation to treat in an insurance context?



Example 5.1

A prospectus published by an insurance company which contains details of cover and standard rates of premium is likely to be regarded as merely an invitation to treat.

A1B Who makes the offer



Consider this...

In a typical insurance transaction, when is the offer made? Who is the offeror and who accepts?

There is no definite rule as to which party (the proposer or insurer) makes the offer and which party accepts.

Sometimes the proposal form which is submitted to the insurer will be the offer and the insurer will accept it by confirming cover or issuing the policy. In other cases, the insurer may

quote a premium based on information supplied in the proposal form and, in doing so, make an offer which the proposer may then accept or decline.

Frequently, an insurance contract is finalised only after lengthy negotiations between the proposer and insurer, often involving a broker or other intermediary. In such cases, there may be a long series of offers, rejections and counter-offers before a firm acceptance of an offer is made by the counterparty.

Special case – the Lloyd's and the London market

Until 2007, insurance contracts used to be formed in the Lloyd's and London insurance companies' market by using a so-called 'slip'. A slip was a brief summary of the main terms and conditions of insurance. It was created for convenience and speed (so that the insurance could be placed quickly) and legally represented the initial contract of insurance. The contract of insurance used to be formed at the moment that the slip was scratched (signed and stamped) by the underwriter.

Importantly, the slip was later replaced (for example, six months later) by a second contract of insurance – referred to as the 'policy'. The policy set out the full terms and conditions of insurance (it was not a summary). The policy superseded the slip as the binding insurance document.

Problems arose when there was a conflict between the terms of the slip and the policy. In one famous case, the final policy wording was not agreed when terrorists attacked the World Trade Center on 11 September, 2001. The UK regulator then challenged the UK insurance industry in December 2004 to end the so-called 'deal now, detail later culture'. This led the market to develop what is known as the contract certainty project.

Contract certainty is achieved by 'the complete and final agreement of all terms between the insured and insurer at the time that they enter into the contract, with contract documentation provided promptly thereafter.' This means that the insured has greater certainty over what it has bought and the insurer has greater certainty over what it has committed to.

First, the Contract Certainty Code of Practice was adopted and then the Market Reform Contract – the 'MRC' – (a standard form of contract with a pre-defined layout and headings) was introduced to the market. Significantly, when using the Market Reform Contract there is only one insurance contract, and not two like the old days. This means that the placing document forms the final contract documentation.

A1C Is communication of acceptance necessary?

In principle, an offer cannot be accepted by doing nothing and that acceptance must generally be communicated to the other party.

Consider this...

When a motor policy is renewed (see [Renewal](#) on page 5/4 below for general points on renewal), a renewal notice containing a temporary certificate and cover note granting 15 days' limited cover will usually be sent to the insured. In what circumstances does the policy come into force?



If the insured does not receive the renewal notice, they cannot accept the offer of temporary 15 days cover which it contains. If they do receive it, however, it will be deemed that they have accepted the offer if they simply continue to use the car on the road.

A1D What must be agreed

An acceptance will be effective only if the parties agree on the essential terms of the contract.

In insurance, the parties must have reached *agreement* on:

- the nature of the risk and the subject matter of insurance (what is to be insured and what perils are to be covered);
- the duration of the contract; and
- the amount of the premium (or at least the method by which the premium is to be calculated).

Insurers need not, however, spell out to the proposer all the other detailed terms of the policy in advance, as long as it is clear that the insurance is to be on the basis of the insurer's usual form of policy for the sort of risk in question (such as private car or household contents). There is, in fact, a presumption in law that the proposer is applying for a policy in accordance with the insurer's usual terms and conditions. In practice, insurers will usually make this clear by means of a suitable statement on the proposal form.



Be aware

If there is no '*consensus ad idem*' ('meeting of minds') on some essential term of the agreement, a valid contract will not be formed.

We earlier referred to the general rule in contract law that it is not open to one party to unilaterally alter the terms of a concluded contract. Despite this, the Court of Appeal has accepted as legitimate the practice of 'signing down' each insurer's participation on a slip where the total subscription exceeds 100%. For example, an insurance company agrees to accept 12% of a risk, but because the risk is oversubscribed, the broker signs them down to just 10% of the risk.

The effect of signing down is to alter both the premium received by a particular underwriter and the extent of their risk; but the Court of Appeal decided that even though the slip is a concluded agreement, signing down was so common within Lloyd's and much of the market the broker's right to do it was an implied term of the contract.

Signing down is now an express contractual provision under the MRC.

A1E Renewal



Consider this...

What happens when an insurance contract is renewed?

When an insurance contract is renewed, a fresh contract is formed, normally on the same basis as the old one.

A fresh offer and acceptance are therefore required. The renewal notice which the insurer issues can be regarded as an offer which the insured can accept by payment of the premium, provided there are no changes in the risk. If the risk has changed in any material way, the business insured must notify the insurers of such changes (see chapter 6 on the pre-contractual information duties). In this case, the insured is making a counter-offer which the insurers may or may not accept.

In consumer insurance the insurer must ask the insured on renewal about the matters that the insurer wants to know, including if the risk is the same or if its nature has changed. Note that there is no duty of disclosure on the insured in consumer insurance.



Be aware

Whether a renewal notice is an offer or an invitation to treat depends on how it is worded and what the insured is required to do following the notice. If the insured is asked to pay the premium or if the insured wants to renew the policy, then the insured's renewal notice will be an offer and the insured accepts it by paying the premium. However, if the insurer is inviting the insured to make a fresh proposal, that might mean an invitation to treat. One must see what action is required by the insured after a renewal notice by the insurer.

Insurers are normally under no obligation to invite renewal of an annual policy. If renewal is not invited, there is, of course, no offer which the insured can accept.

A1F Unilateral offer

In *Danbol Pty Ltd v. Swiss Re International SE (2020) VSCA 274* the Victoria Court of Appeal (Australia) discussed whether an offer by the insurer to extend the cover after the expiry of the property insurance contract could amount to a unilateral offer.

In Danbol the insurers refused to renew the insurance policy on the same terms when the use of the property changed during the currency of the policy. However, on 24 August 2018,

the day the policy expired, they offered the assured a 14 day extension of the policy in return for a specified premium of \$3,506.06 'to assist with placement'.

Upon further communications, on 29 August 2018, the insurer offered an annual policy, and said that if that offer was not accepted the extra premium attached to the 14 day extension applied until 7 September 2018.

The property was damaged by fire around 05.00 on 30 August 2018. At 08.44 the assured purported to accept the renewal terms. The premium was sent on 2 October 2018 but was returned on 4 October 2018. The assured argued that the insurer made a unilateral offer which was capable of being accepted upon the payment of the premium, once the premium was paid, the insurer could not argue that they were not bound by their offer. The insurer argued that no new contract was formed after the previous policy expired.

The court found that by the 24 August email, the insurer offered to the assured a contract of insurance for 14 days' cover. The 14 day extension would have facilitated that process by ensuring that there was no break in cover.

A unilateral contract is one which creates obligations only on the offeror who promises to do something (e.g. make a payment) if the other party performs an act. However, neither the 24 August nor the 29 August email did amount to the offer of an insurer to provide cover in return for the payment of a premium as a unilateral contract in the relevant sense.

There was a mutual promise: the promise to provide cover in return for the promise to pay the premium. That does not describe a unilateral contract. Silence did not mean acceptance and acceptance may be proven through conduct where the conduct can objectively be capable of constituting and conveying acceptance in the eyes of a reasonable person in the position of the offeror. There was nothing in the assured's conduct that manifested with a sufficient degree of certainty that it had accepted the insurer's offer of a 14 day extension of cover.

A1G When does the risk begin to run?

Be aware

You should understand that although an insurance contract will normally come into existence once an offer is accepted, the cover may not operate immediately. The parties may well agree that the risk will begin to run at some date in the future, such as when an existing policy with another insurer expires. In this case, there is a binding contract to insure but the risk has not yet attached. Sometimes insurers stipulate that the risk will run on actual payment of the premium.



This point is considered below.

Activity

Obtain a copy of a typical policy used by an insurer. Does it specify when the contract becomes operative?



A2 Contractual intention and insurance

No legally binding contract will be formed unless the parties intended to be legally bound. In the case of non-consumer (business) agreements, *contractual intention* is usually presumed to exist unless there is strong evidence to the contrary.

Insurance contracts, as commercial transactions, are almost invariably intended by the parties to be legally binding. Only under the most unusual circumstances would the case be otherwise.

A2A Consideration and payment of the premium

Consider this...

What is consideration? How would consideration apply in an insurance contract?



You will recall that under English law, a promise is not legally binding unless it is supported by consideration, i.e. unless something of value is given in exchange for it.

The rules of consideration apply to insurance in the ordinary way. The consideration furnished by the insured in an insurance contract is, of course, the premium payable and that given by the insurer is the promise to pay claims, in other words, the cover which is provided.

Unless the parties have agreed otherwise, the risk is attached even though the premium has not been paid. We have stated earlier that, while a valid contract of insurance will come into force once an offer has been accepted, the risk may not attach immediately. Equally, it is important to understand that under English law, a valid insurance contract may exist before the insured has actually paid the premium, provided they have agreed to pay.



Be aware

A promise to pay is as good a consideration as payment itself.

However, we have also suggested earlier that insurers may stipulate that the risk will not run until the premium is paid. In this case, actual payment is required before insurers can incur any liability under the contract.

We have seen that an insurance policy will be invalid if the essential terms have not been agreed and, for obvious reasons, the parties to an insurance contract will generally fix the amount of the premium before the contract is concluded.



Be aware

It is well established, however, that an insurance contract can be made at 'a premium to be agreed'. In this case, the exact amount of the premium is to be fixed after the contract has come into force.



Example 5.2

In marine insurance, insurers often agree in advance to extend the policy to cover some risks excluded from the original contract if the need arises, in exchange for an additional premium.

A2B Return of premium under insurance contracts

Although this part of the study text is concerned mainly with the formation of insurance contracts, it is convenient to look at the general rules regarding return of premium at this stage.

Some types of policies, and consumer policies, should allow a proportionate return of premium on early cancellation. In absence of such an express right, the insured has no entitlement to a rebate. This is because the obligation to pay the premium (as a whole) arises at the outset of the contract when the insurer started to provide the cover. The premium is, in principle, indivisible that the insurer is entitled to receive the entire premium for the coverage, even if the insurer is on risk for a short period of time.

The parties may amend this by providing that the premium will be paid in instalments and/or if the contract ends prematurely the premium will be returned to the insured pro-rata if the insured had already paid the whole premium. The parties may also agree that if the contract ends prematurely the insured's premium payment obligation will cease, but the insured will be responsible for the premium for the period that the insurer provided cover.

However, if the insurers have never been at risk at all, the insured is entitled to recover their premium. This is an example of where there has been a 'total failure of consideration', which means that the insured has never had anything of value in return for their own payment.



Consider this...

In what situations might a risk fail to run?

The risk may fail to run, resulting in a total failure of consideration, for a number of reasons:

- the proposal may be withdrawn after the premium has been paid;
- the policy may be void by mistake or because there was no *consensus ad idem*;
- the policy may be void because there is no *insurable interest*; and
- the policy may be avoided *ab initio* because the assured negligently breached the duty of fair presentation of the risk.

Be aware

The pre-contractual information duty and remedy for breach of the duty are analysed under different principles in business and consumer insurance.



We will see in chapter 6 that there are special provisions regarding return of premium for breach of the duty of fair presentation of the risk. For instance, the insurer does not have to return the premium if the assured's breach is either deliberate or reckless.

There are also special rules concerning life insurance policies where there is no insurable interest, which we will consider in [Waiver of insurable interest](#) on page 5/18.

Refer to

Refer to [Illegality in insurance contracts](#) on page 3/23 for illegality

A policy may also be void for illegality and, in this case, the insured will usually have no legal right to recover the premium.

Cancellation clauses

As previously mentioned, the general principles on the premium payment obligation and the return of the premium, can be modified by the terms of the contract. In particular, insurers will often allow a partial return of premium when a policy is cancelled mid-term, even though the risk has obviously started to run in this case.

- **Cancellation by the insurer**

Insurers often include a clause allowing them to cancel the policy mid-term, having given the required period of notice to the insured. In such cases a pro rata return of premium is likely to be granted.

- **Cancellation by the insured**

The insured may also be given the right to cancel the policy although something less than a full pro rata return is usually then allowed.

Be aware

Some insurers give no specific rights of cancellation to the insured in the contract but, in practice, allow a return of premium where, for instance, the property insured by the policy is sold.



Activity

Look at one of your own personal insurance policies, for household contents or motor cover. In what circumstances can you as the insured cancel the contract? What does it say about return of premium in that situation? Can the insurer cancel? What notice do they need to provide?



A3 Formal requirements of insurance contracts

Insurance cover may be given orally (often by telephone) and, although a written policy is eventually issued in almost every case, a claim may well happen before the policy is prepared.

A few exceptional cases of insurance contracts (e.g. marine insurance) where some formality is required by law are given in the following.

A3A Contracts by deed

There is no legal requirement for any type of insurance contract to be in the form of a deed.

A3B Insurance contracts which must be in writing

The only type of insurance contract which must be in writing is a marine insurance policy (**Marine Insurance Act 1906**, s.22). To comply with the Act, however, the policy need only specify the name of the insured or their agent, be signed by or on behalf of the insurer and specify the subject matter of the insurance with reasonable certainty.

Note that a contract of marine insurance may be formed without the existence of the policy but, in order to be able to make a claim against the insurer, the insured must hold a policy. In other words, a policy document is required to make a claim but not for a valid contract which may exist before a policy is issued.

A3C Insurance contracts which must be evidenced in writing

Contracts of guarantee must be evidenced in writing, under the Statute of Frauds 1677, s.4. This provision may apply to some fidelity guarantee insurances but not to all of them, since modern fidelity policies are often contracts of insurance only and not contracts of guarantee.

A3D Other insurance contracts where written documentation is required

In motor vehicle insurance, s.143 of the **Road Traffic Act 1988 (RTA 1988)** requires a 'policy' of insurance to be in force before a motor vehicle is used on a public road. Section 147(1) of the RTA 1988 used to provide that the policy is of no effect unless and until a certificate of insurance is delivered to the policyholder. However, this was amended by s.9 of the **Deregulation Act 2015** so that the failure of an insurer to deliver a certificate no longer affects the validity of the insurance.



Activity

Look at your personal motor policy. Identify the policy and the certificate. What do you need to provide as evidence of insurance if requested for an official purpose such as taxing the vehicle?

Refer to

Refer to [Life Assurance Act 1774](#) on page 5/15 for the Life Assurance Act 1774

Life insurance contracts are also subject to some formal rules.

Section 2 of the **Life Assurance Act 1774** requires that the policy shall contain the name of the person interested in it (which suggests the need for a formal policy). Other legislation may require insurers to send to the insured a statutory notice advising them of their right to cancel the policy within a 'cooling-off' period.

A4 Capacity to contract

We noted in [Contractual capacity](#) on page 3/11 that the validity of a contract depends on the parties having full legal capacity to contract and that special rules apply to some people and organisations. We will now consider how this affects insurance.

A4A Insurance contracts made by minors

An insurer who grants cover to a minor is fully liable to meet all valid claims under the policy.

We have seen, however, that the minors themselves are only fully bound by contracts for necessities and beneficial contracts (such as employment): other contracts either do not bind them or are voidable by them.

It follows that an insurer cannot enforce an insurance contract against a minor by suing them for the premiums which are owing, unless the contract is for necessities or is beneficial as defined earlier. Few insurance contracts are likely to fall in these categories.



Consider this...

Can you think of any insurance policy that could be held to be for necessities?

Motor policies may well be necessities since they are compulsory for motorists of any age.

In theory, other insurances could be ‘necessaries’ if they are particularly suited to a minor’s station in life but there are few legal decisions on this point.

In practice, the fact that most insurance policies are either unenforceable against the minor or voidable by them does not create major difficulties. A minor will not be able to recover premiums which they have paid unless there has been a ‘total failure of consideration’, that is, the other party has given nothing of value in return. This means that once the risk has started to run and the minor has had the benefit of some cover, they cannot reclaim their money simply by repudiating the contract. Equally, if a minor refuses to pay the premium, their insurers are under no liability to pay a claim.

A4B Patients with a mental disability and drunken persons

You will recall that the rules affecting drunken persons are similar to those governing patients with a mental disability. The drunken person or patient can avoid the contract only if, at the time of making it, they did not understand what they were doing, and the other party knew of this.

Disputed cases of insurance being sold to mental patients or drunken persons are, thankfully, few.

A4C The contractual capacity of insurers

Refer to

Refer to [Legal personality](#) on page 1/37 for corporations and their formation

Insurers (other than individual Lloyd’s underwriters) are, of course, corporations. Most UK insurance companies are now created by registration under the **Companies Acts**, although in the past some were formed directly by *statute* or Royal Charter. The general rules outlined earlier, thus, apply.

Rather more important for the purpose of this subject, however, is the legislation which has been enacted specifically to regulate the activities of insurers. Policyholders are likely to suffer if an insurer becomes insolvent and, to reduce the risk of this happening, insurers in the UK have been subject to government supervision in one form or another for over 100 years.

Be aware

The main statutes covering insurance companies are now the **Financial Services and Markets Act 2000** and the **Financial Services Act 2012**.



Industrial insurance companies, friendly societies, trade unions and the like are governed by their own legislation, and Lloyd’s is largely self-regulating.

Unlicensed insurers

Before they can write insurance business, companies must obtain authorisation (i.e. a licence) from the UK regulator for the class or classes of business which they wish to transact.

This rule was, however, effectively reversed by the **Financial Services Act 1986**. In general terms, this Act allowed the insured to choose whether to enforce the contract and, if they chose not to do so, they could reclaim their premium. The insurer could enforce the contract only at the discretion of the court. As in the case of the **Insurance Companies Act 1982**, the Financial Services Act 1986 has been superseded by the Financial Services and Markets Act 2000.

Increasingly, European insurance companies are operating in a number of Member States. Provided an insurer is authorised in one Member State, it will be allowed to sell most forms of insurance elsewhere within the European Economic Area, under the supervision of the regulator in the ‘home’ state. Those insurers operating in this way are said to be exercising their ‘EEA passport rights’. Insurers based outside the EEA and wishing to operate within the UK must be licensed in the usual way.

Under the Financial Services Act 2012, the financial services sector in the UK is regulated by two bodies: the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

The PRA authorises financially important firms such as banks, building societies and insurers (both general and life insurers). It also regulates them for prudential issues (capital/solvency etc.). The FCA authorises smaller firms such as financial and insurance intermediaries and regulates them for prudential issues. The FCA regulates **all authorised firms** for conduct of business issues.

You should keep up to date on the progress of this regulatory regime in the trade and financial press.



On the Web

See also the regulators' websites:

www.fca.org.uk

www.bankofengland.co.uk/pru

For instance, the FCA has recently introduced a new Consumer Principle that requires firms to act to deliver good outcomes for retail customers. The new principle will set higher and clearer standards of consumer protection across financial services, including insurance, and require firms to put their customers' needs first. Firms are required to implement the new consumer duty in their businesses by July 2023. This will be discussed in detail in *Insurer's duty of good faith in claims handling* on page 6/19.

B Insurable interest

An agreement to insure must satisfy all the requirements as to offer and acceptance, consideration, capacity and form which were discussed in the first part of this chapter. However, even if these requirements are fulfilled, the contract may still fail if the policyholder has no valid interest in the insured subject matter (for example, property or life or liability) which they wish to insure. This is 'insurable interest'.



Be aware

Insurable interest, in the simplest terms, means that the policyholder must be in a position where they will suffer loss if the event which they have insured against occurs.

In other words, in the simplest terms, insurable interest means that the policyholder must be in a situation where they would experience a loss if the insured event takes place.

B1 Definition

There is no single definition of insurable interest but the following covers its essential elements:

The legal right to insure arising out of a financial relationship recognised at law, between the insured and the subject matter of insurance. This could be a proprietary right or some other types of right. What is required is if the insured will suffer financial loss as a result of loss of, or damage to, the subject matter insured.

B2 Key elements

The key elements of insurable interest are as follows:

- a subject matter of insurance;
- the policyholder must have an economic or financial interest in the subject matter of insurance;
- the interest must be a *current interest*, not merely an 'expectancy'; and
- the interest must be a *legal interest*.

Each of these is considered in turn.

B2A Subject matter

The term 'subject matter' can refer to two things.

Be aware

It is important to understand that when a person arranges insurance on, say, their house, they are insuring not the property as such but their interest in that property. Although the property is the subject matter of insurance, it is this interest which is the subject matter of the contract.



Example 5.3

This concept was expressed neatly by Brett LJ in the case of *Castellain v. Preston* (1883):



...what is it that is insured in a fire policy? Not the bricks and materials used in building the house but the interest of the insured in the subject matter of insurance.

In fact, the most straightforward example of insurable interest is the interest which a person has in property which they own, such as a house (as in the quotation earlier) or a car or other goods. The owner has an interest because destruction of, or damage to, the property will obviously cause the owner loss.

Furthermore, ownership is an interest which is recognised and protected by law. This point is discussed below.

In many cases, the subject matter of the insurance will be something other than material property; it may be human life (in the case of a life insurance policy) or something intangible, such as a debt.

Equally, the interest which is the subject matter of the contract may not be that of a property owner – it may be that of a mortgage lender, or a lessee (tenant). In the case of life insurance, the interest protected by the policy may be that of the husband or wife of the life insured or that of the creditor to whom the life insured owes money.

B2B Economic or financial interest

As we have suggested earlier, the doctrine of insurable interest requires there to be a relationship between the insured and the subject matter of insurance whereby the insured will suffer a financial loss if the insured event occurs.

Although the insurance policy must specify the subject matter of the insurance, the insured need not specify the exact nature of their interest in it, or the amount of their interest, at the time of the contract. However, the interest must be one that is reasonably capable of valuation in money.

In some cases, this is straightforward as in the case of tangible things such as material property or the liability to pay damages to another. In the case of life insurance, it may be more difficult to assess the value of the interest.

Consider this...

What is the value of someone's interest in their own life?



Example 5.4

It is impossible to place a value on one's own life or on the life of one's spouse. As such, the law presumes the interest to be unlimited.



In other cases, such as the interest of a creditor in the life of a debtor, the interest is easier to measure.

B2C Current interest, not merely an ‘expectancy’

English law requires that a person has a current (or present) interest in the subject matter of insurance. A mere hope or expectation of acquiring an interest in the future is not enough.



Example 5.5

The leading case is *Lucena v. Craufurd (1806)*. Here, the Crown Commissioners insured a number of enemy ships which had been captured in the Napoleonic wars when they were still on the high seas.

The authority of the Commissioners to take charge of the ships began only when the vessels reached port and so the court held that the Commissioners had no interest in ships which were lost before they did so. Up until that point, they had merely an expectancy of taking charge of the vessels. One of the judges in the case put forward the following example to illustrate the point:

...suppose the case of the heir at law of a man who has an estate worth £20,000 who is ninety years of age, upon his death bed intestate, and incapable from incurable lunacy of making a will, there is no man who will deny that such an heir at law has a moral certainty of succeeding to the estate, yet the law will not allow that he has any interest, or anything more than a mere expectation.

In other words, it might appear absolutely certain that the heir will inherit the property, but until they actually do so, they have nothing more than an expectancy.

The precise time at which the interest must be present varies according to the class of insurance. The insured need not necessarily have an insurable interest throughout the duration of the contract in every case.

The rules vary according to the class of insurance, and we will look at these in more depth in *The law on insurable interest* on page 5/15.

B2D Legal interest

In England, the interest must also be a legal (or equitable) interest, that is, one that the law recognises and will support.



Example 5.6

In the case of *Macaura v. Northern Assurance Co. Ltd (1925)*, Macaura had insured a quantity of timber on his estate under a fire policy in his own name. He had already sold the timber to a company of which he was the only shareholder. When the timber was destroyed in a fire, the insurers refused to meet the claim on the grounds that Macaura had no insurable interest in the assets of the company. The House of Lords supported the insurers, holding that the insured had an interest in his shares but none in the timber which was owned by the company, a separate legal entity. The fact that the insured would clearly suffer an economic loss as a result of the fire, because the value of his shares would go down, was regarded as insufficient to give him an insurable interest.



Be aware

It is worth noting that in a number of countries where the legal system is based on English law the *Macaura* principle has been rejected, abandoned, or never adopted. They include the USA, Australia and Canada. Generally, in these countries an economic or financial interest in the subject matter is required, but a legal or equitable interest is not.

Although there are some cases in which insurable interest has been narrowly interpreted, they are rare and, generally, insurable interest is defined broadly. There are many examples that demonstrate this – one of the most recent being the case of *Comlex Ltd v. Allianz Insurance Plc (2016)*.

Example 5.7

Comlex v. Allianz (2016) concerned a pub which was owned by a company that went into liquidation due to financial difficulties. The liquidators agreed to sell the pub to B, who had been a manager at the pub, and insisted that B obtain buildings insurance for the pub. The pub was destroyed in a fire prior to the completion of the sale. B's insurer asserted that B had no insurable interest and therefore did not have to meet the claim. The Court of Session, however, ruled that B did have an insurable interest as the evidence indicated that B and the liquidator had entered into a binding agreement under which B was granted a licence to use the property pending the purchase (on the condition she obtained insurance).



Example 5.8

In **Quadra Commodities SA v. XL Insurance (2022)** the insurance was on the commodities of grain that the assured purchased from a seller in Ukraine. The insurance covered 'all physical damage and/or losses, directly caused to the insured goods by misappropriation.'



The assured suffered loss as a result of the seller's fraud that the same cargo was sold to several different buyers. The assured was unsuccessful in recovering the cargo from the sellers who disappeared following the fraud. In a claim against the cargo insurers insurable interest was discussed because the policy was an insurance on property and if no property existed, there was no cover.

The court, however, found on the facts that there were goods in the various warehouses when the warehouse receipts were issued. Importantly for the subject of this chapter, the judge adopted the broad concept of insurable interest that the buyer in this case, by virtue of the contracts and the payment under them, **stood in a legal or equitable relation**, so that they buyer had insurable interest. This was so because the assured buyer might benefit from the safety of that property or might be prejudiced by its loss. Additionally, the judge found that an immediate right to possession of goods also gave the assured an insurable interest.

B3 Why does the law require insurable interest?

There are two main reasons why the law requires insurable interest:

- to reduce moral hazard; and
- to discourage wagering.

B3A To reduce moral hazard

A moral hazard is a situation in which a person with insurance takes greater risks than they normally would without insurance. This is because they know their insurer will foot the bill if something bad happens.

Moral hazard arises when the granting of insurance actually increases the likelihood of a loss occurring, because it changes the incentives and behaviour of the insured.

Example 5.9

The insured may become less careful than they would be if they had no insurance or even cause a loss deliberately in order to collect the insurance money.



On the face of it, the right to insure property in which one has no interest (such as a house or car belonging to a neighbour) could have exactly this effect. At worst, it might tempt the policyholder to commit arson or other destructive acts in order to get the insurance money. The same is true in the case of life insurance, because an unlimited right to insure the lives of other people might provide a motive for murder.



Be aware

Of course, the risk of this happening now is much lower than it might have been in the early years of insurance, when techniques for the detection of crime were far less sophisticated than those of today.

B3B To discourage wagering

Society has often tried to suppress, or at least control wagering (or gambling). Although gambling may provide a useful source of government revenue (!) its effects can be economically damaging and socially harmful.

In the past, insurance policies were often used as a 'cloak' for gambling. As we shall see, it was this irresponsible use of insurance as a means of betting on the lives and property of others that led Parliament to discourage the practice by imposing a need for insurable interest.

In fact, the presence of insurable interest is the key difference between an insurance policy and a wager, but there are other differences, which are summarised in the following table.

Insurance and wagers	
Insurance contract	Wagering contract
The insured is required to have a financial interest in the subject matter of the contract.	The interests are limited to the stake to be won or lost.
The object is to protect the insured against loss and their identity is known before the event.	Either party may win or lose and the loser cannot be identified until after the event.
The insured is under the pre-contractual information duty.	Full disclosure is not required of either party.
In most cases, payment is made only by way of indemnity – i.e. for a loss which has been incurred.	The stakes are not paid by way of indemnity. Payment is made without suffering loss beforehand.
The contract is enforceable by law.	Neither party can enforce the contract in court.

B4 Creation of insurable interest

There are a number of ways in which insurable interest may arise.

B4A Common law

In some cases, insurable interest is automatically presumed to exist.



Example 5.10

- Every person is presumed to have an unlimited interest in their own life. Where an interest is automatically assumed we can describe it as having arisen at common law.
- Ownership: ownership of a car carries with it the right to insure.

B4B Contract

In some cases, a person will agree to accept responsibility for something for which they would not ordinarily be liable.



Example 5.11

The landlord, rather than the tenant, is normally liable for the maintenance of the property which they own. The lease, however, will often contain a condition which makes the tenant responsible for the maintenance or repair of the building. Clearly, a term of this sort in the lease will give the tenant a financial interest in the property which is insurable. Moreover, the lease may make the tenant liable to pay rent even if the building is uninhabitable, which further supports their interest.

The landlord, rather than the tenant, is normally liable for the maintenance of the property which they own. The lease, however, will often contain a condition which makes the tenant responsible for the maintenance or repair of the building.



Be aware

It is worth mentioning that the insurable interest which supports *reinsurance* (discussed later) is contractual because the liability of reinsurers to make payments to the original insurers arises out of the agreement contained in the reinsurance contract.

C The law on insurable interest

A description of how the law on insurable interest developed will help us to understand how its rules apply to different classes of insurance.

As we have seen, an insurance policy may be little more than a bet or wager if there is no insurable interest. In the early days of insurance, life and marine policies were enforceable under common law even if there was no insurable interest, largely because wagers in general were legally enforceable. Fire insurance was the only other common class before the nineteenth century and, although the legal position regarding fire policies is less clear, insurable interest may in this case have been a common law requirement.

This general freedom to insure was often abused and, in particular, the practice of insuring the lives of famous persons (including that of the reigning monarch) became a scandal in the end. In some cases, the activity may have been encouraged by newspapers which published odds on the chance of survival of famous people who were known to be ill. The result was legislation, which was first applied to marine insurance and then to other classes.

C1 Marine insurance

The statute currently governing marine insurance is the Marine Insurance Act 1906, s.4 of which makes marine policies void in the absence of insurable interest.

The Act also provides a useful definition of insurable interest:

In particular a person is interested in a marine adventure where he stands in a legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof.

Time when interest is required

The Marine Insurance Act 1906, s.6 provides that the insured must be interested in the subject matter insured at the time of the loss. There is no requirement of insurable interest when the contract is made, and it does not matter that the interest has ceased since the time of the loss.

Section 6 also allows the subject matter of a marine policy to be insured 'lost or not lost', which means that it is possible for the insured to claim under a marine policy even if they acquired their interest after the loss occurred, unless they were aware of the loss and the insurer was not.

These rules reflect the practices of marine trade where cargo frequently changes ownership in the course of transit. When this happens, the marine insurance policy is assigned to the new owner along with other documents that are part of the transfer of title (ownership) of the goods. As such, the buyer is protected by the policy even though they acquired their interest in the goods some time after the policy was originally effected and even if, unknown to them, the cargo has already been lost.

C2 Life and other classes of insurance

The following section outlines those statutes which relate to classes of insurance other than marine.

C2A Life Assurance Act 1774

In its preamble, the Life Assurance Act 1774 condemns the practice of a 'mischievous form of gaming' on lives; it is often referred to as the Gambling Act. Section 1 prohibits the making of any policy:

...on the life or lives of any person or persons, or on any other event or events whatsoever, wherein the person or persons for whose use, benefit, or on whose

account such policy or policies shall be made, shall have no interest, or by way of gaming or wagering.

There are four major provisions in the Act:

- The person benefiting from the insurance must have an insurable interest in the life or event insured. If there is no insurable interest the contract is void (s.1, earlier).
- The name of the person for whose benefit the policy has been effected must appear in the policy (s.2).
- The insured can recover no more than the amount of the value of their interest (s.3).
- The Act does not apply to insurances on ships, goods or merchandises (s.4).

Life policies are governed by the Life Assurance Act and policies on 'goods and merchandises' are specifically excluded.



Be aware

There is some doubt, and there has been much debate, as to whether the 1774 Act applies to other non-marine insurances and, in particular, whether it applies to the insurance of real property (land and buildings) (see [Other insurances](#) on page 5/18).

Time when interest is required

In life insurance, insurable interest is required at the time when the contract is made – i.e. at inception. However, there is no requirement to prove an interest when a claim arises on death or maturity of the policy.



Example 5.12

This was established in the case of *Dalby v. The India and London Life Insurance Company (1854)*. In fact, Dalby involved the reinsurance of a life policy rather than life insurance itself. The claimant's company had insured the life of the Duke of Cambridge and reinsured the risk with the defendant reinsurer. Although the original insurance was cancelled, the reinsurance contract was kept in force until the Duke died. The defendant reinsurer then denied liability on the grounds that the claimant no longer had an interest because, the original insurance having been cancelled, they themselves did not have to pay out. The court ruled that the requirements of the Life Assurance Act 1774 were satisfied because it did not require that the interest, necessary at inception, should still exist at the time of the loss.



Consider this...

What is the basis for this decision? Why should this be the case for life insurance?

These principles are sound because life insurance premiums are fixed at the beginning of the contract on actuarial principles according to the probable life expectancy of the person whose life is insured. In any event, modern life insurance policies are often really savings plans in which the insurance element is small in relation to the investment content. The absence of any need for an insurable interest at the time of the loss makes for flexibility in transactions involving life policies of this sort, allowing them to be sold or auctioned to persons who have no interest in the life insured.

Finally, you should note that the same principles apply to insurance against death in a personal accident policy.

C2B Insurance policies on goods

Insurance policies on goods are not subject to any statutory requirement of insurable interest (other than on goods involved in a marine adventure which are governed by the Marine Insurance Act 1906).

This class includes insurances on home contents and personal possessions, non-consumer (business) property insurances (other than those on buildings), and goods in transit insurances. Motor policies have also been classed by the courts as insurances on goods, at least where some cover for damage to the insured vehicle is provided by the policy.

C2C Legislation on gambling – the Gaming Act 1845 and the Gambling Act 2005

Although there is no statutory requirement for insurable interest for policies on goods, until recently these insurances (and, indeed, all insurances) were subject to the **Gaming Act 1845**. Section 18 made all contracts by way of gaming or wagering void. The Act probably had the effect of invalidating any insurance policy where the insured had no connection with the subject matter and, possibly, where the amount of insurance was out of all proportion to the value of the subject matter.

In 2007, the law of gambling changed significantly when the **Gambling Act 2005** came into force. The Act provides that '**the fact that a contract relates to gambling shall not prevent its enforcement**'. The effect of this, apparently, is to bypass the need to prove an insurable interest in policies on goods and, possibly, bypass the need to prove an insurable interest in relation to any policy which is neither life nor marine (including policies on real property).

C3 Effect of the principle of indemnity

Refer to

Refer to chapter 9 for property insurance and indemnity

Although the Gambling Act 2005, at first sight, appears to undermine the principle of insurable interest, we should also bear in mind that property insurances are contracts of indemnity. This means that the insured cannot in any case recover more than the amount of their actual loss unless the insurers have agreed to provide insurance on a more generous basis.

C4 Effect of a policy without interest

Where there is no insurable interest, the contract is generally void.

Consider this...

What is the effect of a void insurance contract? If the insurer later determines that there was no insurable interest, what will this mean for the policyholder? Think about this in the context of events that take place after inception, and the policyholder's obligation to pay insurance premiums.



Refer to

Refer to *Effects of illegality* on page 3/23 for *in pari delicto*

You will recall that money paid under a void contract is usually recoverable, which means that a policyholder who has paid the premium for a void insurance policy should be able to recover it and payments made by an insurer under such a policy should also be recoverable. However, policies governed by the Life Assurance Act 1774 are, technically at least, illegal as well as void. You may now also recall that money paid under an illegal contract cannot be recovered in court provided the parties are '*in pari delicto*' ('equal in wrongdoing'). In this case, the insured may not, as a matter of law, be able to recover the premium that it has paid.

Example 5.13

In the case of ***Harse v. Pearl Life Insurance Co. (1904)***, an insurance policy on the life of the policyholder's mother was held to be illegal for lack of insurable interest. The mother lived with her son and kept house for him, and he insured her life for the express purpose of funeral expenses. However, the insurance was held void for lack of insurable interest because the mother had no legal obligation to keep house for her son and he, in turn, had no legal obligation to bury her when she died. The result was that he could not recover his premiums.





Be aware

In reality, insurers will rarely risk their good name by refusing to return premiums in cases like this, and the Financial Ombudsman has made it clear that they should not do so.

Of course, the same principles apply to cases where the insurer has made a payment to the insured under a contract that is void and illegal for lack of insurable interest.

C5 Other insurances

Under the **Marine Insurance (Gambling Policies) Act 1909**, it is a criminal offence to take out or effect a marine insurance policy without insurable interest. However, the passing of the Gambling Act 2005 has complicated the issue of whether insurable interest is still required under any type of insurance contract. As we discussed in *Life and other classes of insurance* on page 5/15, the Gaming Act 1845 had previously disallowed insurance policies that were taken out for the purposes of gaming or wagering. The Gambling Act 2005, however, introduced a new rule that 'the fact that a contract relates to gambling shall not prevent its enforcement' (s.335(1)). This brought about the question of whether it was permissible to have insurance policies without insurable interest.

Section 335(2) of the Gambling Act 2005 states that this rule is '**without prejudice to any rule of law preventing the enforcement of a contract on the grounds of unlawfulness (other than a rule relating specifically to gambling)**'. Therefore, if a statute renders an insurance policy without insurable interest unlawful, the statute still survives after the Gambling Act 2005. The exception to this is: 'other than a rule relating specifically to gambling'. In other words, if the statute is specially related to gambling, the new rule under the Gambling Act 2005 applies and the contract will be enforceable.

The question of whether insurable interest is still required after the Gambling Act 2005 is confusing due to the way the Act is drafted. It would be safer to assume that since the Act did not expressly repeal the legislation that requires insurable interest, in those areas, insurable interest is still required. But there is no certain view on this.

Section 4 of the Life Assurance Act 1774, which excludes insurances on 'ships, goods and merchandises', does not refer to insurance on land and buildings. It may be inferred that the Act extends to non-life insurance other than that of ships, goods and merchandises. However, a policy may insure more than one interest though all the interested parties' names may not appear in the policy. For example, in the case of insurance of a property by a landlord for the benefit of themselves or their tenant, or the insurance of a property by the trustee. It would therefore seem that policies on land and buildings are governed by the same rules as those relating to policies on goods.

In theory, insurable interest may be waived in other types of policies where lack of insurable interest does not render the policy either null or void or unlawful. However, this should not matter much in practice as the insured nevertheless remains under an obligation to prove their loss following the occurrence of the insured peril. If the insured cannot prove their loss, the common law principle of indemnity prevents recovery.

C6 Waiver of insurable interest



Consider this...

We have seen that the law imposes a requirement of insurable interest; but can insurers simply waive this requirement – i.e. agree to do without it?

In the case of marine insurance, which is governed by the Marine Insurance Act 1906, and life insurance, governed by the Life Assurance Act 1774, the requirement cannot legally be waived. However, this does not mean that insurers may not issue policies where there is doubt about the existence of an interest, but simply that such policies cannot be enforced in court.

In fact, there is often a business need for insurance cover in circumstances where it would be difficult to prove an insurable interest.

Example 5.14

- 'PPI' policies, where the insurers expressly agree to dispense with the need to prove any interest are common in the marine market, even though the Marine Insurance Act 1906 specifically declares them void.
- Life insurance policies are often issued in cases where, strictly, there may be no insurable interest in law.



These arrangements work because the insurers can be relied upon to honour the policy. Only in unusual circumstances (such as when the insurer has become insolvent and its affairs are in the hands of a liquidator) is payment likely to be refused. As noted in *Other insurances* on page 5/18, it will also be necessary for the insured (or beneficiary) to be able to demonstrate their loss in the event of a claim – the insurers in these cases are therefore waiving the need to prove the insurable interest at the point of inception, rather than dispensing entirely with the need for such an interest.

C7 Reform of insurable interest (life and life-related insurance)

The English and Scottish Law Commissions consulted on insurable interest both by an Issues Paper in 2008 and as part of their consultation paper, 'Insurance Contract Law: Post Contract Duties and other Issues' in 2011. The Law Commissions sought views on updated proposals in March 2015 and published a draft bill designed to give effect to their proposals in 2016.

Following feedback on the bill, another version was published in June 2018.

As of December 2024, there have been no further developments on the draft bill.

The key points to be aware of are as follows:

- The Insurable Interest Bill only applies to life and life-related insurances (where the insured event is 'death, injury, ill health or incapacity of an individual'). The previous 2016 draft did address non-life insurance contracts but, following feedback, the Commissions accepted that there was little need for legislative reform in this area.
- The bill confirms that life-related insurance is void unless at the time the insured enters into the contract, the insured has an insurable interest in the individual who is the subject of the contract (cl.2(1)).
- Under cl.6 of the bill, s.1 of the Life Assurance Act 1774 will be repealed to the extent that it applies to life-related insurance contracts, and s.2 and s.3 are repealed entirely.

Clause 2 provides a non-exhaustive list of cases in which insurable interest may be proved in life-related insurance.

Clause 3 regulates return of the premium if the insured makes an untrue or misleading statement about their insurable interest in entering into the contract. If the insured is not a consumer, the insurer does not have to return the premium as a result of the contract being void. However, in consumer insurance, the return or non-return of premium will be subject to a fairness assessment.

Be aware

The 2018 draft bill does not apply to general (non-life) insurance.



On the Web

To keep up to date with changes, visit: www.lawcom.gov.uk/project/insurance-contract-law-insurable-interest



The Law Commission wishes for the draft bill to be enacted by the special parliamentary procedure for uncontroversial Law Commission bills.

C8 Rules on insurable interest around the world

It should be noted that the rules governing insurable interest vary significantly across jurisdictions worldwide. While the fundamental principle of insurable interest – to ensure that an insurance contract represents legitimate risk transfer rather than gambling – is widely recognised, the specific rules and requirements differ based on the legal frameworks of each country. In addition, certain jurisdictions, like Australia, have abolished the requirement for an insurable interest.

D Application of insurable interest

The application of the doctrine of insurable interest in various classes of insurance is considered next.

D1 Life insurance

The following are the main examples of insurable interest in the field of life insurance. They fall in two broad categories.

1. The first category covers relationships where a precise financial interest might be difficult to establish, but an insurable interest is, nevertheless, presumed to exist because there is a natural tie of love and affection between the parties. These are described as 'family relationships'.
2. The other broad category is 'business relationships' where a financial interest in the life of another arises from a non-consumer (business) contract or from other non-consumer (business) dealings.

D1A Family relationships

Own life	Every person is presumed to have an unlimited insurable interest in his or her own life.
Spouses	Husband and wife have an unlimited insurable interest in the life of each other. This common law rule is supplemented by the Married Women's Property Act 1882 . Section 11 allows a married woman to insure her own life or the life of her husband for her own benefit. It also provides that a policy taken out by a man for the benefit of his wife or children, or by a woman for the benefit of her husband or children creates a statutory trust of the policy. The effect is that the policy money will pass to the beneficiaries free of any debts of the insured.
Other family relationships	Under English law, no other family relationship automatically gives rise to an insurable interest. So, for example, a parent cannot legally insure their child and a child cannot insure their parents.



Be aware

We should note at this point that English law presumes the existence of an insurable interest only in the small number of family ties mentioned above.

It may be possible to insure members of one's family if a business relationship or some other form of financial reliance exists. However, in this case, it is the business relationship that creates the interest, not the family tie.

Business relationships are discussed next.

D1B Business relationships

There are many business relationships that could give rise to an insurable interest. The main examples are discussed below.

- **Partners**

Partners have an insurable interest in each other's lives up to the amount of any loss or expense that might arise from the death of a partner.



Example 5.15

Partners may be legally obliged to buy each other out on the death of one of them, giving them an insurable interest in each other's lives.

- **Employer and employee**

An employee can insure the life of their employer. However, strictly speaking, their interest is limited to a sum representing their wage or salary for the minimum period of notice under their contract of employment, or the remaining portion of a fixed term contract. The point is that if an employee can be dismissed on being given, say, four weeks' notice, their legal right against the employer is equivalent in value to four weeks' earnings only. Anything beyond this is only an expectancy.

Of course, these principles apply only to personal contracts of employment; nowadays, most people are employed by companies which, of course, cannot die and cannot be insured under a life policy.

An employer has an insurable interest in the life of their employees. Again, the interest is, theoretically, limited to a sum representing the value of the work to which the employer is entitled. If, like the employer, the employee can terminate the contract of employment at any time by giving a month's notice, or less, the value of this interest may not amount to very much.

In practice, however, 'keyman' or 'keywoman' policies for large amounts are often issued on the lives of senior employees. These reflect the cost of training a new employee to fill the role of the old one.

- **Creditor and debtor**

A **creditor** has an insurable interest in the life of their debtor because they may lose financially if the debtor dies before the money is repaid. They may, therefore, insure for the amount of the debt plus interest payable on it. A **debtor** has no corresponding insurable interest in the life of their creditor.

D2 Property insurance

There are many examples of persons who may have an insurable interest in property, including the following:

- **Outright owners of property and part or joint owners.**
- **Mortgagees and mortgagors:** mortgages are commonly arranged in connection with the purchase of houses or commercial property. A mortgage involves a lender (normally a bank or other financial institution), known as the mortgagee, and a purchaser who is known as the mortgagor. Both parties have an insurable interest. The purchaser's interest arises from the ownership of the property and the financial institution (mortgagee) acquires an interest because the property is the security for the loan.

Consider this...

What is the insurable interest for each party?



- **Executors and trustees:** executors and trustees are legally responsible for the property in their charge, and this gives rise to insurable interest.
- **Landlord and tenant:** a landlord (lessor) has an insurable interest in the property that they own. Their tenant (lessee) also has an interest because they may be legally liable to pay for repairs if the property is damaged or destroyed, and may have to pay the rent even when the premises are uninhabitable.
- **Bailees:** a bailee is a person who has legal possession of goods belonging to another. They hold them for a particular purpose and, normally, for a limited time only. They may be paid for doing so or act gratuitously. Motor vehicle workshops, launderers and watch repairers are examples of bailees. In each case, they have a responsibility to take reasonable care of the goods that are left with them and to look after them as if their own.
- **People living together:** one spouse (or person living with another) will have an insurable interest in property belonging to the other if its use and possession is shared. In any case, each may arrange insurance as agent of the other.
- **Finders and people in possession:** a person who finds property will have a right to insure it, since possession gives the finder a right to the property that is better than that of any person other than the true owner. In any event, possession of property, in itself, gives the right to insure it, even though someone else may have a better right to the property. Under English law, there may even be a right to insure when the possession is wrongful.

D2A Limited interests in property

In many cases, a person will have only a limited interest in the property concerned.



Example 5.16

The interest of a part-owner will be limited to the value of their share in the property and the interest of a mortgagee (such as a bank or building society) will be limited to the amount of the loan that has been granted.

It is important to understand that a person with a limited interest may, nevertheless, insure the property for its full value.

This does not mean, however, that they can keep all the insurance money in such a case; on the contrary, the maximum amount they will be able to retain is that of their own interest. Any surplus will generally be held on trust for the other person or persons with an interest in the property.



Example 5.17

A mortgagee will have the right to insure mortgaged property for its full value but will be able to keep no more than the amount of the outstanding debt if the property is destroyed and the insurers pay for the loss in full. The balance must be paid over to the mortgagor (i.e. the purchaser of the house or goods).



Example 5.18

Similarly, it is clear that a bailee can insure goods for their full value and claim on behalf of the owner (bailor) in respect of a loss for which the bailee was not legally responsible. However, the policy in question must be clearly intended to cover the interest of the owner and not just the limited interest of the bailee. Provided this is the case, the bailee can recover in full but, again, can keep no more than the amount of their own loss (if any). The balance is held on behalf of the owners of the goods and must be paid over to them.

D2B Overlapping interests in property

It will be clear from what has been said that different people (such as mortgagor and mortgagee, landlord and tenant and bailor and bailee) can have an insurable interest in the same property. To avoid confusion, and possible double insurance, it is obviously sensible for the parties to agree about who should arrange the insurance. For this reason, a mortgage deed or tenancy agreement (lease) will normally state which of the parties shall have the duty to insure and bailees, such as warehouse keepers and carriers of goods, will agree with the owner about how insurance is to be arranged. The same is true of hire-purchase agreements for the purchase of motor cars or other property. These usually state that the borrower must arrange insurance on the vehicle or property concerned.



Activity

What interests in property do you think exist under a leasehold arrangement in which there is a leaseholder who lives in (or potentially rents out) the property, and a freeholder who owns the property and grants the lease to the leaseholder? How do you think the parties should agree on their responsibilities for taking out insurance?

D3 Insurance of profits

A common example of the insurance of profits is business interruption (BI) insurance, which covers 'profit' which is lost following damage to the insured's property, such as their factory buildings, machinery or other goods. One might argue that the insured under such a policy has no legal right to make profit from the use of these assets but merely an expectancy of doing so. However, because this is not a mere expectancy, but one that is founded on a legal right (the right of ownership of the property), it gives an insurable interest.

The coronavirus outbreak and ensuing government controls caused a substantial level of loss and distress to businesses, which triggered a surge in business interruption insurance claims against insurers. Where insurers rejected those claims some assureds individually

sought from the courts to determine whether any cover had been triggered by the pandemic, and if so, what is the ambit and scope of such cover provided for by their policy wordings.

The Financial Conduct Authority of the UK (FCA) is the conduct regulator of insurers in the United Kingdom. Its strategic objectives include ensuring the relevant markets function well and that appropriate protection is provided for consumers. In response to the surge of coronavirus related business interruption claims against insurers, the FCA reached a framework agreement with eight different insurers.

On the Web

www.fca.org.uk/publication/corporate/bi-interruption-test-case-framework-agreement.pdf



As provided by this agreement, the FCA initiated ***Financial Conduct Authority v. Arch Insurance (UK) Ltd (2021)*** (the FCA test case) which was to be the first case admitted to the **Financial Markets Test Case Scheme (Practice Direction 51M)**.

The scheme applied to a financial list claim 'which raises issues of general importance in relation to which immediately relevant authoritative English law guidance is needed ('a qualifying claim').' The Practice Direction 51M has since been revoked.

Unlike a typical insurance law dispute, the test case is not a legal action that was brought by the assured against the insurer seeking recovery under a particular insurance contract. Instead, the FCA, representing the interests of the large number of policyholders (many of whom are small to medium sized enterprises), sought declarations in respect of the relevant business interruption policy wordings. The FCA estimated that the test case covered some 700 policies issued by over 60 different insurers and affecting up to 370,000 policyholders.

The FCA's objective is to achieve a swifter resolution of the uncertainty and to enable the FCA to fulfil its regulatory objectives more quickly.

The High Court decided in favour of the assureds in the majority of the wordings tested. The Supreme Court heard an appeal which leapfrogged the Court of Appeal. In its judgment delivered on 15 January 2021, the Supreme Court upheld and extended the High Court's judgment. As a result, 14 out of 21 selected policy wordings were held to respond to the COVID-19 related business interruption claims.

D4 Liability insurance

Introduction

Companies and individuals face an ever-increasing range of liability arising from their actions, including damage to others' property, injury to others, and contract disputes, to name just a few. Liability insurance is a critical safeguard against unforeseen events that can have financial implications.

What is liability insurance?

Liability insurance covers business owners, independent professionals, self-employed people, and individuals against the cost of compensation claims following fault of negligence brought against them by:

- employees;
- clients;
- customers;
- shareholders;
- investors; or
- members of the public.

In other words, in liability insurance the insured peril involves the risk of being held liable (due to negligence or sometimes errors/omissions) to pay compensation to a third party arising from such events as (note: this is a simplification as each line of business is slightly different):

- bodily injury;
- property damage;
- financial losses resulting from such injury or damage; or
- pure financial losses in certain cases.

A quick explanation of 'third party' and 'negligence':

Third party

A 'third party' is a party who is neither an insured named in the policy (the first party) nor an insurer (the second party). The insurer agrees to indemnify the insured against certain 'legal liabilities' it may incur towards third parties. It is not an insurance of persons or property, but of these legal liabilities.

Generally, the insured is not 'legally liable' to the injured party until either liability is admitted by the insured (with insurer's consent), or a judgment is awarded (and appeals are finished). In practice, in many cases the loss adjuster and/or lawyer investigates the claim, and settles it (while never admitting liability on behalf of their client).

What is negligence?

Negligence refers to the failure to take reasonable care or steps to prevent loss or injury to another party. It can be viewed as an act, or a failure to act, that falls below the established standard of care required in a particular circumstance.

For negligence to be established, there are four steps:

Establishment of duty: for negligence to be established, the first step is to determine that the accused had a duty of care towards the claimant. If the accused owed no duty of care, then the analysis stops there – there is no negligence.

Breach of duty: once a duty of care is established it must be shown that this duty was breached. This breach arises when a party fails to meet the standard of care expected in the given circumstances.

Causation: a direct link must be demonstrated between the breach of duty and the harm caused. In essence, the harm must have been a foreseeable consequence of the negligent action.

Damages: the claimant must prove they have suffered a loss or injury as a result of the negligent act. If the accused has not suffered any loss or injury, or cannot prove it, then the analysis stops there – there is no negligence to be indemnified.

In other words, was a duty owed, was it breached, did the breach lead to loss or injury, and did that breach cause damages?

At a deeper level, liability insurance protects against hazards associated with private activities (personal liability), business operations (premises, product risk), professional activities (medical treatment, planning, controlling, etc.) or a specific item of property (motor vehicles, waterborne craft, aircraft, buildings, machinery). Motor, marine, and aviation third party liability is dealt with in the respective line of business, whereas liability associated with owning and operating completed buildings and assembled machines is usually handled in general third-party liability insurance.

Benefits of liability insurance

The insured benefits under liability insurance consist of providing indemnity for justified claims, defending against unjustified or excessive claims as well as handling claims and representing the insureds vis-à-vis claimants. In a way, the insured is buying the claims-handling expertise of the insurer – the insurer handles third-party liability claims on a daily basis, and knows how best to deal with specific claims, and when to settle claims.

By ensuring victims are compensated for negligent acts, businesses can avoid protracted legal disputes, thereby preserving their reputation in the community.

From the perspective of the victim, liability insurance ensures that victims of negligence receive compensation.

Example 5.19

Two examples:



Medical malpractice: a surgeon who inadvertently leaves a surgical tool inside a patient could be deemed negligent. Liability insurance would cover the ensuing claims, protecting the medical professional from potential financial ruin.

Professional indemnity: an architect who designs a faulty building may be held negligent if the building collapses. Their liability insurance would cover the damages awarded to affected parties.

How does liability arise?

Liability insurance involves claims made against an insured based on legal liability – meaning statutory liability (civil law and/or public law). As a rule, contractual liability exceeding statutory liability is not covered by liability insurance policies. There is no indemnity for criminal liability.

The main types of liability insurance are:

- Professional indemnity.
- Product liability.
- Directors' and officers' liability.
- Employers' liability.
- Public liability.
- Cyber liability.

For further information, please see appendix 2.

D5 Reinsurance

When insurers grant cover, they agree to pay the insured money if a particular loss or event occurs. Having assumed a liability to pay claims under the policies that they issue, insurers then have an insurable interest arising from that liability.

In other words, they can themselves insure against the risk of having to pay claims, or pay claims that exceed a certain level. This is done by means of a reinsurance contract. Put simply, **reinsurance is insurance for insurers**.

The subject matter of the reinsurance contract is the original insurer's liability to indemnify their policyholders.

The Marine Insurance Act 1906 (s.9) recognises that an insurer has an insurable interest in their risk and may insure in respect of it. The Act also provides that the original insured has no right or interest in the reinsurance, unless the policy provides otherwise.

Finally, you will recall that the leading case of **Dalby v. The India and London Life Insurance Company (1854)** concerned a question of insurable interest in the reinsurance of a life policy.



Key points

The main ideas covered in this chapter can be summarised as follows:

Formation of an insurance contract – general principles

- Like any other contract, an insurance contract comes into existence once the offer made by one party is unconditionally accepted by the other.
- The rules of consideration apply to insurance in the ordinary way – the consideration given by the insured in an insurance contract is the premium (or the promise to pay the premium) and that by the insurer is the promise to pay claims.

Insurable interest

- Insurable interest is required for an insurance contract to be valid.
- Insurable interest means the policyholder must have the legal right to insure, arising out of a financial relationship recognised at law between the insured and the subject matter of insurance.
- The key elements of insurable interest are:
 - a subject matter of insurance;
 - the policyholder must have an economic or financial interest in that subject matter;
 - the interest must be a current interest, not an expectancy; and
 - the interest must be a legal interest.
- The law requires insurable interest to reduce moral hazard and to discourage wagering.
- Insurable interest may arise:
 - at common law – in which an interest is automatically assumed (e.g. every person is presumed to have an unlimited interest in their own life); or
 - through a contract – a person may agree to accept responsibility for something for which they would not ordinarily be liable (e.g. a landlord, rather than the tenant, is normally liable for the maintenance of the property which they own).

The law on insurable interest

Marine insurance

- Insurable interest is required by the Marine Insurance Act 1906, s.4.
- The Marine Insurance Act 1906, s.6 provides that the insured must be interested in the subject matter insured at the time of the loss.
- There is no requirement of insurable interest when the contract is made, and it does not matter that the interest has ceased since the time of the loss.

Life insurance

- Insurable interest is required by the Life Assurance Act 1774, s.1.
- In life insurance, insurable interest is required at the time when the contract is made, i.e. at inception. However, there is no requirement to prove an interest when a claim arises on death or maturity of the policy.

Insurance policies on goods

- There is no statutory requirement for insurable interest and, as a consequence of the Gambling Act 2005, a policy on goods without insurable interest is enforceable in theory, even if it amounts to a wager. However, in practice, the principle of indemnity would prevent recovery by a person who had suffered no loss and would generally restrict any recovery to the amount of the loss. Insurable interest in goods was discussed in *Quadra Commodities SA v XL Insurance Co SE [2022] EWHC 431 (Comm)*.

Effect of a policy without interest

- Where there is no insurable interest, the contract is generally void.

Key points

Other insurances

- Other policies (such as policies covering land or buildings and liability insurances) may possibly be covered by the Life Assurance Act 1774, s.1. In the case of policies on land and buildings, insurable interest may also be required under common law. However, the position is not very clear and the safest way to deal with it is through the principle of indemnity which requires proof of loss before making a claim under an insurance contract.

Application of insurable interest

- The main examples of insurable interest in life insurance are for family relationships and non-consumer (business) relationships.

Self-test questions

1. What essential terms of the contract must be agreed upon for an insurance policy to be valid?
2. What type of insurance contract must be in writing?
3. Give a simple definition of insurable interest.
4. What are the key elements of insurable interest?
5. Why does the law require insurable interest?
6. At what time is insurable interest required in the case of a life insurance policy?
7. In what class of insurance is there no statutory requirement of insurable interest?
8. What is the legal effect on a policy when insurable interest is lacking?
9. Give three examples of persons who may have an insurable interest in property.

You will find the answers at the back of the book

6

Pre-contractual information duty

Contents	Syllabus learning outcomes
Introduction	
A Misrepresentation	5.4, 5.5, 5.6
B Duty of disclosure	5.4, 5.5, 5.6
C Breach of the pre-contractual information duty	5.4, 5.5, 5.6
D Scenario 6.1	
Key points	
Self-test questions	

Learning objectives

After studying this chapter, you should be able to:

- distinguish between misrepresentation and non-disclosure;
- explain the duty of disclosure;
- describe the nature of material facts;
- describe the forms which breach of the insured's pre-contractual information duty may take and explain the remedies available;
- explain the effects of legislation and voluntary codes of practice on the insured's pre-contractual information duty; and
- distinguish between the pre-contractual information duties in consumer insurance and non-consumer (business) insurance.

Introduction

Insurance contracts are contracts of utmost good faith (**Marine Insurance Act 1906 (MIA 1906)**, s.17). This means, in simple terms, that the insurer and the insured have a duty to deal honestly and openly during their contractual relationship.

The doctrine of utmost good faith is a minimum standard, legally obliging all parties entering a contract to act honestly and not mislead or withhold critical information from one another. It is one of the most fundamental doctrines in insurance law. It provides general assurance that the parties transacting insurance are truthful and acting ethically, allowing the insurer to price and underwrite the risk with information that is accurate and complete, and to continue to offer coverage. Unlike insurance contracts, most commercial agreements do not subscribe to the doctrine of utmost good faith. Instead, many are subject to *caveat emptor*, or 'buyer beware'.

Under the MIA 1906, the duty of utmost good faith used to extend to the insured's pre-contractual information duty too. The remedy for breach of the pre-contractual information duty (pre-contractual duty of good faith) was avoidance of the contract only. However, the pre-contractual information duty has changed as a result of the **Consumer Insurance (Disclosure and Representations) Act 2012 ('2012 Act')** in consumer insurance and the **Insurance Act 2015 (IA 2015)** in non-consumer insurance.

The 2012 Act came into force on 6 April 2013 and applies to all 'consumer insurance contracts' made on or after that date.

A 'consumer insurance contract' is a contract of insurance between:

1. an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession; and
2. an individual who carries on the business of insurance and who becomes a party to the contract by way of that business (whether or not they are in accordance with the rules of the **Financial Services and Markets Act 2000**).

Refer to

Refer to [Defective contracts](#) on page 3/20 for defective contracts

The 2012 Act abolished the pre-contractual duty of disclosure for consumers and replaces this with the duty to take reasonable care not to make a misrepresentation.

The IA 2015, which came into force in August 2016, replaces the insured's pre-contractual information duty which applied to non-consumers with the duty of fair presentation of the risk – a less significant change than for consumers but one which was designed to modernise the law for commercial insurance contracts. This new duty effectively imposes two duties on the parties to the contract:

- a duty not to misrepresent any matter relating to the insurance – i.e. a duty to tell the truth; and
- a duty to disclose all material facts relating to the contract – i.e. a duty not to conceal anything that is relevant.

The IA 2015 also reformed the remedy for breach of the duty of fair presentation of the risk and separated it from the duty of utmost good faith.



Be aware

The IA 2015 abolished sections 18, 19 and 20 of the MIA 1906. While the IA 2015 retained some of the principles as they applied under the MIA 1906 and the common law, it also introduced some new provisions which were not seen in the law as it stood before.

We will consider both the old duty and the new principles of the IA 2015, and look further at the 2012 Act in the rest of this chapter.

The legal rules on misrepresentation apply to all contracts. However, the duty of disclosure, although not unique to insurance, applies to few other contracts, and nowhere else is it so important.

Key terms



This chapter features explanations of the following ideas:

Continuing duty of disclosure	Fraudulent misrepresentation	Innocent misrepresentation	Material facts
Moral hazard	Non-disclosure	Physical hazard	Positive duty of disclosure
Qualifying breach of the duty of fair presentation of the risk	Qualifying misrepresentation		

A Misrepresentation

You will recall that a misrepresentation is a false statement of fact that induces the other party to enter into the contract.

To affect the validity of the agreement, the false statement must:

- be one of fact (rather than a statement of law, or of opinion or belief);
- be made by a party to the contract;
- be material (i.e. something which would influence a reasonable person in deciding whether to enter into the agreement);
- induce the contract (i.e. be something that the other party relied upon in deciding to enter into the agreement); and
- cause some loss or disadvantage to the person who relied upon it.

These rules apply to insurance in much the same way as they do to other types of contract.

Be aware

However, the test of 'materiality' is different in insurance.



Refer to

Refer to [Material facts](#) on page 6/6 for material facts

A **material fact** in insurance is defined according to what a 'prudent insurer' would deem material rather than the opinion of a reasonable person. A 'prudent insurer' is a theoretical insurer who needs to know all the material facts before entering into a contract of insurance. For example, a ship insurer would like to know if a ship to be insured was involved in a collision with another ship two days ago, even though the incident has not been reported as a claim.

A1 Innocent and fraudulent misrepresentation

You will remember that when a person makes a false statement with the deliberate intention of misleading another and putting them at a disadvantage this may be regarded as *fraudulent misrepresentation* (but the insurer will have to prove fraud).

If the statement is false but there is no intention to mislead the other party, it can be described either as negligent or an *innocent misrepresentation*.

Negligent misrepresentation occurs where the statement is false because the person making it did not take sufficient care to check that it was correct.

In non-consumer (business) insurance, as a matter of strict law, an insurer may seek remedy on the grounds of misrepresentation regardless of whether the misrepresentation is fraudulent, negligent or innocent.

In consumer insurance, the insurer may only seek remedy for a misrepresentation which is negligent or fraudulent. This is because the 2012 Act imposes the duty to take reasonable care not to misrepresent material facts.

Where the misrepresentation is fraudulent, the insurer may avoid the contract and may keep any premium that has been paid.

The question of remedies for breach of the pre-contractual information duties is discussed in more detail later.

A2 Examples of misrepresentation in insurance



Example 6.1

The following are examples of misrepresentation in insurance:

- A proposer for theft insurance says that the premises are protected by a burglar alarm when they are not.
- A proposer for motor insurance declares that their car has not been modified in any way when it has.
- A proposer for life insurance gives their age as 25 when, in fact, they are aged 35.
- A proposer for property insurance states that the property is in a good state of repair when, in fact, it is in poor condition (e.g. it had a leaking roof or broken windows).
- A proposer for property insurance implies, in respect of a previous fire at their home, that the fire had occurred at other premises and had been the fault of contractors. The fire had been at their house and the contractors were the insured's alter ego.



Consider this...

What effect would these misrepresentations have upon the application for insurance and the terms offered by the underwriter?

B Duty of disclosure

It is useful to compare insurance contracts with contracts for the sale of goods.



Consider this...

We considered earlier in this text the general rules affecting contracts for the sale of goods. Remind yourself about *caveat emptor*.

Contracts for the sale of goods are subject to the doctrine of '*caveat emptor*' ('let the buyer beware').

Although the buyer of goods is given considerable protection by statutes such as the **Sale of Goods Act 1979** and the **Unfair Contract Terms Act 1977** (which applies to commercial contracts generally but not to insurance), the basic responsibility of each party is still to make sure that they make a good bargain. This is largely because the buyer is able to examine the goods, assess their quality, and judge for themselves whether the price is fair. Therefore, so long as neither party positively misleads the other, and any questions which are asked are answered truthfully, the contract cannot be avoided simply because one party finds that they have made a poor bargain. In particular, neither party is required to disclose information that is not asked for.



Example 6.2

This means, for example, that if you are selling a car, you are under no positive duty to disclose anything about it to the buyer (although, of course, if you do give information it must be correct).

B1 Positive duty of disclosure in non-consumer (business) insurance

Consider this...

A contract for the sale of goods will involve tangible property, such as the car in our example above. However, the parties to an insurance contract are dealing with a product that is intangible. How will this affect the position of both parties?



First, it affects the proposer:

- Unlike a car, the insurance policy cannot be tested by the proposer before it is bought.
- The proposer will have to trust that the insurers will pay their valid claims when the time comes.
- Equally, the proposer will not know the details of the cover that they are to receive unless the insurers make the information available to them in advance.

Second, it affects the insurers:

- On the face of it, the proposer is the only one who has full knowledge about the subject matter of insurance – the thing to be insured.

Example 6.3

If a person wishes to insure a car (rather than buy or sell one) the insurance company will only know what they tell them about it. If the car has been modified, or it is not roadworthy, the insurers will have no practical means of knowing unless the proposer discloses the information.



For these reasons, in business insurance there is a **positive duty of disclosure** going beyond a mere duty not to misrepresent matters which are, in fact, disclosed.

Example 6.4

Scrutton, LJ, summed up the duty in *Rozanes v. Bowen (1928)*: as the underwriter knows nothing and the man who comes to him to ask him to insure knows everything, it is the duty of the assured...to make a full disclosure to the underwriter without being asked about all the material circumstances. This is expressed by saying it is a contract of utmost good faith.



In this case, the existence of the duty of disclosure is explained by the fact that the insured is likely to know more about the subject matter than the insurer. The judgment assumes that an insurer will not be able to discover the full facts about a risk unless the proposer volunteers the necessary information.

This was certainly true in the early days of marine insurance. Communications were poor and a typical underwriter, sitting in a coffee house in London, would otherwise find it very difficult to get information about the ships and other risks that were offered for insurance, many of which were in distant parts of the globe. It is less true today, because travel is easy and information is both abundant and easily transferred by electronic means. On the other hand, it still takes time and money to collect information, and both can be saved by getting details of the risk directly from the person who applies for insurance.

Be aware

All this has led to some debate as to what the extent of a proposer's duty should be, and some pressure for reform of the law. The question of reform, and the alternative approach in some other legal systems is discussed below.



The IA 2015 does not substantively change the position; s.3(4)(a) of the Act provides that the insured is required to disclose every material circumstance which the insured knows or ought to know (the same requirement as that which previously applied under MIA 1906) s.18. Section 4 of the IA 2015 defines what the insured 'knows' and 'ought to know' for the purposes of the duty of disclosure in s.3. Insureds have a positive duty to seek

out information about their business by undertaking a reasonable search and by making enquiries of their staff and agents (such as their insurance broker).

The IA 2015, as a new provision, sets out that the duty of disclosure is complied with if the insured gives the insurer sufficient information to put a 'prudent insurer' (in practice an underwriter) on notice that it needs to make further enquiries for the purpose of revealing those material circumstances (s.3(4)(b)). This becomes like a game of tennis where the proposer provides certain information, and the underwriter asks for further information until the underwriter has satisfied themselves that they have adequate information to underwrite the risk.

Moreover, the IA 2015 brings a detailed provision on determining 'knowledge of the insured' (s.4). If the insured is an individual (as in the case of a sole trader or practitioner), they will be taken to know anything which is known by the person or people who are 'responsible for the insured's insurance', in addition to their own knowledge.

Section 4(3) sets out the individuals whose knowledge will be directly attributed to the insured where the insured is not an individual. For example, in the case of a company, they are the insured's senior management or the person or people responsible for the insured's insurance. The definition of 'senior management' in a corporate context is likely to include members of the board of directors but may extend beyond this, depending on the structure and management arrangements of the insured.

The definition of a person 'responsible for the insured's insurance' is expected to cover, for example, the insured's risk manager if they have one, and any employee who assists in the collection of data or negotiates the terms of the insurance. It may also include an individual acting as the insured's broker.

B1A Agent's duty

In non-consumer (business) insurance, the insurer can seek remedy for the breach of the fair presentation duty if the insured's agent breaches the duty. Section 4 of the IA 2015 regulates this principle in its provision that what is known to the person who is responsible for the insured's insurance is attributed to the insured.

In common law, a person is responsible for the acts of their agent and so a careless or reckless misrepresentation by an agent is treated as if it had been made by the principal. This principle is maintained in consumer insurance by s.12(5) of the 2012 Act, which states 'Nothing in this Act affects the circumstances in which a person is bound by the acts or omissions of the person's agent'.

Under the 2012 Act, an intermediary is considered to be the insurer's agent if the intermediary:

- is the appointed representative of the insurer;
- collects information from the consumer with express authority from the insurer to do so; or
- has authority to bind the insurer to cover and does so.

In all other cases, it is presumed that the agent is the consumer's agent unless, in light of the relevant circumstances, the consumer proves otherwise.

B2 Material facts

We turn now to the question of what, exactly, the parties must disclose for non-consumer (business) insurance.

The essential duty is to disclose all facts or circumstances that are material to the risk.

This leads, in turn, to the crucial question of how a material fact is defined.

The standard definition for non-consumer (business) insurance is provided by s.7 of the IA 2015. This states that every circumstance is material...

if it would influence the judgment of a prudent insurer in determining whether to take the risk and, if so, on what terms.

This definition is regarded as a codification of the common law which applies to all insurance contracts.

Because the duty as set out under the IA 2015 is a pre-contractual duty, the materiality of a fact is judged by reference to the position as it existed at the date of placing the risk.

We will consider some aspects of the definition in s.7(3) of non-consumer (business) insurance.

B2A Prudent insurer

First, it should be noted that material facts are again defined only in terms of what an insurer, rather than an insured, would wish to know.

Second, although the term 'prudent insurer' suggests a rather cautious individual, the courts have held that this term has the same meaning as 'reasonable insurer'; thus, the test is an objective one.

B2B What does 'influence the judgment' mean?

This is an important question.

If there is **non-disclosure**, and the insurers wish to avoid the policy, do they have to prove that a hypothetical 'reasonable insurer' would have declined the risk or asked for a higher premium if the full facts had been known?

Example 6.5

In *Container Transport International Inc. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd (1984)*, the Court of Appeal held that insurers do not have

to prove that knowledge of that fact in question would have changed the decision of a reasonable insurer. They held that the words 'influence the judgment' simply mean that the fact must be one which a typical, reasonable underwriter would have wanted to know when forming their opinion of the risk.



Example 6.6

The decision in the CTI case was affirmed by the House of Lords in *Pan Atlantic Insurance Co. v. Pine Top Insurance Co. (1994)*.



However, their Lordships considered a second question in the **Pine Top** case and introduced a second element.

- What if the fact in question was material, in that a typical, reasonable underwriter would have wanted to know about it, but it would have made no difference to the decision of the actual underwriter who took the risk – perhaps because the actual underwriter was not especially 'prudent'?
- In answer to this question their Lordships held that, in order to avoid the contract, it was not enough to show that a material fact was not disclosed.
- It was also necessary to show that the underwriter in question was induced by the non-disclosure into entering into the contract on the relevant terms.

This test, known as the 'actual inducement test', introduces a **subjective** element and brings the law on non-disclosure into line with the law on misrepresentation.

With regard to the proof of inducement, the courts also discussed the following questions:

- Where materiality is proved by the insurer, should it be presumed that the insurer was induced to enter into the contract by a material non-disclosure or misrepresentation?
- Would such a presumption shift the burden of proof from the insurer to the insured, requiring the insured to prove that the insurer was not induced into accepting the contract?

The courts rejected that the general presumption of inducement would appear as soon as materiality is proved. However, they also recognised that proof of inducement is a matter of fact and decided that inducement may be presumed in some rare cases, depending on the facts involved.

For example, in *St Paul Fire v. McConnell Dowell Construction (1995)* three of the four different underwriters who had subscribed to the same risk proved inducement, but the fourth was unable to produce evidence to this effect. The court accepted presumption of inducement in this case. Another situation in which the presumption may arise is where the leading underwriter and the following underwriters have to prove inducement.

If the leading underwriter was induced to enter into the contract by e.g. a material misrepresentation, the followers' assessment of the risk, which trusted the leader's judgment with respect to the insurability of it, was also influenced by such misrepresentation.

The IA 2015 provides that an insurer may seek remedy for breach of the duty of fair presentation of the risk only if the insured's breach is qualifying. In other words, only if the insurer either:

- would not have entered into the contract at all; or
- would have entered into the contract on different terms.

As a result, **inducement** is now a statutory test for a remedy for breach of the duty of fair presentation of the risk (s.8(1)).

Cases of non-disclosure and misrepresentation

The question to be asked in order to prove inducement differs in cases of non-disclosure and misrepresentation:

- With regard to non-disclosure, it is 'what would the insurer have done if the true position had been disclosed to him prior to the conclusion of the contract?'
- With regard to misrepresentation, in *Involnert Management Inc v. Aprilgrange Ltd (The Galetea) (2015)*, Leggatt J held that it is 'what would the insurer have done if there had been no misrepresentation?', but not 'what would the insurer have done if the insured had told the truth?'



Example 6.7

In *The Galetea*, the subject matter insured was a yacht which was purchased in 2007 for €13m. It was insured for the same amount from year to year, without any thought being given to whether this was still the appropriate insurance value.

When the yacht was insured in 2011 for the same amount, the actual value was approximately €7m. Leggatt J decided that if the insurer had been told the actual value of the yacht, it would not have insured the yacht for €13m.

However, if misrepresentation had not been made and, for example, the value on the proposal form had been left blank, this would not have made any difference to the insurer as it regularly insured yachts without being given such information.

B2C Need there be a connection between the 'missing facts' and the loss? (The 'nexus' question)

The issue of non-disclosure usually arises when there is a dispute about a claim under the policy.



Consider this...

What is the position if the proposer fails to disclose several previous burglaries at their property when they arrange their household insurance and the insurers discover this fact when investigating a subsequent fire claim?

In fact, even if there were no connection at all between the fire claim and the previous burglaries (which is likely) the insurers would have the right to seek remedy for non-disclosure.

This is because it is the relevance of a particular fact to the risk as a whole that is the issue, not its relevance to the circumstances of any particular claim.

Therefore, the right to avoid the contract does not depend upon there being any connection ('nexus') between the non-disclosure (or misrepresentation) and the circumstances of the loss.

In fact, if insurers discover an actionable breach of the pre-contractual information duty at any time, they can seek remedy for the breach. They do not have to wait for a claim to happen before doing so.

Refer to

Refer to *The Insurance: Conduct of Business (ICOBS) rules* on page 6/26 for ICOBS

You should be aware of the restrictions imposed by ICOBS in relation to taking coverage points against consumer policyholders.

B2D Consumer insurance

As will be explained in *Consumer insurance* on page 6/23, the insurer, under the 2012 Act, can seek remedy for breach of the duty only if the misrepresentation was caused by the consumer's failure to exercise reasonable care not to make a misrepresentation, and if the insurer proves inducement.

There is no separate test of materiality in consumer insurance.

In *Jones v. Zurich Insurance Plc (2021) EWHC 1320 (Comm)* the court assessed the materiality of the fact misrepresented by the assured as embedded in the test of inducement. The assured made a false statement as to an insurance claim he had made under another cover prior to the current insurance contract being formed. The court was persuaded that the insurer would have acted differently had the assured not made a misrepresentation. That was a material fact for the insurer that led to an inducement, namely, that affected the insurer's judgment.

The 2012 Act gives examples of things which may need to be taken into account to determine whether or not a consumer has taken reasonable care not to make a misrepresentation, such as:

- the type of consumer insurance contract in question, and its target market;
- any relevant explanatory material which is publicity produced or authorised by the insurer;
- how clear and how specific the insurer's questions were;
- in the case of a failure to respond to the insurer's questions regarding the renewal or variation of a consumer insurance contract, how clearly the insurer communicated the importance of answering those questions (or the possible consequences of failing to do so); and
- whether or not an agent was acting for the consumer.

This list is not intended to be exhaustive.

B3 Matters which must be disclosed

In the majority of cases, the person who applies for insurance will complete a proposal form. This will contain specific questions designed to obtain information about the risk that the insurers need. Furthermore, large or abnormal risks are likely to be inspected by the insurers, whose surveyor will be able to identify hazardous features for themselves. Nevertheless, if the proposer is aware of something that is material, they must declare it, whether or not they are asked to do so.

Whether any particular thing is material or not is a question of fact, to be decided by the trial judge if there is a dispute: we have also seen that there is an 'actual inducement' test.

The insured is under the duty to disclose every material circumstance which the insured knows or ought to know. Under the IA 2015, the duty is complied with where a material circumstance is not itself disclosed, but the proposer has given the insurer sufficient 'signposts' which would lead a prudent insurer to make further inquiries which, when answered, would reveal material circumstances. This is intended to ensure that insurers are engaged in the disclosure and fair presentation process.

In line with the common law rule, the Act requires disclosure of information which the insured knows or ought to know. The word 'knowledge' of an individual for this purpose is defined by the Act as including:

not only actual knowledge, but also matters which the individual suspected, and of which the individual would have had knowledge but for deliberately refraining from confirming them or enquiring about them.

This is a codification of the 'blind-eye' test which has been adopted by the common law. If a fraud has been perpetrated on the insured by one or more of the individuals who

are responsible for the insured's insurance or, in the case of a legal person, an individual who is part of the insured's senior management, knowledge of that fraud is not imputed to the insured.

While the MIA 1906 did not provide a list as such, the IA 2015 has brought some guidance as to determine whether a fact is material or not. Under s.7(4), examples of things which may be material circumstances are:

- special or unusual facts relating to the risk;
- any particular concerns which led the insured to seek insurance cover for the risk; or
- anything which those concerned with the class of insurance and field of activity in question would generally understand as being something that should be dealt with in a fair presentation of risks of the type in question.



Be aware

However, the materiality of some types of fact is so well established that the need to disclose them is unlikely to be disputed. Equally, it is well established that some matters need not be disclosed, including a number of categories laid down in the IA 2015, section 3(5).

At common law, matters requiring disclosure can be divided into:

- those that relate to the physical characteristics of the risk, which we can call *physical hazard*; and
- those which relate to the character and behaviour of the insured, which we can call *moral hazard*.

B3A Physical hazard

Facts in this category include the following:

- An adequate description of the subject matter of insurance. Of course, the insurers will generally ask questions about this in the proposal form or, if no proposal form is used, carry out a survey of the risk.
- Details of any unusual features of the subject matter (such as non-standard construction in the case of buildings) which make the risk worse than a normal risk of its class.

It may be helpful to look at different classes of insurance and give examples of facts concerning physical hazard which require disclosure:



Example 6.8

Fire insurance: the construction of the building, the nature of its use, fire detection and fire fighting equipment.

Theft insurance: the nature of stock, its value and the nature of security precautions.

Motor insurance: the type of car, whether it has been specially adapted, details of regular drivers.

Marine cargo: the type of cargo, the terms of sale, how the cargo is carried, its destination, whether containerised.

Life assurance: age, previous medical history.

It should be emphasised that these are only examples of material facts – it is not by any means a complete list.

B3B Moral hazard

Moral hazard refers to aspects of the risk that depend on the character and behaviour of the insured.



Be aware

The dividing line between moral and physical hazard is not always precise, and some of the examples mentioned below may relate to physical hazard as well as moral hazard.

Identity of the insured

The **Equality Act 2010** repealed and replaced various pieces of legislation that outlawed discrimination, including the **Race Relations Act 1976**, the **Sex Discrimination Act 1975** and the **Disability Discrimination Act 1995**. The 2010 Act replaced these with a united measure that outlaws discrimination on the grounds of 'protected characteristics'. These are listed under s.2 as:

- age;
- disability;
- gender reassignment;
- marriage and civil partnership;
- pregnancy and maternity;
- race;
- religion or belief;
- sex; and
- sexual orientation.

After 21 December 2012, following an implementation into UK law of a European Court ruling (the **Test Achats (2011)** decision), insurers are no longer able to consider gender when pricing insurance policies. The main policies to be affected are those which use gender as a factor in pricing for risk: motor insurance, annuities and life insurance.

Insurers have long taken the view that a person's occupation may indicate moral hazard and have applied special terms to some occupational groups, for various classes of insurance. There is no law to prohibit this.

Criminal acts

A proposer with a history of criminal activity presents the strongest indication of potential moral hazard. Previous criminal offences are, therefore, always likely to be regarded as material by the courts unless the offence(s) in question are very minor or very old.

There need not necessarily be a connection between the type of criminal offence and the type of insurance proposed for.

Example 6.9

Thus, in **Woolcott v. Sun Alliance and London Insurance (1978)**, a twelve-year-old conviction for armed robbery was held material to a proposal for household buildings insurance.



Although decisions of this sort have been criticised, they are clearly justifiable, because any criminal offence of dishonesty is relevant to a contract which requires honest dealing by the parties.

In **Berkshire Assets (West London) Ltd v. Axa Insurance UK Plc (2021) EWHC 2689**, the assured was asked to confirm that its directors 'have not, either personally or in any business capacity, been convicted of a criminal offence or charged (but not yet tried) with a criminal offence'. The answer was confirmed, but one of the directors, MS, was in fact facing criminal charges brought by the Malaysian authorities in relation to his previous employment in an international firm of accountants. MS believed that the charges were spurious and designed to put commercial pressures on his ex-employees. Following a flood at the insured premises the insurer avoided the policy for non-disclosure. The court held that the insurer was entitled to avoid the policy even though the charges against MS were dismissed after the insurance contract was made. Materiality was assessed as the facts stood before the insurance contract was made – the duty was pre-contractual. Outstanding criminal charges were, based on expert evidence, material facts; and the insurer had demonstrated that they would not have insured the premises if the charges had been disclosed.

Previous losses and claims under other policies

These may be evidence of extra physical hazard or moral hazard. In either case they are material.

Any other adverse insurance history

Examples include a refusal to insure by a previous insurer or the imposition of a loaded premium (this means a premium that is increased or 'loaded' over and above a company's

standard premium rate due to a perceived higher risk) or special terms. Again, extra moral or physical hazard may be involved.



Be aware

In the case of marine insurance, there is no duty to disclose that a risk has been previously refused by other underwriters. The explanation of the marine rule is that it would be unreasonable to require a broker in the (Lloyd's) marine market to remember and disclose details of each individual underwriter who had declined the risk.

Details of other policies currently in force

Refer to

Refer to chapter 10 for contribution

If the insured already has a fire policy covering their factory, this will reduce the liability of the insurers under a second policy because the two policies would share any loss between them – this principle is referred to as contribution – each policy would contribute. However, in the case of non-indemnity insurances such as life and personal accident (where a person can buy as much cover as they can afford), most insurers would want to know if the proposer was already heavily insured (for example for £1,000,000 or more), and the failure to disclose this may be a breach of the duty of fair presentation of the risk.

As mentioned previously, the pre-contractual duty of disclosure does not apply to consumer insurance. Therefore, in consumer insurance, the insurer is expected to ask questions about other policies currently in force.

In this respect it is worth mentioning **Jones v. Zurich Insurance Plc (2021) EWHC 1320** in which J was insured under a policy which covered loss of his personal effects while holidaying. In response to the question before the contract was concluded, 'Any losses or claims in the last five years?' the presentation stated, 'No'. J, however, made a claim within that period and had recovered £15,000 from insurers in respect of a diamond lost from a ring by his then girlfriend. J subsequently made a claim for a watch valued at £190,000 lost on a skiing holiday. The court held that the insurer had the right to avoid the policy. J made a misrepresentation, and the policy would not have been issued had the insurer known of the earlier claim.

B4 Matters which need not be disclosed

Some things need not be disclosed, even if they are material. They include the following.

Matters of law

Everyone is deemed to know the law.

Factors which lessen the risk

There is no requirement to disclose factors that reduce the risk – i.e. make it better than a normal risk of its type. For example, the subject matter insured, a yacht, is laid up in a secure area which is guarded by security personnel, so the risk of theft is much lower than for a normal yacht of this type.



Example 6.10

- The installation of an alarm system for a theft risk; or
- automatic sprinklers for a fire risk.

Facts known by the insurers

Rather obviously, there is no duty to tell insurers things that they already know. The information does not have to come from the proposer. In fact, it does not seem to matter where the information comes from, provided the source is reliable. The IA 2015 sets out the standards used to determine what the insurer knows in this respect (s.5).

Facts which the insurers ought to know

In some cases, the courts take the view that, while the insurers might not have actual knowledge of the circumstances, they have 'constructive knowledge', that is, they ought to know of them. This category covers a number of situations, including the following:

- Facts which are notorious (i.e. matters of common knowledge).
- An insurer is deemed to know about things that are in the public domain, such as the fact that a state of war exists in some countries.
- Facts about the trade which the underwriters insure.

Insurers are deemed to be aware of the normal trade practices in the businesses they insure and the usual risks associated with them. However, this does not necessarily extend to events that have affected the trade in question, even if they are quite recent.

Information that is waived by the insurers

Waiver may be expressed or implied. Express waiver may occur if the insurer agrees, by an express clause in the insurance contract, to waive the duty of good faith or its right to seek remedy for the breach of the duty.

In some cases, a court may rule that it was unnecessary for the proposer to disclose certain material facts, because the actions of the insurers suggested that they were prepared to waive (i.e. do without) disclosure of them (known as implied waiver). For instance, disclosure of some facts may, when objectively assessed, put the insurer on enquiry and if the insurer chooses not to follow up on that, the insurer is deemed to have waived the right to receive that information.

Example 6.11

The most common example is the proposer who writes a phrase such as 'see your records' on the proposal form in answer to a question about their previous claims history. Insurers will be regarded as having waived their right to the full information if they do not pursue the matter further, meaning that the insurers do not ask further questions or do not check their own claim records, as suggested by the proposer.



Be aware

If a proposer gives no answer at all to a question on a proposal form – i.e. leaves that part of the form blank – the position is less clear, but if the insurer goes on to issue the policy, this could also be taken as a waiver.



This principle is now codified by s.3(4)(b) of the IA 2015. Accordingly, the insured satisfies the duty of disclosure if it discloses sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances. If the insurer elects not to ask for further information about this matter, it is assumed to have waived the duty of disclosure for the further information which could have been revealed by it asking additional questions.

Further clarity was provided in ***Young v. Royal and Sun Alliance Insurance plc (2020)*** where the insured, K investment limited, insured its commercial premises in Glasgow. A fire damaged the premises and upon the insured's claim the insurer purported to avoid the insurance contract for material non-disclosure.

The insurance cover was placed by the insured's brokers who prepared electronically a market presentation of some 20 pages which included a moral hazard declaration. There were also boxes to be ticked in respect of a list of propositions. One of those propositions was that: 'no proposer, director or partner of the insured under the contract in question has ever been made bankrupt, insolvent, or subjected to such proceedings'. The box was left unticked, and so when the form was received by the insurers it simply saw the word 'none' in response to the moral hazard declaration. The insurer did not know which questions 'none' referred to.

The presentation was followed by an email from the insurer which stated: 'Insured has never ... been declared bankrupt or insolvent ... [or] had a liquidator appointed'. The broker confirmed that it was accurate.

The insured had been the director of four companies which had been dissolved after insolvent liquidation, or had been placed into insolvent liquidation in the previous five years.

The assured breached the duty of disclosure. The court held that the words 'insured has never been declared bankrupt or insolvent' were not to be construed as seeking confirmation and thereby waiving further disclosure. The tenor of the email was that the insurer had regarded the presentation of the risk as complete via the market presentation and was merely stating the terms and conditions of coverage.

Facts that are outside the scope of specific questions

If an insurer asks a question of limited scope, by implication there is a waiver of related information that goes beyond the scope of the question.



Example 6.12

If an insurer asks for details of all accidents or losses that have occurred in the last five years, there is no need to disclose accidents that occurred more than five years ago, even if they are material.

For instance in **Jones v. Zurich** mentioned above, the insurer's question of 'Any losses or claims in the last 5 years' implies that the insurer waives any claim history beyond the previous five-year period.

Facts which an inspection of the risk should have revealed

If the insurer carries out a survey or inspection of the risk, there is no duty to disclose facts that should have been obvious to the surveyor or which any reasonable surveyor would have enquired about. However, this principle does not extend to unusual features of a risk that a conventional inspection would not reveal.

It goes without saying that the proposer must not actively conceal hazardous features of the risk.

Facts which the proposer does not know

As a general rule, there is no duty to disclose facts which the proposer does not know.

In marine insurance there is a duty to disclose 'constructive knowledge', a term mentioned above which, in this context, refers to facts that the proposer ought to know in the ordinary course of their business.

An insured ought to know what should reasonably have been revealed by a reasonable search of information available to the insured (whether the search is conducted by making enquiries or by any other means) (IA 2015 s.4(6)).

An insured is not taken to know confidential information known to the insured's agent if the information was acquired by the insured's agent (or by an employee of that agent) through a business relationship with a person who is not connected with the insurance contract (IA 2015 s.4(4)).

Convictions that are 'spent'

Convictions that are 'spent' under the **Rehabilitation of Offenders Act 1974**, as amended by the **Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LASPO)**, need not be disclosed. The LASPO changes have applied in England and Wales since 10 March 2014 and rehabilitation periods for both community orders and custodial sentences now comprise the period of the sentence plus an additional specified period.



Example 6.13

Under LASPO, an adult offender sentenced to two-and-a-half years custody must disclose their conviction for the period of the sentence plus a further four years (giving a total rehabilitation period of six-and-a-half years). A fine must be disclosed for one year from the date of conviction.



Be aware

Under the LASPO changes, a conviction resulting in a custodial sentence of more than four years' imprisonment is never 'spent'. This applies to both adults and minors under the age of 18.

B5 Duration of the duty

This section looks at the rules that govern the time when the duty of disclosure applies.

Under CIDRA 2012 and IA 2015, the duty of fair presentation of the risk begins at the commencement of negotiations for an insurance contract and ends when the contract is formed.

It is formed at the point where there is an offer and unqualified acceptance. There is no general duty to disclose new material facts that arise during the currency of the contract.

The parties, by an express contractual term, may agree that the facts that either emerge or come to the assured's knowledge after the contract is formed have to be disclosed to the insurer. However, the duty of disclosure in this context is to be assessed as a term of the contract instead of an extra-contractual duty. The duty under CIDRA 2012 and IA 2015 is extra-contractual.

Consider this...

Why is this a logical rule?



This is a sensible rule because the insurers calculate the premium on the basis of the risk as it appears at inception and agree to run the risk, for better or worse, for an agreed period of time, often twelve months. The insured has, in turn, no right to a reduction in premium if the risk should improve in the course of the policy term.

B5A Position at renewal

If the insurers invite renewal of the contract the duty of disclosure is revived.

The insured will, therefore, have the duty to declare any changes in the risk or new material circumstances that have arisen during the current period of insurance. If the insured makes no such declaration, they will be taken to have affirmed that the facts relating to the risk stand unchanged.

Note that representations made in negotiations for one contract will not automatically apply to the new contract made upon renewal.

Long-term insurances

Assuming that the product is a non-consumer (business) insurance policy, in the case of life insurance and certain associated classes, the position is different. In this case, the insurer is obliged to accept the renewal premium if the insured wishes to continue the contract. There is no fresh duty of disclosure. In fact, the term 'renewal' is misleading, because these are long-term contracts that do not cease at the end of the year.

Annual payment is merely a convenient alternative to a single lump-sum premium payable at the beginning.

Example 6.14

If a person who had been insured under a life insurance policy for ten years was told by a doctor that they were suffering from a terminal illness, there would be no legal requirement to inform the insurers of this fact. However, this fact would have to be disclosed in the case of an annual personal accident and sickness policy.



B5B Continuing duty of disclosure

Both the IA 2015 and the 2012 Act now regulate the pre-contractual information duties. Previously, under the MIA 1906, the duty of fair presentation was analysed under the duty of good faith and it was not clear if the duty of good faith continued to apply at the post-contractual stage. Controversies arose as the only remedy for breach of the duty of good faith was avoidance of the policy. When applied to a post-contractual breach, this remedy created unjust results as the claims which were paid by the insurer before the breach had to be returned to the insurer.

The IA 2015 and CIDRA 2012 have both made it clear that the duty of fair presentation of the risk applies at the pre-contractual stage. They also clarified that the duty of fair presentation of the risk is not the same as the duty of good faith – they are two distinct concepts.

As mentioned above, the duty to disclose material facts which emerged after the contract was made may arise only if the contract expressly requires the assured to do so.



Be aware

An insurance contract may provide that the insured is under the duty to disclose new material facts after the contract was concluded. Two examples may be provided here:

1. Changes in the contract

The first case is where there is an agreed change in the contract during the period of insurance. In these circumstances, the insured has a duty to notify material facts which relate to the change.



Example 6.15

Where the insured changes their car or wishes to add new drivers to their motor policy, they clearly have a duty to disclose to their insurers all material facts relating to the vehicle or drivers concerned when making the change.

Similarly, if a policyholder wished to increase the sum insured under their fire policy, they would have to disclose details of any new property that they had acquired or any other relevant circumstances connected with the change, if they wish for the policy to cover such additions to the risk.

In the circumstances above, if the insured fails to inform the insurer of the relevant changes, the risk would be of a different nature than the one the insurer had agreed to cover. As a result, the insurer would be able to argue that they never agreed to insure the alterations made to the risk. However, this should not be confused with the duty of disclosure that applies at the pre-contractual stage. That duty comes to an end when the contract is made. The changes referred to above are analysed under the contract. Whereas the duty of fair presentation of the risk is an extra contractual principle.

2. Increase of risk clauses

It is open to the parties to insert an express clause in the insurance contract which requires the assured to disclose to the insurer any material circumstances that arise after the contract is made.



Example 6.16

Clauses of this sort have been included in UK fire policies for many years and also appear in contracts providing 'all risks' cover on business or industrial property, which are now sometimes used in place of the conventional fire policy. A contractual remedy may also be expressly stated in case the assured fails to comply with such a contractual requirement.

The usual form of wording provides, among other things, that if there is any 'alteration' in the property insured which increases the risk of damage, cover on such property will cease unless the alteration is admitted (i.e. notified to and accepted) by the insurers. It appears that the insured will be in breach of a clause of this sort only when the change or alteration is permanent.

These clauses are usual in commercial property and business interruption policies but less common elsewhere. However, some insurers have sought to introduce them in household and motor policies.



Activity

In terms of increase of risk clauses, what types of obligation do you think an insurer may look to include in personal motor, travel or pet insurance policies?

B6 Good faith and the duty of fair presentation of the risk

The IA 2015 separates the duty of fair presentation of the risk from the duty of good faith in non-consumer insurance. The remedy for breach of the duty of fair presentation has been amended and, in certain cases, alternative remedies to avoidance of the contract have been

introduced. As mentioned above, the Act expressly states that the duty is on the insured and is pre-contractual.

Section 17 of the MIA 1906 retains the duty of utmost good faith which may materialise in the form of the duty to act openly, honestly and in fair dealing throughout the contractual relationship. However, s.17 of the MIA 1906 does not set out a remedy for breach of the duty of utmost good faith. If the insured's failure to comply with the matters stated above is to be argued by the insurer as breach of the duty of 'good faith', the insurer will have to prove that the insured failed to act in a commercially fair and businesslike way (e.g. in altering the risk). In the absence of an express remedy in the contract for breach of the duty of good faith, the court will determine a remedy as fair, just and reasonable in the circumstances in question.

The consumer duty that the FCA has introduced as Principle 12 requires firms, including insurers, to 'act to deliver good outcomes for retail customers'. The Duty includes three cross-cutting rules which set out how firms should act to deliver good outcomes for retail customers. The cross-cutting rules require firms to:

- act in good faith towards retail customers;
- avoid causing foreseeable harm to retail customers; and
- enable and support retail customers to pursue their financial objectives.

The duty to act in good faith towards retail customers is a standard of conduct characterised by honesty, fair and open dealing, and consistency with the reasonable expectations of customers. If a firm identifies that it has caused customers harm, either through its action or inaction, the firm must act in good faith by taking appropriate action to rectify the situation. This includes considering whether remedial action, such as redress, is appropriate.

The firms are required to implement the new duty in their business practices by July 2023.

On the Web

www.fca.org.uk/publications/policy-statements/ps22-9-new-consumer-duty



B6A Good faith in the claims process

Section 17 of the MIA 1906 provides that a general duty of good faith exists throughout the currency of the policy.

This is most significant if there is a breach of good faith, and particularly fraud, during the claims process.

The law relating to claims generally is dealt with in chapter 8, but it is convenient to discuss the duty of good faith in the context of claims at this point.

Example 6.17

The leading case on this subject is the decision of the House of Lords in **Manifest Shipping Co. v. Uni-Polaris Shipping Co. (2001)** (The Star Sea).



In The Star Sea, the insured vessel of that name put to sea in what was held to be an unseaworthy condition because of defects in its fire-fighting equipment and the master's ignorance regarding the operation of the equipment. Failure to extinguish a fire on board caused the loss that was the subject of the claim.

In fact, two other vessels owned by the insured had previously been lost as a result of engine-room fires and two experts' reports had drawn the attention of the insured to the defects involved. However, these reports were not disclosed to the insurers at the time of the claim in respect of The Star Sea, which would not have been valid if the insured had known of the ship's unseaworthiness when it put to sea. The insurers argued that failure to disclose the reports was a breach of the insured's continuing duty of good faith.

In fact, the insurers failed to prove that the insured knew of the unseaworthiness, but the case is important because it clarified the extent of the duty of good faith in the context of claims.

The general effect of the decision in *The Star Sea* is to confirm the existence of a general duty, on both parties to an insurance contract, to act in good faith throughout the currency of the insurance. There is no dispute as to the existence of the post-contractual duty of

good faith but in terms of the period of time that it applies, *The Star Sea* held that it is superseded, once the parties become engaged in litigation, by the rules contained in the Civil Procedure Rules.

It is important to note that:

- making a fraudulent claim may be in breach of the duty to act in good faith, but the remedy for making a fraudulent claim is expressly stated by the IA 2015 as forfeiture of the entire claim;
- the right to repudiate the contract may arise in the case of actual fraud in the claims process, as set out by the IA 2015; that is, a deliberate attempt to deceive the insurers and gain an advantage from doing so;
- the falsehood in question must be substantial (not trivial), could be done either deliberately or recklessly (e.g. not merely negligent) and material in the sense that it had a decisive effect on the insurer's willingness to pay; and
- the burden of proving fraud rests on the insurer and the standard of proof required is likely to be rather higher than the usual standard of the civil law.

Refer to

Refer to [Fraudulent claims](#) on page 8/19 for fraudulent claims

Claiming for a loss that one knows has not occurred, or for property that has not been lost, is clearly fraud.

Similarly, exaggerating the amount of the loss in a claim against the insurer is also fraudulent.



Example 6.18

In *Galloway v. Guardian Royal Exchange (UK) Ltd (1999)* a case in which a burglary claim for £16,000 was genuine up to £14,000 but fraudulent for the balance of £2,000, the court held that the whole claim was forfeited.

If fraud is proven, the whole claim is forfeited and the insurer may also terminate the contract, should it wish to do so.

Remedy for fraudulent claims

The IA 2015 codifies the remedy for fraudulent claims in both consumer and non-consumer insurance. Section 12 of the Act states that the insurer is not liable to pay the claim if the insured makes a fraudulent claim. Moreover, the Act clarifies that the insurer may recover from the insured any sums paid by the insurer to the insured in respect of the claim.

The insurer may, by notice to the insured, treat the contract as having been terminated with effect from the time of the fraudulent act. Termination does not affect the rights and obligations of the parties to the contract with respect to a relevant event occurring before the time of the fraudulent act (s.12(3)).

The IA 2015 aims to enact remedies for fraudulent claims in group insurance. It applies to, for example, a group life policy.

That is, a policy whereby an employer takes out a policy in their own name but every employee is a beneficiary under the policy. An employee who is injured at work will be paid by the insurer. However, if, for example, an employee fakes an injury and makes a claim, they will lose their rights, but the policy itself will be unaffected and other employees will still be able to make claims (s.13).



Be aware

You should note that some insurance policies (including most commercial property insurances) have an express 'forfeiture' or 'fraud clause'. This typically states that in the event of a fraudulent claim 'all benefit under the contract shall be forfeited' or that the 'entire policy shall be void'.

The effect of this might be to invalidate even previous 'honest' claims, which would then have to be repaid to the insurer.

The validity of such clauses is subject to s.16 and s.17 of the IA 2015. Accordingly, parties may not contract out of the provisions of the IA 2015 on fraudulent claims in consumer insurance to the detriment of the insured. It is permitted to contract out of such provisions in business insurance to the detriment of the insured, but only if the insurer satisfies the transparency requirement under s.17.

Activity

Find a business property wording used by your employer or on the internet. Does it contain a fraud clause? If so, do you think the insured will be treated more harshly under the fraud clause than they would under IA 2015 if fraud was established?



Recently, the Supreme Court held that an insurer who discovers fraud after a settlement has been reached with the claimant may set aside the settlement if the requirements of misrepresentation are proved.

Example 6.19

Hayward v. Zurich Insurance Company plc (2016) In 1998 H made a claim against his employers, asserting that he had suffered a serious back injury at work. The employer's liability insurers, Zurich, argued that the claim of £419,316.59 was excessive. However, on trial, H succeeded on liability and later settled in October 2003 for £134,973.11.



In 2005, H's neighbours approached his employer and stated their belief that his claim of having suffered a serious back injury was not consistent with his conduct and activities, and that he had recovered fully from the injury about a year before the settlement. In 2009 Zurich commenced proceedings for damages for fraudulent misrepresentation and, in the alternative, avoidance of the settlement agreement.

On trial, the judge found that H had deliberately exaggerated the extent of his injuries at the original trial. The judge, therefore, set aside the settlement money and instead awarded H damages in the sum of £14,720. H was required to repay the balance. The Supreme Court later supported this decision in its ruling that it was enough that Zurich was able to show that the misrepresentation was a material cause of it entering into the settlement.

It is important to be aware that if the facts above were to arise now, it is likely that the entire claim would be struck out due to the application of the **Criminal Justice and Courts Act 2015** s.57 (under which a claim for personal injury will fail where the claimant is found to have been fundamentally dishonest in relation to part of the claim, even if part of the claim is genuine).

B6B Insurer's duty of good faith in claims handling

The new consumer duty mentioned above requires firms to enable and support retail customers to pursue their financial objectives. The FCA recognises that consumers can only pursue their financial objectives where firms support them in using the products and services they have bought.

A product or service that a customer cannot properly use and enjoy is unlikely to offer fair value. It would be regarded as a poor practice if an insurance firm has a complex claims process which deters many customers from pursuing claims. Assume that the insurer requires customers to provide hard copies of all evidence and refuses to consider any requests from customers to waive this requirement. This firm would be unlikely to be regarded as acting in good faith or enabling its customers to realise the expected benefit of the insurance product they have bought, including making a claim without unreasonable barriers.

B7 Compulsory insurances

The pre-contractual information duties apply to compulsory insurances in exactly the same way as they do to other classes.



Consider this...

What are the major classes of compulsory insurance in the UK?

There are two major types of insurance cover that are compulsory (required by law) in the UK.

Employers' Liability: insurance is required by law under the Employers' Liability Compulsory Insurance Act 1969. The Act requires employers to insure against their liability for personal injury to their employees. With respect to pre-contractual information duties, there are no special rules at all. If the proposer is guilty of misrepresentation or non-disclosure, the insurers may avoid the policy in its entirety.

In *Komives v. Hick Lane Bedding Ltd (2021) EWHC 3139 (QB)* the employer became insolvent and the injured employees addressed their claims against the employer's liability insurers. The insurers avoided the policy for breach of the duty of fair presentation of the risk as the employer misled the assured on a number of matters in relation to the business including that the employees were employed under conditions that were described as 'modern slavery'. Neither the Employers' Compulsory Insurance Act 1969 nor the Employers' Liability (Compulsory Insurance) Regulations 1998 prevented the insurer from avoiding the insurance contract for such breaches by the assured.

Motor Insurance: all drivers are required by law (under the Road Traffic Act 1988) to have in force an insurance policy to cover their liability for bodily injury to or damage to third party property which arises from the use of a motor vehicle.

Regarding pre-contractual information duties there is a basic right for insurers to avoid the insurance policy for breach of the pre-contractual information duties. Under s.151 of the **Road Traffic Act 1988** (RTA 1988) there is a special procedure which allows the victim of a road accident who has obtained a judgment (order for damages) against a guilty motorist to claim directly from the latter's insurers. The RTA 1988 s.152(2) specifically allowed insurers to refuse payment if the policy was 'obtained' by non-disclosure or misrepresentation by obtaining a declaration from the court confirming the right to avoid. The RTA 1988 s.152 has been amended by the **Motor Vehicles (Compulsory Insurance) (Miscellaneous Amendments) Regulations 2019**, which came into force on 1 November 2019. Accordingly, the insurer is no longer permitted to either avoid or cancel the insurance policy after the traffic accident has occurred (i.e. after the third party victim suffers injury as a result of the accident for which the insured is responsible). However, the insurer may still avoid the insurance contract **before** the event (the cause of death/bodily injury/damage to property, giving rise to the liability) taking place.

Since the 2012 Act (in consumer insurance) and the 2015 Acts (in business insurance) came into force, the remedy of avoidance for insurers under s.152(2)(a) of the Road Traffic Act 1988 can be sought only for situations which entitle the insurer to avoid the contract within the 2012 Act, i.e. only where the insurer proves a qualifying misrepresentation. Additionally, the breach of the duty of fair presentation of the risk has to be either deliberate or reckless or if neither deliberate nor reckless, the insurer can prove that the insurer would not have entered into the contract with the assured had there been no breach (i.e. had there been a fair presentation of the risk).

C Breach of the pre-contractual information duty

A breach of the pre-contractual information duty may occur on the part of the insured only. In other words, only an insured (or proposer) can breach this duty.

Be aware

You should note that, here, we are considering breach of the pre-contractual information duty in relation to the negotiation or renewal of a policy and not in the context of claims (which we have discussed already).



C1 Breach by the insured

C1A Non-consumer (business) insurance

In non-consumer (business) insurance, a breach of the duty of fair presentation of the risk may take the form of:

- misrepresentation; or
- non-disclosure.

In non-consumer insurance the breach of the duty may be in the form of innocent, negligent or fraudulent, and the remedy provided by the Act for the breach is proportionate to the seriousness of the breach.

The IA 2015 introduces a proportionate (to the seriousness of the breach) remedy for breach of the duty of fair presentation of the risk. The first point to note is that the insurer has a remedy against the insured for a breach of the duty of fair presentation of the risk, only if the breach is 'qualifying'. A **qualifying breach of the duty of fair presentation of the risk** is where the insurer shows that, but for the breach, it:

- would not have entered into the contract of insurance at all; or
- would have done so only on different terms (s.8(1)).

In other words, a qualifying breach is the one where the insurer proves inducement. In this case:

- The insurer may avoid the contract (to treat it as if it never existed) if a qualifying breach was either deliberate or reckless (schedule 1). In such a case, the insurer need not return any of the premiums paid (schedule 1).
- If a qualifying breach is neither deliberate nor reckless, the insurer may avoid the contract if the insurer would not have entered into the contract on any terms in the absence of the breach. In this case, however, the insurer must return the premiums paid (schedule 1).

Since the IA 2015 provides a proportionate remedy to the seriousness of the breach, the insurer may not avoid the contract but seek an alternative remedy if the insurer **cannot** show that it would not have entered into the contract on any terms but for the breach (in cases where the breach is neither deliberate nor reckless). As such:

- If the insurer would have entered into the contract, but on different terms (other than in relation to the premium), the contract is to be treated as if it had been entered into on those different terms if the insurer so requires.
- For example, if there had been full disclosure, the insurer would have included an exclusion clause in the policy and so the clause is treated as part of the contract.
- If the insurer would have entered into the contract, but would have charged a higher premium, the insurer may proportionally reduce the amount to be paid on a claim.
- The formula to calculate the percentage to 'reduce proportionally the amount to be paid on a claim is:

$$x = \frac{\text{Premium actually charged}}{\text{Higher premium}} \times 100$$

- In other words, if the insurer would have charged a premium of £1,350 but in fact charged £1,000, the consumer would receive 74% of their claim (i.e. $1000/1350 \times 100$).

Under the **Misrepresentation Act 1967**, in the case of a fraudulent misrepresentation, insurers may have a right to claim damages in addition to avoiding the policy. If the misrepresentation is negligent, damages will be available as an alternative to avoiding the policy. However, there has been no reported English case of an insurer recovering damages from the insured under the 1967 Act, so the right is one that exists in theory rather than practice.

Remedies for breach of the duty of fair presentation of the risk by the insured (business insurance)		
	Innocent breach by the insured	Deliberate or reckless breach by the insured
Right to avoid the policy as a whole?	YES (if the insurer proves that the insurer would not have entered into the contract at all had there been a fair presentation)	YES
Right to keep the premium as well?	NO	YES
Right to ignore the breach and allow the policy to stand?	YES	In theory YES (it may be considered unlikely that, after discovering the assured's state of mind (either deliberately or recklessly breaching the duty) the insurer would exercise the option of keeping the policy in force).
Right to refuse a particular claim but allow the policy to stand?	YES (although this should be a business like decision, the relevant legislation does not entitle the insurer to do so but does not prevent the insurer from doing so either)	In theory YES (but would the insurer keep the policy enforceable after discovering the assured's state of mind (either deliberately or recklessly breaching the duty)?)

If the insurer wishes, it may waive (give up) its right to avoid the contract and allow the policy to stand.

In most cases, waiver takes place by 'affirming' the breach. In other words, while the insurer may treat the contract as if it never existed, it treats the contract as still enforceable between the parties – e.g. it pays the claim under the contract by electing not to avoid it.

Additionally, after discovering the breach, a long-term silence on the part of the insurer may also be interpreted as waiver (as opposed to avoiding the policy within a reasonable time). There is a danger that if the insurer stays inactive for some time after discovering the breach, its silence may be interpreted as 'waiver' of the breach.

For instance, if the insurer purports to avoid the contract seven years after the insurer had discovered the breach, the court would question why the insurer waited for so long. On the other hand, a three-month silence is likely to be interpreted as the insurer needing time to investigate the claim before purporting to avoid the insurance contract.

Variations

The provisions of the IA 2015 regarding the duty of fair presentation of the risk also apply to variations of the contract (s.2(2)). Part 2 of schedule 1 of the Act sets out remedies for breach of the duty of variations to the contract. Accordingly, if a qualifying breach was deliberate or reckless, the insurer may terminate the contract from the time when the variation was made. To terminate the contract, the insurer must give the insured notice of termination. The insurer will not need to return any of the premiums paid upon termination under these circumstances.

If the breach of the duty of fair presentation was not deliberate or reckless, the remedy is based on what the insurer would have done had the insured made a fair presentation of the additional or changed risk on variation. The IA 2015 makes a distinction between variations involving a reduction in premium and all other variations (that is, where the premium was increased, or not changed, as a result of the variation). In either case, if the insurer would not have agreed to the variation on any terms, the insurer may treat the contract as if the variation was never made.

If the premium was increased, the insurer must return the additional premium paid for the variation. If the premium was reduced, the insurer may reduce proportionately the amount to be paid on claims arising out of events after the variation.

If the insurer would have included additional terms relating to the variation (e.g., a warranty relating to the new risk), the insurer may treat the variation as if it contained those terms.

If the insurer would have charged a different premium for the variation, or would not have changed the premium when in fact it increased or reduced it, the amount to be paid on claims arising out of events occurring after the variation may be reduced in proportion to the premium that the insurer would have charged. Paragraph 11(3) of schedule 1 makes further provision about the formula, depending on whether the insurer increased or reduced the premium or did not change it.

C1B Contracting out

The parties to a non-consumer insurance contract may contract out of the IA 2015 to the detriment of the insured by what the Act refers to as a 'disadvantageous term'. However, the Act provides that the parties may only do so if the transparency requirement is met; this means that the disadvantageous term must be clear and unambiguous as to its effect and the insurer must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into or the variation agreed.

Group insurance

As per the IA 2015, we will use the following definitions:

- 'Cs' refers to one or more persons who are covered by the contract; and
- 'Consumer C', is a person who is one of the aforementioned 'Cs' whose cover could have been a consumer insurance contract if they had entered into the contract themselves.

Refer to

Refer to [Good faith in the claims process](#) on page 6/17 for s.13 of the IA 15

Under s.18(2) of the Act, and with reference to matters dealt with in s.13 of the Act, if a term of the contract puts one of the consumer C in a worse position than the individual would otherwise be in, it is of no effect. The policyholder in this situation will usually be a non-consumer such as an employer, and therefore, the contract will usually be a non-consumer insurance contract. However, though the contract is a non-consumer contract, the real beneficiaries are consumers who are protected from the effects of contracting out.

With reference to non-consumer C (any of the Cs who are not consumers), and with reference to matters dealt with in s.13 of the Act, if a term of the contract puts non-consumer C in a worse position than they would be in by virtue of that section, it is of no effect, unless the requirements of s.17 have been met.

It is possible that a consumer may take out a policy for the benefit of other consumers who become group members. In this situation the contract would be a consumer contract. This is dealt with by s.15 of the Act.

C1C Consumer insurance

Under the 2012 Act, the insurer can only seek remedy if misrepresentation is qualifying. That is if:

- the misrepresentation was caused by the consumer's failure to exercise reasonable care; and
- the insurer shows that without the misrepresentation, it would not have entered into the contract (or agreed to the variation) at all, or would have done so only on different terms.

The 2012 Act classifies qualifying misrepresentation as either:

- deliberate or reckless if:
 - the consumer knew that it was untrue or misleading, or did not care whether or not it was untrue or misleading; or
 - knew that the matter to which the misrepresentation related was relevant to the insurer, or did not care whether or not it was relevant to the insurer.
- or, careless; i.e. if it is not deliberate or reckless.

The burden of proof that a qualifying misrepresentation was deliberate or reckless is on the insurer. In this respect, the 2012 Act also states that unless the contrary is shown, it is presumed that:

- the consumer had the knowledge of a reasonable consumer; and
- the consumer knew that a matter about which the insurer asked a clear and specific question was relevant to the insurer.

The cases on the breach of the duty of fair presentation of the risk by a consumer demonstrated that unless the insurer satisfies such burden of proof the insurer may not avoid the contract. In both ***Southern Rock Insurance Co Ltd v. Hafeez (2017)*** and ***Ageas Insurance Ltd v. Stoodley (2019)*** the insurer argued that the assured breached the duty either deliberately or recklessly but the courts held that the assureds were careless, but not either deliberate or reckless in breaching their duty.

Insurers' remedies for qualifying misrepresentations

Qualifying misrepresentations were deliberate or reckless:

The insurer may avoid the contract if a qualifying misrepresentation was deliberate or reckless. In such a case, the insurer need not return any of the premiums paid, except to the extent (if any) that it would be unfair to the consumer to retain them.

Qualifying misrepresentation was careless:

In such a case, the insurer's remedies are based on what it would have done if the consumer had exercised reasonable care not to make a misrepresentation.

- If the insurer would not have entered into the consumer insurance contract on any terms, the insurer may avoid the contract and refuse all claims, but must return the premiums paid.
- If the insurer would have entered into the consumer insurance contract, but on different terms (excluding terms relating to the premium), the contract is to be treated as if it had been entered into on those different terms if the insurer so requires.
- If the insurer would have entered into the consumer insurance contract (whether the terms relating to matters other than the premium would have been the same or different), but would have charged a higher premium, the insurer may proportionately reduce the amount to be paid on a claim. The formula is again as follows:

$$x = \frac{\text{Premium actually charged}}{\text{Higher premium}} \times 100$$

The formula to calculate how much the insurer may deduct from the insured amount to be paid, is the same formula which applies in business insurance under the IA 2015 as stated above.

In ***Zurich v. Jones*** mentioned above, the insurer did not allege a deliberate or reckless breach. The insurer purported to avoid the contract and, since the breach was careless, the insurer could do so only if the insurer proved that it would not have entered into the contract in the absence of misrepresentation. The expert evidence showed that the policy would not have been issued had the insurer known of the earlier claim. The insurer, therefore, successfully avoided the policy.

Insurance on the life of another

The 2012 Act also states that where a life policy is taken out by the insured on the life of another person (L), where L is not a party to the policy, any information provided to the insurer by L is to be treated as having been provided by the insured themselves. For example, if a wife takes out a policy on the life of her husband, and the husband deliberately misstates facts about his health, the insurers will have the appropriate remedy against the wife as the insured. The insurer also retains its rights under the Act against the wife in respect of any false statements made by her.

C2 Breach by the insurer

As mentioned above a breach of the pre-contractual information duty may occur on the part of the insured only. If the insurer breaches the pre-contractual information duty, it will be considered under s.17 of the MIA 1906.

Neither the IA 2015 nor the 2012 Act contain any provisions about the insurer's breach of the duty of fair presentation of the risk. If the insurer is in breach of the pre-contractual information duty, it will be analysed under s.17 of the MIA 1906.

Prior to its amendment by the IA 2015, section 17 of the MIA 1906 stated:

A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.

However, s.14(3) of the IA 2015 omits the words 'and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party'. As such, a contract of marine insurance under the IA 2015 is still a contract based upon utmost good faith, but without the attachment of the remedy of 'avoidance' to its breach.

MIA 1906 s.17, in its amended form, omits the remedy of avoidance. Therefore, as mentioned above, if either the insured or the insurer breached the duty under s.17, the remedy will be decided by the court as the court finds it just and fair under the circumstances.

Furthermore, the IA 2015 does not overrule any common law rule which imposes a general duty to act in good faith. As a result of this duty, the insurer may be required to act in good faith at the pre- and post-contractual stage in the form of disclosing material information to the insured and to act in a fair and business-like manner in claims handling. It seems, therefore, that the insurers' duty of good faith will be decided by the common law and the MIA 1906.

In addition, an insurer may be deprived of the right to avoid a policy because of its own lack of good faith.

Pre-contractual breach by the insurer

Example 6.20

Banque Financiere de la Cite S.A. v. Westgate Insurance Co. Ltd (1991) concerned non-disclosure on the part of the insurers. The insurers were aware that insurance brokers had fraudulently issued cover notes for credit insurance to their clients when the cover had not been completed and were sued by the insured for failing to disclose this fact to them. The case confirmed the previous position under the MIA 1906 that the only remedy for the insured in such a case was to avoid the contract and recover the premium. It was held that there was no right to claim damages in addition.



If this case had come before the courts after the IA 2015, the court would have been able to decide on an alternative remedy to avoiding the contract by the insured by applying s.17 of the MIA 1906 and the common law.

It should be noted that the **Financial Services Act 2012**, s.89 – replacing s.397 of the Financial Services and Markets Act 2000 with effect from 1 April 2013 – makes it a criminal offence for a person to make a statement which they know to be false or misleading in a material respect, and to make such a statement recklessly or dishonestly to conceal any material facts, in each case with the intention of inducing another person to enter into a contract of insurance.

Further, s.90 of the 2012 Act creates the offence of engaging in a course of conduct which creates a false or misleading impression of the market or the price of a specified relevant investment. The provisions apply to all financial products, and if it relates to an insured or insurer or a consumer or non-consumer, there may be a criminal remedy for misrepresentation.

Alternatively, as far as retail consumers are concerned, the insurer's breach of the duty of good faith, if it falls under the new consumer duty, can also be assessed under the Principle 12 duty as mentioned above. For instance, as the FCA explains, enhanced home insurance that covers additional risks or provides enhanced customer service often costs more than a standard policy and this is likely to be reflected in the price. Retail consumers do not all need to claim under the additional coverage, or make use of the additional customer services, for the product to provide fair value.

Insurers must ensure that there is a reasonable relationship between the price charged and benefits and that there is a reasonable probability of a consumer in the target market claiming when the policy was designed and sold.

In such cases the firms are under the duty to remedy their poor practices. They are required to 'put themselves in their customers' shoes' when considering whether their communications equip customers with the right information, at the right time, to understand the product or service in question and make effective decisions.

C3 The Insurance: Conduct of Business (ICOBS) rules

Alongside the ongoing project of reform of insurance law, there have also been some regulatory changes which affect, mainly, personal lines of insurance. To a large extent it is the requirements of these regulatory changes which have now been enacted in the Consumer Insurance (Disclosure and Representations) Act 2012 discussed above. It is useful to understand a little about the background of these regulatory changes when considering the impact and intent of the Act.

In February 2005, the Financial Services Authority (FSA) took over the regulation of general insurance business in the UK and, as part of the process, the previous voluntary Statements of Insurance Practice used by the industry were withdrawn and replaced by a set of rules contained in the FSA Insurance Conduct of Business (ICOB) Sourcebook, which was part of the FSA 'Handbook' of regulations governing the financial services industry as a whole. However, the FSA was replaced by two new regulators, the FCA and PRA, in April 2013.

The rules were revised in January 2008 as the FSA Insurance: Conduct of Business Sourcebook (ICOBS) and have been adopted by the FCA from April 2013 as the FCA now regulates insurers and intermediaries for conduct of business issues.



Be aware

The provisions relating to the duty to take reasonable care not to make a misrepresentation are mainly contained in chapter 8 of ICOBS, which deals in general terms with claims handling by insurers.

In relation to breach of the duty to take reasonable care not to make a misrepresentation, rule 8.1.1 states:

An insurer must:

...not unreasonably reject a claim (including by termination or avoiding a policy).

Rule 8.1.2 then goes on to address what is meant by 'not unreasonably reject a claim'.

Other than where there is evidence of fraud, a rejection of a consumer's claim will be unreasonable if it is for:	Non-disclosure, where the policyholder could not reasonably be expected to have disclosed the material fact. Non-negligent misrepresentation of a material fact.
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This rule is similar to the provision in the Statements of Insurance Practice, mentioned above, whereby insurers undertook not to repudiate claims where the breach of good faith was innocent. Similarly, the rule applies, in effect, only to 'private' insurances, except that the rule now uses the term 'retail customer' to describe those to whom it applies.

'Consumer' is defined as 'any natural person who is acting outside their business, trade or profession' (buyers of insurance who are not 'consumers' are described as 'commercial customers').



Consider this...

Why would the regulators make such a distinction between consumers and commercial customers?

The reason for confining the rule to 'consumers' is that 'commercial customers' – business people who buy insurance – are assumed to be better informed than private buyers and more likely to have the benefit of expert advice (including that of an insurance broker) when arranging their insurance. As a result, they are less in need of protection.

The ICOBS rules apply to all insurers regulated by the FCA and PRA. They also have the force of law, so that the FCA could bring enforcement action against an insurer that acted in breach of them.

The ICOBS rules also restrict an insurer's rights to seek remedy for breach of warranty or condition and lay down a number of general requirements in connection with claims handling by insurers.

These issues are discussed in more detail in the chapters that follow.

Activity

Look again at the Law Commission's reform of consumer insurance law as discussed above. Compare the 2012 Act to the requirements under ICOBS.



D Scenario 6.1

D1 Scenario 6.1: Question

Apply the main principles governing the formation of insurance contracts to practical situations (LO5.8)

You work for an insurance company. Mary books an appointment with you to arrange motor insurance for herself. She tells you she is 30 years old and has no previous driving convictions. Mary takes out insurance with your company based on the information she has provided. A colleague sees Mary in the office and later tells you that he knows her. He says she is 21 years old and has been previously disqualified from driving.

Identify, with justification, what remedies are available to you, the insurer.

When planning your answer, use the following four-step IRAC approach:

- provide an **introduction** that identifies the focus of the question;
- look at the **relevant** areas of law;
- **apply** the principles of the law to the scenario; and
- provide a **conclusion** to your answer.

Note: the M05 study text is based on English law. All scenarios included are set in England; therefore English law applies.

D2 Scenario 6.1: How to approach your answer

Aim

This fictional case study tests the reader's ability to apply the pre-contractual information duty to practical situations (learning outcome 5.8).

It is recommended that you use the following four-step IRAC approach when planning your answer.

Look at the relevant areas of law

The relevant law depends on the nature of the transaction. Different legal principles apply depending on whether the contract is a non-consumer (business) or a consumer contract. As this is a consumer contract, the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) would apply. The test is now whether the consumer has acted with reasonable care rather than the materiality of the information given.

Provide an introduction that identifies the focus of the question

Assuming that Mary took out the motor policy as a consumer for herself, this question is about potential misrepresentation – in the consumer insurance context no duty of disclosure applies. Where the insurer argues Mary's breach of the relevant duty, the focus of the investigation will be whether Mary exercised reasonable care not to misrepresent to the insurer.

If Mary is found to have failed to exercise such care, the next question will be whether the insurer was induced to enter into the contract by Mary's misrepresentation. Assuming that the insurer satisfies the inducement text, then the investigation will move to if Mary was careless, or she breached the duty either deliberately or recklessly. The last matter then will

determine the remedy – whether avoidance or otherwise – that the insurer is entitled to seek for the breach.

Apply the principles of the law to the scenario

It is likely that a proposal form was completed which would require Mary to give certain information. Depending on what information was required, the incorrect responses may be regarded as misrepresentations. The information given seems to relate to moral hazard – i.e. to the individual rather than the subject matter. Age discrimination is outlawed under the Equality Act 2010 but, in insurance, actuarial information may be relevant and linked to age. The most serious issue here could be Mary's driving history. You, as the insurer, could only seek a remedy under certain circumstances. You would have to show that any misrepresentation was qualifying – i.e. the insurer was induced to enter into the contract by a material misrepresentation.

In other words it is necessary to prove that had there been no misrepresentation, the actual insurer (you) would not have entered into the contract at all, or, if you would have agreed to insure Mary, would you have done so on different terms than you did.

The remedies available to you depend on the nature of the misrepresentation. If, for example, it was deliberate or reckless as might be inferred here (the burden of proof being on you, the insurer) then the contract of insurance can be avoided (i.e. when avoided it will be of no legal effect). If it is a careless misrepresentation, you may be entitled to proportionately reduce the payments of any claims, using the actual premium you would have charged with the correct information.

Or, you could treat the contract as having been entered into on different terms than you actually did, e.g. including an exclusion clause upon knowledge of the driving history.

Remember to provide a conclusion to your answer that directly links back to the question and relevant area(s) of the law.



Key points

The main ideas covered in this chapter can be summarised as follows:

Introduction

- Contracts of insurance are contracts based upon utmost good faith.
- In consumer insurance, there is no duty of disclosure. Instead, there is a duty to take reasonable care not to make a misrepresentation.
- In non-consumer (business) insurance, the duty to make a fair presentation of the risk imposes the following on the parties to the insurance contract:
 - a duty not to misrepresent any matter relating to the insurance; and
 - a duty to disclose all material facts relating to the contract.
- The test for material misrepresentation in insurance contracts is modified from that in general contracts.

Misrepresentation

- A material fact in insurance is defined according to what a ‘prudent underwriter’ would deem material rather than a reasonable person.
- In non-consumer (business) insurance, as a matter of strict law, an insurer may seek remedy on the grounds of misrepresentation regardless of whether the misrepresentation is fraudulent, negligent or completely innocent.
- In consumer insurance, the insurer may only seek remedy for a misrepresentation which is either deliberate or reckless or careless (i.e. negligent). The 2012 Act excludes an innocent breach from its scope as it imposes the duty to take reasonable care not to misrepresent material facts.

Duty of disclosure

- In non-consumer (business) insurance only, there is a positive duty of disclosure going beyond a mere duty not to misrepresent what is in fact disclosed.
- In both consumer and business insurance, the insurer has to prove inducement before seeking remedy for breach of the pre-contractual information duties.
- Unlike the MIA 1906, the IA 2015 provides some guidance to determine materiality of a fact.
- In non-consumer (business) insurance, material facts that should be disclosed include facts relating to physical hazard and moral hazard.
- In non-consumer (business) insurance, some things need not be disclosed even if they are material. These include:
 - matters of law;
 - factors which lessen the risk;
 - facts known by the insurers and those which the insurers ought to know;
 - information that is waived by the insurers;
 - facts which the proposer does not know and ought not to know; and
 - convictions that are ‘spent’ under the Rehabilitation of Offenders Act 1974, as amended by the Legal Aid, Sentencing and Punishment of Offenders Act, 2012.
- The pre-contractual information duties begin at the commencement of negotiations and come to an end once the contract is concluded. A fresh duty arises when the contract is renewed.
- As contracts of insurance are contracts based upon utmost good faith, the parties must act in good faith throughout their contractual relationship. Remedy for breach of the duty to act in good faith will be determined by common law.
- The pre-contractual information duties apply to compulsory insurances in exactly the same way as they do to other classes – although in the compulsory motor vehicle insurance context, when a victim makes a claim against the insurers, the insurer's

Key points

ability to avoid the contract after the accident occurred is restricted by the relevant statutory provisions.

Breach of the pre-contractual information duties

- In business insurance, the insurer's remedy for breach of the duty of fair presentation of the risk depends on whether the breach is deliberate or reckless or whether it is neither deliberate nor reckless.
- In consumer insurance, the insurer's remedy for breach of the duty to take reasonable care not to make a misrepresentation depends on whether the misrepresentation is deliberate, reckless or careless.
- If insurers are in breach of the duty of fair presentation of the risk, the remedy will be determined by common law in reference to s.17 of the MIA 1906. The conduct regulators of the insurers in the UK also impose the insurers to act in good faith in some certain circumstances. An insurer who fails to comply with such principles by their poor practices will be required to remedy such practices and the harm suffered by the consumer as a result. See the new consumer duty under Principle 12.

Self-test questions

1. What two duties does the duty of fair presentation of the risk in non-consumer (business) insurance impose on the insured?
2. Distinguish between innocent and deliberate or reckless misrepresentation.
3. What is meant when it is said 'a contract of insurance is a contract based upon utmost good faith'?
4. How does the law define a material fact in non-consumer (business) insurance?
5. In non-consumer (business) insurance, if the insured fails to disclose a material fact and, subsequently, a loss occurs, do the insurers have to prove that there is a connection between the non-disclosure and the particular loss in order to seek remedy for the non-disclosure?
6. In non-consumer (business) insurance, in what two cases might there be a continuing duty of disclosure under a general insurance policy?
7. In non-consumer (business) insurance, can insurers avoid the policy for breach of the duty of fair presentation of the risk in the case of (compulsory) employers' liability insurance?
8. In non-consumer (business) insurance, can insurers reject a particular claim but allow the policy to stand when there is a breach of the duty of fair presentation of the risk?
9. In non-consumer (business) insurance, how do the remedies for breach of the duty of fair presentation of the risk vary according to whether the breach is either deliberate or reckless or innocent?
10. Explain the circumstances under which an insurer can avoid the policy taken out by a consumer insured.

You will find the answers at the back of the book

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7

Insurance contracts and key terms

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Learning objectives

After studying this chapter, you should be able to:

- explain the main rules governing the interpretation of insurance contracts;
- explain the rules that apply to the construction of contracts;
- understand warranties and other terms of insurance contracts;
- explain how warranties are made and describe the effect of a breach of warranty or other term; and
- distinguish between joint and composite insurance contracts and explain the rights under them.

Introduction

We have seen that a breach of the pre-contractual information duty by the assured may allow the insurer to avoid the contract. Furthermore, the breach may take the form of either non-disclosure or misrepresentation, but remember that the former does not apply in business consumer insurance.

The above does not arise out of the contract as the duty of fair presentation of the risk applies at the pre-contract stage.

When a term of the contract is breached (not complied with) by one party, the law allows the other party to seek a remedy for such breach.



Consider this...

How could an insured breach an insurance contract? And how could an insurer breach an insurance contract?

Breach by an insurer might fail to indemnify the assured within a reasonable time for a valid claim. The insurer's failure to do so would be a breach of an implied term under IA 2015 section 13A.

Breach by an insured is when an insured may fail to pay the premium. In practice, it is usually the insured rather than the insurer who breaches an insurance contract.

It is important to understand the difference between a breach of the pre-contractual information duties and breach of contract.

- Breach of pre-contractual information duties: the breach normally arises from a failure to supply full and accurate information in the negotiations that lead up to the formation of the contract, in other words, before the contract has come into existence.
- Breach of contract: the breach arises from a failure to comply with a term of the contract itself, so that the breach occurs after the contract has been made and as a result of one party not keeping to the agreement that has now come into force.



Key terms

This chapter features explanations of the following terms and concepts:

Ambiguity	Collateral conditions	Composite insurance	Compulsory insurances
Conditions	Construction	Exact compliance	Exception clauses
Implied warranties	Joint insurance	Statutory rules	Warranties

A Terms of a contract

You will recall that when we speak of the terms of a contract, we simply mean the details of the agreement. A contract term is defined as any provision or term that forms part of a contract. Each of these terms provides a contractual obligation and if this is breached, then it will lead to certain remedies.

The terms are usually contained in a written document but in some cases they may be oral or implied by law – in that sense, not all the terms of a contract are contained in the written agreement.

A1 Terms in non-insurance contracts

In *Conditions and warranties* on page 3/19, we saw that in the general law of contract, terms are traditionally classified into *conditions* and *warranties* and that this classification is based on the importance of the terms in question and the consequences if they are not observed.

Consider this...

In the general law of contract, which has more serious consequences, breach of a warranty or breach of a condition?



You will recall that a warranty in the general law of contract is a term concerning a minor part of the agreement only. If it is broken, the injured party has a right to claim damages but not, in general, to treat the contract as repudiated.

A condition, on the other hand, is a term that relates to an important aspect of the agreement: it 'goes to the root' of the contract. If such a term is broken, the victim has a right not only to claim damages but also to terminate the contract.

A2 Terms in insurance contracts

Be aware

You should note from the beginning that the words 'condition' and 'warranty', though they are used in insurance, do not have the same meaning as in the general law of contract.



The classification of the terms of an insurance contract is in some ways more complex than the classification that applies in the general law of contract.

In this chapter we are concerned mainly with terms that impose obligations on the insured, i.e. those that require the insured to do something (or not do something) as their part of the bargain.

The terms of an insurance contract cover all sorts of things including, for example, requiring the assured to take some risk avoidance measures and to notify a loss within a clearly defined period of time (e.g. within 72 hours after the insured becomes aware of the loss). These provisions may be described as 'conditions' or even 'warranties' in the contract, depending on how they are worded. If the insured fails to comply with a term of this sort, a question then arises as to what is the effect of the breach:

- Does the cover end automatically, or do the insurers have the choice of ending it?
- Or do the insurers simply have the right to refuse payment of a particular claim or, perhaps, only claim damages?
- Or does the cover stop when the term is not being complied with and then start again when the insured does comply?

Judges and lawyers have developed a variety of words and expressions to describe the terms that bring about various different effects, including 'warranty', 'condition precedent' and 'suspensive condition', but these are, in most cases, simply convenient labels. They are more than labels with regards to claims (when a condition precedent to insurer's liability is a claim provision, i.e., it is not risk related, section 11 of IA 2015 doesn't apply and upon its breach, the insurer is not liable).

In other words, as explained in *Warranties, conditions and other terms* on page 7/9, remedies for warranties and conditions precedent used to be determined on the basis of how such term was classified: warranty or condition precedent. Such labelling determined the remedy for the term's breach. Since the IA 2015 s.11, such labelling alone does not suffice for the insurer to seek the remedy that the law allows for breach of the term.

However, as also explained in *Warranties, conditions and other terms* on page 7/9 in detail, s.11 of IA 2015 does not apply to claims provision. Therefore, if the policy labels a claim provision (e.g. a claim co-operation clause), breach of that clause, if condition precedent, suffices the insurer to deny liability for the reason of the assured's breach. In order to be able to understand the link between a condition, a warranty (i.e. labelling) and the remedy, and s.11's interference with the insurer's ability to seek remedy for their breach and the areas where such interference is not possible you need to understand:

- warranties;
- conditions;
- remedies allowed under IA 2015 and the court cases and contractual remedies: and
- s.11 IA 2015.

And you need to separate claims provisions from other types of contractual obligations as their breach is assessed differently as covered in several different chapters of this study text.

A3 Interpretation of insurance contracts

An insurance underwriter must, of course, decide which risks are acceptable and which must be rejected. However, the underwriter must also decide how much cover they are prepared to grant for a given price.

Some perils (such as war perils) may not be insurable at all (in the sense that not enough premium will be collected by the insurer to pay the vast amount of damage caused by a war) and others may be insurable only for an extra premium.

The cover provided under an insurance contract must be precisely defined. It will be necessary to state clearly the perils which are covered, and the perils which are excluded. To achieve this, the insurance policy must be drafted carefully. Its meaning must be clear and there must be no ambiguities or inconsistencies between different parts of the document.



Example 7.1

- What exactly is meant by words such as 'storm' or 'flood' when they are used in insurance policies?
- Is damage to the roof of my house caused by strong wind or a heavy snowfall, damage by 'storm'?
- If I forget to turn off the taps when I run a bath and the overflowing water ruins my carpets, is this a 'flood'?

Unfortunately, even with careful policy drafting, disputes about the meaning of the words used in insurance contracts occur from time to time, especially when large amounts of money are at stake, the issues are unique (have not been considered by the courts before), and when both sides think that they have a good legal case. Issues may arise, for instance, on the true meaning of an exclusion or whether the words used in the policy cover the loss in question. The COVID-19 pandemic was a good example of disputes arising regarding the meaning of words used in insurance policies.

In this section we are concerned with the rules which have been developed to resolve these disputes, i.e. the rules which govern the meaning and scope of words used in insurance policies. These are sometimes called rules of *construction* which, in this context, simply means rules of interpretation.

If a dispute involving the words in an insurance policy comes before an English court, the role of the court is merely to decide the meaning of the words used by the parties.

Unless, perhaps, the term is covered by the Consumer Rights Act 2015 discussed below, the court has no general power to overturn or question an exclusion clause or other term of the policy on the grounds that it is unreasonable, or unfair to one of the parties.

The principles of interpretation used by the courts fall into two categories:

- **statutory rules** (i.e. rules laid down in legislation); and
- **common law rules** (i.e. rules developed by the courts).

We will consider each in turn.

A4 Statutory rules

In some countries the wording of insurance policies is tightly regulated. In some cases policy wordings have to be specifically approved by a government regulator or even follow a standard wording laid down at state level.

Refer to

Refer to [Unfair Contract Terms Act 1977](#) on page 3/17 for UCTA

You should note, however, that under English Law there is very little statutory control over the wording of insurance policies generally, so that the parties are almost completely free to include whatever terms they wish.

The COVID-19 Business Interruption insurance test case of January 2021 was a good example of this – there were more than 20 different policy languages used by 20 different insurers.

You will recall also that insurance policies are excluded from the **Unfair Contract Terms Act 1977 (UCTA)**, which allows the wordings of some contracts to be challenged on the grounds that they are unreasonable. Nevertheless, some statutory control has been imposed by the **Consumer Rights Act 2015** (which replaced the **Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR)**).

A4A Consumer Rights Act 2015

In *Consumer Rights Act 2015* on page 3/18, we looked at how the Consumer Rights Act 2015 affects terms of a contract. We will now look in more detail at how it affects the construction of insurance contracts specifically.

Before the enactment of the Consumer Rights Act 2015, UTCCR applied to certain contracts entered into by consumers. Contracts concluded between a trader and a consumer have now been removed from the scope of UTCCR so that it only applies to contracts concluded between parties acting in the course of business.

The 2015 Act makes the following changes to consumer contracts:

- Removal of the requirement that ‘a term must not have been individually negotiated before a term could be challenged on the grounds that it was unfair’. The consumer is now entitled to claim the protection of part 2 even when the term has been individually negotiated with the trader. Terms which define the main subject matter of the contract or determine the price are excluded from review, as long as they are in ‘plain, intelligible language’.
- Prohibition of traders from referring to either a term of a consumer contract or a consumer notice to exclude or restrict liability for death or personal injury resulting from negligence.
- Provision that neither an unfair term of a consumer contract nor an unfair consumer notice is binding on the consumer (s.62).

Section 62 goes on to define an unfair term or notice as that which, contrary to the requirement of good faith, causes a significant imbalance in the parties’ rights and obligations under the contract to the detriment of the consumer.

Where a term of a consumer contract is not binding on the consumer as a result of part 2 of the Act, the contract continues, as far as is practicable, to have effect in every other respect (s.67).

Unlike UCTA, this legislation does apply to insurance contracts, provided the policyholder is a ‘consumer’.

Section 65 of the 2015 Act, which relates to ‘traders’, does not apply to insurance.

Be aware

The Act is not concerned with the overall fairness of the agreement itself, but rather with the ability of the consumer to enforce their rights under it.



The Act may not be used by an insured who wishes to challenge the validity of a particular exclusion or warranty on its policy or to argue that the overall cover provided was too narrow, given the premium paid. However, an insured might well be able to use the Act to challenge the fairness of conditions relating to the claims process, if they appeared to impose unreasonable demands.

Example 7.2

A claims condition allowing the policyholder only a very short period of time in which to notify a claim is likely to infringe the regulations.



This may also apply to a condition which requires the insured to provide an excessive amount of documentary proof in support of their claim.

A5 Common law rules for the interpretation of insurance policies

Over the years the courts have developed many rules to help resolve doubts about the meaning of words used in contracts. We will examine the main ones here. You should note that these rules of interpretation apply to non-consumer (business) contracts and legal documents generally, and not just to insurance policies.

A5A Ordinary meaning

Refer to

Refer to [Common law rules](#) on page 1/17 for the literal rule

In the case of a dispute, the court will assume that the parties intended the words in question to bear their ordinary meaning. This is, essentially, the same 'literal rule' that applies to the interpretation of statutes.



Example 7.3

In *Thompson v. Equity Fire Insurance Co. (1910)* a fire policy covering a shop excluded liability for loss or damage occurring 'while gasoline is stored or kept in the building insured'. The policyholder did, in fact, have a small quantity of gasoline which he used for cooking, but the court held that the exclusion did not apply because the words 'stored or kept', in their ordinary meaning, implied storage in large quantities, for the purpose of trade.

A5B Technical or legal meaning

The presumption that words are intended to bear their common meaning may not apply if the word in question has a clearly established technical meaning. In this case, the technical meaning may be taken to be the one intended. Of course, insurance has its own vocabulary and some words (such as 'average') have acquired such a technical meaning.



Be aware

However, a court may not allow an insurer to rely upon the technical meaning of a word unless they have made it very clear that a technical meaning is intended, particularly if the insured is not likely to be familiar with the technical term in question.

You should bear in mind that the Consumer Rights Act 2015 effectively requires consumer contracts to be in 'plain, intelligible language'. This means that specialised terms cannot be used in personal lines policies unless they are clearly defined in simple language.

Insurers have made good progress in recent years in introducing 'plain English' policies, especially for personal lines business so that modern policies are usually quite easy to read and understand. Nevertheless, insurers should take care when using technical terms and avoid those that an ordinary consumer might not understand.



Activity

Visit the Plain English campaign website at: www.plainenglish.co.uk. Read more about how public and corporate bodies including insurers are taking steps to ensure the use of 'plain English' in non-consumer (business) documents.

Insurance policies also often use words that have a distinct legal meaning, and it is then presumed that the legal meaning is intended. Words like 'theft', 'riot' and 'average' all used in property insurance, provide good examples.

The doctrine of precedent covered in [Precedent and case law](#) on page 1/19, applies to the interpretation of words used in insurance.



Consider this...

What is the effect of the doctrine of precedent?

Once one court has considered the meaning of a word then its decision is likely to influence future cases where the word is used in a similar context within the same sort of contract.

So, although words such as 'fire' and 'storm' have no legal or technical meaning, they have acquired a particular (though not absolutely precise) meaning when used in insurance policies, as a result of a series of court decisions.

A5C The importance of context

The meaning of a word always depends on its context. If the meaning is doubtful, a court will first consider the immediate context of a word and then, if necessary, the wider context of the paragraph or section, or even the policy as a whole.

There are a number of detailed rules concerning context.

This general principle of interpreting a word in the light of other words used with it is sometimes described as the '*noscitur a sociis*' ('a word may be known by the company which it keeps') rule.

In other words, the meaning of a word or term may be enlarged or restrained by reference to the object of the whole clause in which it is used. *Noscitur a sociis* is often utilised when terms are used in a list, allowing words to draw meaning from the common elements of the list.

Example 7.4

In *Young v. Sun Alliance & London Insurance* (1977) the court held that seepage of water from a meadow into a downstairs lavatory to a depth of no more than a few centimetres was not a 'flood' within the meaning of the insured's household policy. The perils 'storm, tempest or flood' were grouped together in the policy wording, suggesting that 'flood' meant (as one of the judges put it) 'something which has some element of violence, suddenness or largeness about it', like the other two perils.



Example 7.5

The same words – 'storm, tempest or flood' – were considered in another case: *Rohan Investments Ltd v. Cunningham* (1999). Here damage was caused by the escape of water from the roof, which had accumulated over a nine-day period when there was very heavy rainfall. In this case, the court held that the rapid accumulation and subsequent ingress of water was sufficiently abnormal to constitute a flood.



The *ejusdem generis* rule is a rather more specific principle of construction based on context. It provides that general words which follow specific words are taken as referring to 'things of the same kind' ('*ejusdem generis*') as the specific words. For example, if a policy refers to cars, trucks, tractors, motorcycles, and other motor-powered vehicles, a court might use *ejusdem generis* to hold that such vehicles would not include airplanes, because the list included only land-based transportation.

Another rule of context is '*expressio unius est exclusio alterius*' ('specifying one thing implies the exclusion of other things' – those which are not specified). So, where specific words are used which are not followed by any general words, the provision in question applies only to the things specified.

A5D Ambiguity: the *contra proferentem* rule

Words used in insurance contracts may be **ambiguous**, and they may carry two (or more) possible meanings. A dispute may occur because the insured insists on one meaning and the insurers insist on another. Where this is the case, the courts may apply the *contra proferentem* rule, under which the clause is construed against the party who proposed it (i.e. the drafter of the clause), so that the other party is given the benefit of the doubt.



Example 7.6

The contra proferentem rule is illustrated by ***Houghton v. Trafalgar Insurance Co. Ltd (1954)***. In this case an exception in a motor policy stated that cover would not apply when the vehicle was 'conveying any load in excess of that for which it was constructed'. The insurers argued that because the insured had carried six passengers in the insured vehicle (which was designed for only five) the exception operated and the loss was not covered. However, the court accepted the alternative interpretation put forward by the insured, that the clause operated only where a weight load was exceeded, which had not happened in this case.

For the *contra proferentem* rule to apply, there must be genuine ambiguity. In other words, there must be an alternative construction that is reasonable rather than one which is grammatically possible but far-fetched in reality.

We can now appreciate that different rules of construction can bring about different results when applied to the same case.



Example 7.7

The application of the *contra proferentem* rule rather than the *noscitur a sociis* rule to the case of ***Young v. Sun Alliance & London Insurance***, mentioned in *The importance of context* on page 7/7, would have produced a result in favour of the insured rather than the insurer. That is, the word 'flood' could have been viewed as ambiguous, in which case the insured would have been given the benefit of the doubt. In fact, the judges in Young were almost persuaded to apply the *contra proferentem* rule but in the end did not do so.

It is not very common for insurance contracts to apply the *contra proferentem* rule. The rule may apply, but only very rarely.

It has been suggested that the *contra proferentem* rule is a rule 'of last resort': in other words, it should only be used when other aids to interpretation do not reveal the meaning of the disputed words.

The construction of a contract is one unitary exercise in which the court has to consider the language used and ascertain what a reasonable person, who had all the background knowledge, which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court has regard to all the relevant surrounding circumstances. Where the parties used unambiguous language, the court has to apply it. But 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. This, however, is not the application of the *contra proferentem* rule but simply applying the rules of contractual construction.

A5E Inconsistencies

Insurance policies, like other written documents, sometimes contain inconsistencies or contradictions, so that one part of the document appears to conflict with another. The courts have developed a number of rules for dealing with this:

1. Where printed words conflict with words that are hand-written or typed, the latter take precedence since it is assumed that the parties intended to adapt a standard form to meet the needs of their particular case. On the same principle, an endorsement (i.e. a document or note recording a change in the insurance contact) is likely to overrule anything in the printed policy that appears to conflict with it.
2. In the case of a contradiction between a proposal which led to the formation of the contract and the terms of the policy document, which is issued later, the policy document is likely to take precedence, being the final and formal expression of the agreement.
3. An express term of the contract will overrule any implied term. For example, a marine insurance policy may expressly override or modify the implied warranty of seaworthiness which s.39 of the **Marine Insurance Act 1906 (MIA 1906)** carries into every contract of marine insurance.

Be aware

Bear in mind that the rules discussed above are, perhaps, best understood as guides that may assist the court rather than very strict principles of law. None are infallible and in some cases alternative rules of construction may appear equally appropriate and yet lead to different results, as we have seen already.



B Warranties, conditions and other terms

B1 Warranties

We begin by looking at terms that are described as warranties.

Be aware

Before the **Insurance Act 2015 (IA 2015)**, warranties were the most important terms in an insurance contract and brought about the most drastic effects if they were broken. However, we will see that the IA 2015 mitigated some of the drastic effects of breach of an insurance warranty.



B1A Nature of warranties

A warranty is, essentially, a promise made by the insured relating to facts or to something which they agree to do.

A warranty may relate to past or present facts (i.e. be a promise that something was so or is so), or it may be a continuing warranty, in which the insured promises that a state of affairs will continue to exist or they will continue to do something. Whether a warranty is present or continuing is a matter of construction of the relevant promise.

For example, the seaworthiness warranty under section 39(1) of the MIA 1906 is a present warranty as it refers to seaworthiness at the commencement of the voyage.

B1B Continuing warranties

Continuing warranties are often applied by insurers to ensure that some aspect of good housekeeping or good management is observed by the insured.

Example 7.8

The warranty may require:

- Rubbish to be cleared up each night.
- The burglar alarm to be put into full and proper operation whenever the premises referred to in the policy are left unattended and that such alarm system shall have been maintained in good order throughout the currency of the insurance.
- That the insured should take safe keys home with them when they leave business premises at night.
- All outside doors to be locked and windows to be secured.
- (In the context of insurance of a pub) the kitchen ducting not to be in contact with combustible materials and specialist inspection of the ducts to be carried out every six months.
- An insured vessel not to sail out of sheltered port when there is a typhoon or storm warning at that port, nor when the destination or intended route may be within the possible path of the typhoon or storm announced at the port of sailing, port of destination or any intervening port.



Alternatively, the function of the warranty may be to ensure that certain high-risk practices or activities are not introduced without the insurer's knowledge.



Example 7.9

The warranty may provide:

- that no inflammable oils may be stored; or
- no work carried out at a greater height than 12 metres; or
- no woodworking should take place.

B1C Exact compliance

A warranty must be exactly complied with. If it is broken, under s.10 of the Insurance Act 2015, the insurance cover is suspended from the moment the warranty is breached until it is remedied. In principle, the cover is suspended, even if the breach did not cause or have any connection with a loss. However, if, s.11(3) of the Insurance Act 2015 is applicable to this particular warranty, what caused the loss will have some impact on the insurer's ability to rely on the assured's breach of a warranty. This will be discussed further in *Terms not relevant to the actual loss* on page 7/16.

Not all breaches can be remedied. For example, if an insured ship sinks after the insured breaches the warranty, the warranty may not be remedied.

Where the breach can be remedied, the insurer is not liable for any loss that occurs from when the warranty is breached until it is fixed. For example, this would apply from when a burglar alarm system becomes inoperative until the insured fixes the breach.

Moreover, the insurer is not liable for losses attributable to something that happened during the time that the insured breached the warranty. This covers situations in which the loss occurred after the insured fixed the breach, but is attributable to something which happened before the breach was remedied by the insured.

Once the breach is remedied, the suspension is lifted i.e. cover is provided again by the insurer. Therefore, while the MIA 1906 and the common law provided that breach of a warranty could not be remedied, the IA 2015 changes this position so that now such a breach can be remedied.

The IA 2015 s.10, in principle, does not require the chain of causation to be established between breach of warranty and loss. As long as the loss occurs between the time that warranty is breached and the breach is remedied, the insurer is not liable irrespective of the causal link between the loss and the breach of warranty.

In other words, if a warranty is in relation to a fire alarm and if loss occurs because of a flood, this does not affect the insurer's ability to deny liability for breach of the warranty so long as the loss occurs in the time period when the assured breached the warranty. However, section 10(2) uses the word 'attributable' for losses which occur after the breach is remedied, but were attributable to an event which occurred before the breach was remedied.

The words 'attributable to' do not require the satisfaction of the 'proximate cause' test (i.e. the dominant, efficient cause). If, for instance, the assured breached a fire alarm warranty, and the loss occurs after the breach is fixed, and the cover is lifted, a loss occurs and it is linked with something happening during the time the fire alarm warranty was not complied with, the insurer will not be liable for the loss. The 'link' here does not have to be as close as the 'proximate cause' but a looser link than that, between what happened during the breach of warranty and the loss after the breach was fixed, suffices for the insurer to deny liability for the loss.

Moreover, IA 2015 s.11(4) provides: this section may apply in addition to section 10.

As a result, if IA 2015 s.11(3) is applicable where the assured breaches a warranty, that may or may not be relevant to the actual loss. This will be explained further on in *Terms not relevant to the actual loss* on page 7/16.

B1D How warranties are made

Warranties can arise expressly or impliedly. An express warranty may be created by the use of the word 'warranty' in the clause in question. Alternatively, the court may interpret an express clause in the contract to be a warranty, irrespective of the terminology that the parties used (see below for the three questions to be asked in this interpretation). Warranties may also be implied by the MIA 1906. *Implied warranties* are found in marine insurance only.

1. Express warranties

Warranties may be expressly stated in the policy itself. The word 'warranty' or 'warranted' may be used and although this is good evidence of the intention to create a warranty it is not conclusive. In other words, the court might not regard it as a warranty, even though it is labelled a warranty. For example, expressions such as 'warranted free of capture and seizure' merely mean that the risks in question are not covered by the policy, and the clause is really an exclusion, not a warranty.

On the other hand, the court may decide, as a matter of interpretation, that a term in a contract is a warranty, even if the parties to the contract did not use the word warranty. This does not occur very often, but there have been cases which have been decided this way. The standards that the courts apply to determine whether a term which is not expressly stated is a warranty are as follows:

- whether the term goes to the root of the transaction;
- whether the term bears materially on the risk; and
- whether damages would be an adequate remedy for breach.

2. Implied warranties

Warranties may be implied in marine insurance only. Section 39 of the Marine Insurance Act 1906 carries the implied warranty of seaworthiness automatically into every marine insurance policy.

Be aware

As mentioned above, whether IA 2015 section 10 remedy will be available for the insurer will depend on analysing section 10 and section 11 of the IA 2015 together. Section 11 applies not only to insurance warranties, but to all types of risk related terms, including conditions and conditions precedent. In other words, the section disregards the labelling of the term. It applies to terms that aim to **mitigate the risk**, no matter what labelling – whether condition or warranty – is used for the term.



Please read carefully all the terms covered in this chapter and understand their scope and remedy for their breach first. Methodologically, this is the way to understand what section 11 of the IA 2015 is trying to achieve. After you have learnt different types of classification of terms and remedy allowed in law for their breach, you may study section 11 and understand what obstacle for the insurer to seek the remedy is there under section 11, which is otherwise, 'in principle', available for the insurer.

Section 11 is relevant to conditions as well as warranties. The fact that section 11 is mentioned above but not yet covered in detail is because its scope is broader than warranties.

Please read section 11 below under *Terms not relevant to the actual loss* on page 7/16 and make sure you understand how section 10 and section 11 interact with each other.

Please also bear in mind that when you study condition below under 7B2 section 11 it is relevant to conditions too.

Because section 11 applies to warranties and conditions, first, study warranties, then, conditions, then section 11, and after all, you will learn how to assess (1) warranties, i.e. section 10 and section 11, and (2) conditions and section 11.

Please do not stop learning about warranties here and do not assume that this chapter misses section 11. As previously noted, section 11 will be covered below under *Terms not relevant to the actual loss* on page 7/16.

B2 Conditions



Be aware

In an insurance context, conditions are contractual terms, other than warranties, that impose an obligation on the insured (either risk or claims related). Conditions can also be classified in various ways.

B2A Conditions precedent to the contract

A condition precedent to the contract is one which states, in one form of words or another, that the policy will not come into effect if the insured fails to comply with the term in question.



Example 7.10

A life insurance policy may contain a condition that the policy will not come into effect until the premium is paid.

B2B Conditions precedent to liability

Conditions precedent to the insurer's liability are often concerned with, but not limited to, the claims process such as notification of a claim within a specified time, or not to admit liability after causing an accident. It allows the insurers to discharge themselves from liability for a particular loss (which is tainted by the breach) if the term is broken.

B2C Minor terms in insurance policies

Collateral conditions (or 'mere' conditions)

Collateral conditions (conditions that are not classified as 'condition precedent') are regarded as minor terms, the breach of which will still entitle the insured to make a claim under the insurance contract. If the breach is so serious that it goes to the root of the contract, the insurer may terminate the contract. If, on the other hand, the breach is trivial, the insurer will have to pay for the insured's loss but may claim damages (by virtue of deduction from the claim in respect of the prejudice suffered for the breach).

For instance, if the insurer lost the opportunity of investigating the cause of the insured loss because of the insured's late notification (which is a mere condition in the contract of insurance), the insurer will be entitled to deduct from the amount to be paid to the assured the amount of the prejudiced, e.g. 15% deduction.

Another example of a mere condition may be a clause in an employer's liability policy which requires the insured to keep a record of wages in a proper wages book. This is not a condition precedent but merely a collateral provision for the purpose of adjusting the premium.

Whether a term is a condition or a condition precedent is a matter of construction of the relevant term. In this case:

- where the clause does not refer to the words 'condition precedent'; or
- does not contain strong words such as 'the insurer will not be liable for the loss if the insured does not comply with the condition'; or
- there is no term that providing 'insurer's liability depends on the assured's observance of the policy terms and conditions', it is likely that the relevant term will be a mere condition.



Be aware

The use of 'condition precedent' is an indication but not conclusive to determining that the true nature of the clause is a condition precedent. Stating the remedy expressly, for example by saying 'the insurer will not be liable if the condition is not complied with', is a safer option for creating a condition precedent.

Moreover, if the policy contains a general reference such as 'liability of the insurer depends on the insured's full observance of the policy conditions', this general reference, read together with the relevant obligation imposed on the assured, renders that condition a condition precedent to insurer's liability.

You may consider conditions precedent to insurer's liability as an 'unless' provision. In a way the insurer makes it express in the contract to the assured that 'unless you do this, I will not be liable for your loss.'

Be aware

As noted above, and you are reminded here one more time, that whether the remedy that the law in principle allows the insurer to seek for breach of a condition will depend on reading the relevant condition with section 11 of the IA 2015. You will study section 11 below under *Terms not relevant to the actual loss* on page 7/16 because section 11's scope is broader than simply applying to conditions (or simply to warranties). You must first learn all the risk related terms and the consequences of their breach – which is in principle available to the insurer. Then you must learn section 11 in order to be able to find a connection between those terms and section 11, so that you can learn how to read the rules about risk related terms, in principle, available to the insurer and how section 11 impacted those rules.



Your tasks can be summarised as follows in the correct order:

1. Identify the obligation imposed on the assured.
2. Identify the labelling of the obligation (whether warranty, condition or condition precedent to insurer's liability).
3. Identify – in principle – what remedy is available for its breach.
4. Identify if section 11 applies: the first question to ask about is whether it is a risk-defining or a risk-mitigating term (please see below).
5. Risk-defining term: apply the remedy – you do not need to consider section 11(3) of the IA 2015.
6. Risk-mitigating term: see if the assured can satisfy the burden of proof under s.11(3).
7. Finally always bear in mind that claims provisions are not risk-mitigating, they are obligations complied with after the risk occurs. They do not require any discussion of s.11. Once you identify the classification of the term (its label) and the remedy provided either by contract or by the common law for it, you can apply the remedy after its breach, with no other considerations – other than waiver if the facts require you to discuss it – in case the insurer waives the remedy for the breach.

B3 Exception clauses (or exclusions)

Virtually all insurance policies carry a number of exceptions (or exclusions), which excuse insurers from liability. There are many different examples of exclusions. It could be that there is no cover when the loss is caused by a particular peril, or particular types of property are excluded, certain types of risk are excluded, or certain geographies not covered (e.g. territorial exclusion for Russia, Ukraine and Belarus).

Example 7.11

For example, a fire policy may exclude fire caused by earthquake and a theft policy may exclude theft of money, or theft involving collusion by an employee of the insured.



Such *exception clauses* are usually easy enough to distinguish. Of course, these clauses do not place any obligation on the insured and they cannot be 'broken' by the insured.

Please note that whether an exception clause has the effect of excepting the insurer's liability will depend on reading the clause together with section 11. This will be covered below under *Terms not relevant to the actual loss* on page 7/16.

B3A 'Suspensive conditions' or 'clauses describing the risk'

The effect of breach of a warranty before the IA 2015 was viewed by many as draconian, or overly harsh. Therefore, in some cases, the courts determined that the relevant clause was not a warranty but a suspensive condition which, when breached, resulted in suspension of the cover during the period that the insured breached the clause and remedied the breach.



Example 7.12

In *Farr v. Motor Traders' Mutual Insurance Society (1920)* the claimant insured two taxi cabs, and in answer to a question on the proposal form as to whether the vehicles were driven in one or more shifts each day answered: 'Just one'. When the accident in question happened, the vehicles were only being used for one shift per day, but some time earlier one of the vehicles had been driven in two shifts for a short period. It was held that the statement on the proposal form did not create a continuing warranty that the vehicles would only be driven in one shift, but meant that cover would not apply when the vehicles were being driven in more than one shift.

The general effect is somewhat like an exclusion, as discussed above, except that in this case all cover is 'suspended' when the condition is not adhered to, whereas an exclusion does not suspend cover, but simply narrows it.

A breach of a warranty does not terminate the risk automatically under the IA 2015. Under s.10 the cover is suspended during the period that the assured fails to comply with the warranty.

Hence, the above breach would be met by the suspension of the cover at the time that the vehicle was used for more than one shift. As explained below, IA 2015 s.11, to some limited extent, restricts the insurer's ability to deny liability for breach of a risk-mitigating term. The above example would be regarded as a risk-defining term. Risk-defining terms are out of scope of s.11, meaning that s.11 will not restrict the insurer's right to reject liability for the breach in *Farr* above.

B4 Breach of warranty or condition

It may be helpful to begin by summarising the effect of a breach in each case. Please note that whether the effect stated below arises or not depends on section 11, which will be explained below under *Terms not relevant to the actual loss* on page 7/16.

Breach of warranty

- Under the MIA 1906 and common law, cover terminated automatically and, in effect, the contract ended.
- However, the IA 2015 repealed any rule of law in a contract of insurance which causes a breach of a warranty to result in the discharge of the insurer's liability. Under IA 2015 section 10 the insurer has no liability under a contract of insurance in respect of any loss that occurs or is attributable to something that happens after a warranty (express or implied) has been breached but before the breach is remedied. In other words, the breach suspends the insurance cover during this period (assuming that the breach can be remedied).
- The insurer does not have to prove a connection between the breach and any loss that has occurred unless the warranty is intended to reduce the risk of loss of a particular kind, location or time, due to the application of IA 2015 s.11 (see *Terms not relevant to the actual loss* on page 7/16).
- The insured is permitted to remedy the breach; once it is remedied the suspension is lifted.

Breach of condition precedent to the contract

- If a condition precedent is never fulfilled, the contract never comes into existence.

Breach of condition precedent to liability

- The insurer is automatically discharged from liability for the claim which is tainted by the breach. Prejudice is irrelevant.
- The policy remains in force.

Breach of collateral (or 'mere') condition

- Remedy depends on the seriousness of the breach. In most cases the insurer is not entitled to reject the claim.
- If the breach is not serious enough to entitle the insurer to terminate the policy, the insurer cannot reject the claim and has to pay for the loss. However, it may claim damages in the form of reduction from the amount to be paid under the insurance contract. For example, in *Milton Keynes v. Nulty (2013)* the insurer had to indemnify the insured despite the

breach of a (mere) condition, but was also entitled to deduct 15% from the indemnity to reflect the prejudice suffered as a result of the breach.

Breach of a ‘susceptive condition’

- Cover is suspended for as long as the insured fails to comply with the condition, but resumes if and when they start to comply with it again. The concept of suspensive conditions was invented by the common law courts through interpretation of the term in question in order to avoid the draconian consequences of breach of a warranty available in law at the time. Currently, after the law reform introduced by IA 2015, the breach of warranty has the same effect as a suspensive condition discussed by the court previously, so long as it is practically possible to remedy the breach. Hence, today, the court will unlikely need to name a warranty a suspensive condition given that IA 2015 section 10 provides the same remedy as the courts previously applied by naming the warranty as a suspensive condition.

B4A Waiver of breach of warranty

As stated, under the MIA 1906 and common law, breach of an insurance warranty used to result in automatic termination of cover. The insurer was discharged from liability automatically, leaving no options for the insurer to elect. As a consequence, waiver by affirmation or waiver by election did not apply in the case of breach of an insurance warranty. The only way to prove waiver of breach of an insurance warranty was held to be promissory estoppel.

A promissory estoppel means that an insured who has broken a warranty cannot enforce the contract unless they can prove that the insurers clearly indicated, by their words or conduct, that they do not intend to rely on the breach of warranty as a defence to further liability under the policy. Additionally, it is necessary to prove that the insured relied on the insurer's representation to that effect and it is inequitable for the insurer to go back on their promise.

Example 7.13

The following are examples of insurer's actions that would support an argument of waiver by estoppel:



Knowing of the breach, the insurers:

- issued or renewed the policy;
- advised the insured about future loss prevention; and
- resisted the claim on grounds other than breach of warranty without reserving the right to rely on further points of defence under the insurance contract (which would include breach of warranty).

Under the IA 2015, the cover does not terminate automatically as a result of a breach of a warranty. However, s.10 of the Act uses the following wording:



An insurer has no liability under a contract of insurance in respect of any loss occurring, or attributable to something happening, after a warranty (express or implied) in the contract has been breached but before the breach has been remedied.

The insurer's waiver of this wording has not been tested by the courts yet. However, in principle, it is possible for an insurer to waive a breach of warranty during the suspensive period (i.e. before the insured has remedied the breach).

Be aware



As noted a number of times above – and you are reminded here one more time – whether IA 2015 section 10 remedy is available for the insurer depends on reading section 10 together with section 11. For section 11, please see *Terms not relevant to the actual loss* on page 7/16.

B4B Terms not relevant to the actual loss

Section 11 of the IA 2015 is titled 'Terms not relevant to the actual loss'. This section **does not apply to a term which defines the risk as a whole but to one, which if complied with, would reduce the risk of one or more of the following (s.11(1)):**

1. loss of a particular kind;
2. loss at a particular location; or
3. loss at a particular time.

Thereafter if a loss occurs and the term has not been complied with, the insurer cannot rely on non-compliance to exclude, limit or remove liability if the insured can show that the non-compliance '**could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred**'.

For example, assume that the insured is required to maintain a burglar alarm system within the insured property. If the insured does not comply with this requirement and the property is damaged by flood the insurer may not be able to rely on the breach to deny liability if the insured satisfies s.11(3) of the IA 2015. The same applies if a term requires a ready-to-operate sprinkler system and the insured suffered a loss as a result of a break in at the property.

Interaction between s.10 (breach of warranty) and s.11 (terms not relevant to loss)

As explained above, the general position under IA 2015 s.10 is that breach of a warranty will mean that cover under an insurance policy is suspended, and the insurer will not be liable for any claims until the breach is remedied by the insured. However, if the warranty applies to a loss of a particular kind, or loss at a particular location or time, s.11 will apply. If the insured can show that the breach did not increase the risk of the loss that occurred, they should be able to claim under the policy (this is stated in s.11(3)) despite the non-compliance with the warranty.

The purpose of s.11 is to prevent the insurer from denying liability for breach of a contractual term where the breach may not have any relevance to the actual loss. However, the application of s.11 to insurance cases is yet to be tested by the English courts.



Be aware

It should be noted that the IA 2015 did not change any rule of law regarding claims conditions (e.g. claim notification or co-operation clauses). Thus, the common law rules stated above regarding claims provisions are still applicable. Section 11 only applies to risk clauses as stated under s.11(1).

Note: s.11 and the principles stated above apply only where the terms in the questions **do not define the risk as a whole**. If the terms define the risk as a whole, see for instance, the Farr case above that the insurer defined the risk as the use of the vehicle for one shift only, the insurer may rely on s.10 of the IA 2015 if the term is a warranty or the available contractual or common law remedy without being restricted by s.11 of the IA 2015. There are no set standards to determine 'what type of terms define the risk as a whole'. It will be a matter of interpretation which was left to the courts by the law maker.

B4C Summary and examples of how IA 2015 s 10 and s 11 apply together

When you analyse a warranty your starting point is s.10. But when you come to a conclusion on s.10 you must not stop there because your assessment has to always take into account s.11. This is because s.10 and s.11 must be read together (as stated in s.11).

How it works:

1. Analyse if s.10 applies.
2. Assume you found a breach of warranty and s.10 is applied.
3. Keep analysing the matter by moving to s.11.
4. First question you must ask: does this term describe the risk as a whole?
5. If the answer is yes: do not discuss s.11 anymore. Whatever remedy can be found under s.10 applies.

6. If the answer to the first question above is no, then ask if this is a risk mitigation term. If the answer is yes, then discuss s.11.

S.11(3): say, if a risk-mitigating term is breached, the assured can still make a claim if the breach could not increase the risk of loss in the way the risk has occurred. If this is proven by the assured, the assured can make a claim. The burden of proof of s.11(3) is on the assured.

Example 7.14

I take out twelve months' travel insurance for a round the world trip. The insurance includes a warranty stating that I am not allowed to visit Antarctica. However, four months into the trip I decide to spend a week in Antarctica. My insurance cover stops from the moment I step into Antarctica, but my cover starts again when I leave 7 days later and continues like it would have without the trip to Antarctica. If I tripped on ice in Antarctica and broke a bone I would not be covered. To clarify, I would not be insured but s.11(3) may be applicable if this warranty is risk-mitigating rather than risk-defining. But it is likely that it will be a risk defining term – this is a geographical limit to the cover – and the insurer's right to reject the claim will not be restricted by s.11(3).



But, if I tripped a week before or after Antarctica, I would be fully covered. This is because I had not breached the warranty before I travelled to Antarctica.

When a warranty is breached the cover is suspended. If the breach can be remedied, the suspension is lifted. If the breach cannot be remedied, the suspension cannot be lifted.

However, for example, where a property has been damaged by dropping paint down the stairs, it is expected that an insured could show that a failure to use the required type of lock on a window could not have increased the risk of that loss. In this case the insurer should pay out on the damaged stairs claim.

If the damage occurred during the time when the cover was suspended, the cover can be lifted only if the breach may be remedied. Some breaches may never be remedied; which means, subject to s.11, the insurer is not liable because of s.10.

If the warranty about the paint is a risk-defining term, s. 10 remedy applies because s. 11 does not apply to risk-defining terms. If the warranty is a risk-mitigating term, s.11(3) may apply.

B5 Insurance: Conduct of Business (ICOBS) rules

In *The Insurance: Conduct of Business (ICOBS) rules* on page 6/26, we looked at the rules contained in ICOBS regarding insurers' remedies for breach of the duty to take reasonable care not to make a misrepresentation in consumer insurance. These rules contain important provisions concerning the rejection of claims for breach of condition or warranty. The background to these rules is similar to that of the rules relating to good faith; they derive from earlier voluntary codes of conduct – the 'Statements of Insurance Practice' – which the ICOBS rules have now replaced.

Consider this...

What is the effect on cover in the case of a breach of warranty and a breach of condition?



ICOBS 8.1.2 states that:

A rejection of a consumer's policyholder's claim is unreasonable, except where there is evidence of fraud, if it is for: ...

(3) breach of warranty or condition unless the circumstances of the claim are connected to the breach...

Effectively then, insurers can avoid a claim by a 'consumer' under a general insurance contract only when the breach in question did actually cause or contribute to the loss. This rule applies, in a slightly modified way, to life insurance.

Sections 10 (Breach of warranty) and 11 (Terms not relevant to the actual loss) of the IA 2015, as explained above, apply to both business and consumer insurance contracts. Therefore the ICOBS rules should be considered together with the sections of the IA 2015 which aim to limit the insurer's defences for breach of warranties or terms not relevant to the actual loss.

B6 Contracting out of the Insurance Act 2015

Consumer insurance

With regard to the sections of the IA 2015 regulating breach of warranty and terms not relevant to the actual loss, the parties are prohibited from contracting out of these sections in the context of consumer insurance, if contracting out would mean putting the consumer in a worse position than the Act provides.

Non-consumer insurance

Refer to

Refer to [Contracting out](#) on page 6/23 for the transparency requirement

Contracting out of s.9 (the section that does not allow creating a warranty via a basis of the contract clauses) of the IA 2015 is prohibited. In other words, even if the transparency requirement is met, the insured is not permitted to create a warranty by basis of the contract clauses.

Sections 10 and 11 may be contracted out of in the context of non-consumer insurance if the transparency requirement under s.17 of the Act is satisfied.

Accordingly:

The insurer must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into or the variation agreed (s.17(2)) and the disadvantageous term must be clear and unambiguous as to its effect (s.17(3)).

B7 Compulsory insurances

In [Compulsory insurances](#) on page 6/20, we noted that the principles surrounding the pre-contractual information duties for consumers and non-consumers apply to **compulsory insurances** in the normal way, and allow insurers to seek remedy for breach of these duties: there are no special rules.



Be aware

There are special rules for compulsory insurances when it comes to breach of warranty or breach of condition. The rules are complex and are described only briefly here. They relate to motor insurance and employers' liability insurance.

B7A Motor insurance

Motor insurance is governed in the UK by the **Road Traffic Act 1988**. The purpose of the insurance rules of the Road Traffic Act is to make sure that a road accident victim will always receive compensation if they are injured due to the negligence of another person.

Insurance is made compulsory so that even though the wrongdoer may be unable to pay the damages themselves, their insurers will do so. However, if the wrongdoer lost their right to claim under their own insurance by breaking a warranty or condition, the victim might not receive any compensation at all, because the insurers will have the right to terminate the cover or refuse the claim.

The **Road Traffic Act 1988**, therefore, stipulates that an insurer cannot reject a third party traffic accident's victim's claim by relying on certain types of policy condition or warranty.

Example 7.15

If a policyholder injures somebody when they are drunk or their car is unroadworthy, the insurers cannot refuse to indemnify them for the personal injury claim against them by relying on policy conditions which exclude liability when the driver is under the influence of drink or drugs, or which require them to maintain the vehicle in a roadworthy condition at all times. The first condition is prohibited by section 148 (2) (a), and the second by section 148 (2) (b).



Be aware

It must be emphasised that the restrictions in s.148 are in place purely to protect the rights of the victim. They do not prevent insurers from relying on policy exclusions in connection with claims that are not subject to the **Road Traffic Act** (such as claims for damage to the insured's own vehicle). Furthermore, the Act allows insurers to reclaim from the policyholder themselves any damages which they have been obliged to pay to the victim as a result of the operation of section 148.



B7B Employers' liability insurance

Similar rules apply to employers' liability insurance. In this case they are contained in the **Employers' Liability (Compulsory Insurance) Regulations 1998**. Five types of condition or warranty are prohibited by the Regulations.

As a result of these prohibitions an insurer cannot, for instance, reject an employers' liability claim:

- on the grounds of late notification, or
- because the insured has failed to comply with a policy condition which requires them to take reasonable care to protect their employees against injury or disease.

The use of policy excesses (deductibles) is also prohibited.

As in the case of motor insurance, the employers' liability insurer is given a right of recovery and can (in theory) reclaim from the employer any amount that they have had to pay to the employee solely by virtue of the Regulations.



Be aware

It is worth noting that the 1998 Regulations do not invalidate all restrictive conditions and warranties in employers' liability policies. For example, so-called 'trade warranties', which are used to exclude various types of hazardous work, are quite valid in law, although their use has been criticised by the courts.

Another important distinction between compulsory motor vehicle insurance and employers' liability insurance is that while in the former the third party victim can make a claim directly against the insured driver's insurer irrespective of the insured person's financial position, in the latter a direct claim against the insurer is permitted only if the insured employer is insolvent or in other types of financial difficulties as set out in the Third Parties (Rights Against Insurers) Act 2010.

C Joint and composite insurance

Two or more persons are often insured under a single policy.

When there is more than one person insured it is important to decide whether the policy is joint or composite.

- A **joint** policy (the interest of the assureds is the same, e.g. husband and wife insure their joint property) is 'indivisible', so that a breach by one insured (such as a breach of the duty of fair presentation of the risk) may cause the whole policy to fail.
- By contrast, a breach or default by one insured under a **composite** (the interest of the insured persons are different, e.g. a mortgagor and mortgagee insured together) policy may invalidate their own cover without affecting the right of other insured persons to claim, provided the latter are innocent of the breach or default.

A composite policy can be viewed as a bundle of separate contracts between the insurers and the various insured persons – but contained in a single policy.

C1 Distinguishing joint and composite policies

Under English law, the distinction between a **joint insurance** and **composite insurance** hinges on the interests of the insured persons.

If the insured persons share a common interest in the subject matter, for example, where they are joint owners of property, the policy is likely to be joint. On the other hand, where the interests are different, as in the case of lessor and lessee, or mortgagor and mortgagee, the policy is likely to be composite.



Example 7.16

A case mentioned in *Moral hazard* on page 6/10, *Woolcott v. Sun Alliance & London Insurance (1978)*, provides an example of the latter. Here the claimant applied for a mortgage from his building society and, via the mortgage application form, proposed for fire insurance at the same time. However, he did not disclose that he had been convicted of armed robbery 12 years previously. The court held that the insurers could avoid the policy as far as the claimant was concerned but allowed the building society, which was also insured, to recover, since the interest of the building society was different and the policy was composite.

Other examples of co-insurances which have been held to be composite in nature include construction risks policies covering contractors and sub-contractors and policies covering a number of companies within one group. An example of the latter is the Maxwell group, which had fidelity coverage under a group policy. Each company had a separate interest to insure and the insurance was composite. Therefore, fraud within one company (Mirror Group Newspapers) did not taint coverage and the payment of claims for other companies in the group.

It may be possible for parties who have the same interest in the subject matter (such as joint owners of property) to insure either on a joint or composite basis. Again, partners in a partnership may be able to insure jointly (on the basis that they are jointly and severally liable, so their interests are the same) or on a composite basis. Where there is doubt about the true basis of the insurance the courts are likely to consider the policy wording as well as the nature of the parties' interests in order to determine whether the insurance is joint or composite.



Example 7.17

For example, if the policy states that the parties are being insured 'for their respective rights and interests', and the interests are, indeed, different, it is likely to be treated as a composite policy.

Again, the policy may state specifically that the wrongful act or neglect of one insured person will not prejudice the rights of another insured.



Example 7.18

Property policies sometimes contain a 'mortgage clause' stating that the cover provided in respect of the mortgagee (lender) will not be invalidated by any act or neglect of the mortgagor or owner.

Similar clauses are found in other policies and may be described as 'anti-avoidance clauses', 'breach of warranty clauses' or 'incontestable' clauses.



Example 7.19

The case of *Arab Bank plc v. Zurich Insurance Co. (1999)* provides a good illustration of the approach taken by the courts when there is doubt about the nature of a policy covering several parties.

In this case the defendant insurers provided professional indemnity insurance to JDW, a company that carried out estate agency and valuation business. The claimants obtained judgment for breach of professional duty against JDW but the insurers denied liability to indemnify the firm. They did so on the basis of non-disclosure and breach of warranty, based on the assumed fraud by JDW's managing director (B) in making valuations for the claimant.

Under the policy, various persons were included within the definition of the insured, including the company itself and its directors.

Company directors do not have a common interest and are not jointly and severally liable for each other's defaults. The court ruled that this was a composite insurance that covered the company and each of its directors individually. The company JDW was vicariously liable for the fraud of the managing director (B) and, while B could not claim an indemnity, the insurers were liable to indemnify JDW.

Refer to

Refer to *Subrogation* on page 10/2 for subrogation

In reaching this decision the court was also influenced by the wording of the policy, and particularly the fact that it allowed the insurers to exercise rights of subrogation against any fraudulent director – i.e. recover a claim payment from the fraudster. This implied that the policy was intended to protect 'innocent' directors while denying cover to guilty ones, indicating that the policy was intended to be composite.

C2 Rights under joint and composite policies

Where a policy is joint the rights of the joint insureds stand or fall together, whereas under a composite policy each party has a separate interest and can make an independent claim that is unaffected by the rights, or lack of rights, of the other parties.

As we have seen, this distinction becomes particularly significant where there has been fraud, a breach of good faith or breach of warranty by one (or more) co-insureds but not by others, as in the *Woolcott* and *Arab Bank* cases discussed above. However, there are other situations where the distinction may be important.

Refer to

Refer to *Illegality in insurance contracts* on page 3/23 for contracts against public policy

One such case is where the loss has been brought about by the 'wilful misconduct' of the insured or where payment of the claim might be against public policy. If the property in question is jointly owned, and the insurance is joint (which is likely to be the case), an 'innocent' co-insured could find themselves in a difficult position.

Consider this...

What about the situation of the estranged spouse who deliberately sets fire to the family house or other jointly owned property, perhaps as an act of revenge. If the policy is joint then, on principle, neither party can recover. Does this seem exceedingly harsh on the 'innocent' party?



Be aware

At present the law is unclear on this point, although the Financial Ombudsman has taken the view that the innocent party is entitled to one-half of the amount that would have been payable in the absence of the wrongful act.



Most recently, in *Suez Fortune Investments Ltd v. Talbot Underwriting Ltd (The Brillante Virtuoso)* (2019) the owner's fraud did not nullify the claim by the co-assured bank against the insurer, whereas the insurance was composite. The court held that the insured shipowner's deliberate attempt to sink the ship caused the loss, not a peril of the sea. Indeed, the ship suffered damage which led the ship to become a constructive total loss. However, the fact that the loss was not caused by a peril insured against but by wilful misconduct of the insurer, disallowed a co-insured bank to make a claim against the insurer.

In other words, the loss was not accidental either when a claim is made by the insured, or the insurer.

D Scenario 7.1

D1 Scenario 7.1: Question

Apply the classification and interpretation of insurance contract terms to practical situations (LO6.5)

Usha has a household insurance policy which she took out with your company last year. Her house has been burgled and some very valuable jewellery has been stolen. She reports this to you but, in the course of the conversation, she reveals that she was in the rear garden of the house when the burglary happened. She says that she often leaves the front door unlocked when she is in the rear garden. She was unaware of the burglary until she re-entered the house. Her insurance policy provided that all the front and back doors of the property must be locked at all times.

What impact might this information have on Usha's claim against the insurer?

When planning your answer, use the following four-step IRAC approach:

- provide an **introduction** that identifies the focus of the question;
- look at the **relevant** areas of law;
- **apply** the principles of the law to the scenario; and
- provide a **conclusion** to your answer.

Note: the M05 study text is based on English law. All scenarios included are set in England; therefore English law applies.

D2 Scenario 7.1: How to approach your answer

Aim

This fictional case study tests the reader's ability to apply the classification and interpretation of insurance contract terms to practical situations (learning outcome 6.5).

It is recommended that you use the following four-step IRAC approach when planning your answer.

Provide an introduction that identifies the focus of the question

All contracts have terms – some of which are traditionally classified as conditions or warranties. In insurance contracts these classifications apply differently. The classification was more important pre-IA 2015 era than now when there was a breach of the terms. Section 11 of the IA 2015 now allows the claim to be assessed in substance rather than only on the form of the clause, i.e. whether it is classified as a condition or warranty.

Look at the relevant areas of law

The relevant area of law is the effect of non-compliance with a policy term by the insured. Such obligations may be classified as a warranty or condition. A warranty must be exactly complied with. The impact for a breach of warranties is set out in the Insurance Act 2015 (section 10) which must be considered together with section 11 of the IA 2015. Such terms are often about good management or housekeeping of property. Policy wording often includes a requirement to secure property but this may be intended to apply when the property is left unoccupied. The policy in question uses the words 'at all times', requiring continuing compliance.

Apply the principles of the law to the scenario

In this scenario, it should be considered if the term that Usha breached can be classified as either a warranty or a condition.

The clause says the following:

'Her insurance policy provided that all the front and back doors of the property must be locked at all times'.

From the wording it is not clear whether the clause above is a warranty or a type of a condition. If it is to be interpreted as a warranty, the insurer may argue non-liability under

section 10 of the IA 2015. However, section 10 has to be read together with section 11 of the IA 2015.

If the insurer proves it would not have insured this risk without having such a provision in the contract, the insurer has a strong case that this is a term that defines the risk as a whole. As a result, s.11 of IA 2015 does not apply and the insurer may reject liability under s.10.

However, if this clause is a risk mitigation term rather than being risk defining as a whole, Usha might want to try her chance under s 11(3) of the IA 2015.

On the other hand, looking at how the loss has occurred, Usha's chance to prove s 11(3) is slim.

If the relevant policy term is a condition precedent to insurer's liability, the insurer may be able to refuse to pay for Usha's loss and the assessment of s11(3) will be similar to the one above.

If the relevant clause is a mere condition, Usha would have a better chance to successfully claiming against the insurer. Breach of a condition will entitle the insurer to reject liability only if the breach of the conditions was so serious that it went to the root of the contract.

Remember to provide a conclusion, like the model answer presented above, to your answer that directly links back to the question and relevant area(s) of the law.

Note: it is sometimes necessary to consider a number of potential outcomes if it is unclear what the outcome will be (in this case because the precise policy wording is unknown). **It is not appropriate to decline to answer on the basis that further information is needed** as you will have been given all the information required to answer the question.



Key points

The main ideas covered in this chapter can be summarised as follows:

Terms of a contract

- To assist in resolving disputes over the meaning of words in insurance contracts, there are a number of rules of construction:
 - Statutory rules – the Consumer Rights Act 2015 imposes requirements for fairness and the use of intelligible language.
 - Common law rules – relating to the words' ordinary meaning; technical or legal meaning; context (*noscitur a sociis and ejusdem generis*); the *contra proferenter* rule in cases of ambiguity.

Warranties, conditions and other terms

- A warranty is essentially a promise made by the insured relating to facts or to something they agree to do, or not to do.
- Continuing warranties are often applied by insurers to ensure that some aspect of good housekeeping or good management is observed.
- Warranties can arise expressly, when clearly stated in the policy, or, in marine insurance only, may be implied as well as being express.
- The creation of a warranty by virtue of a basis of contract clause has been abolished in both consumer and business insurance.
- The consequences of a breach of an insurance warranty prior to the Insurance Act 2015 were viewed by many to be draconian. The IA 2015 reformed the effect of and mitigated some of the harsh consequences caused by a breach of an insurance warranty.
- The IA 2015 neither changed the rules regarding creation of warranties nor proposed a chain of causation requirement between the breach and the loss. Instead of terminating the cover, the Act suspends the cover during the time that the insured breaches the warranty. Thus, it enables remedying the breach of a warranty.

Breach of warranty

- An insurer has no liability under an insurance contract for any loss which occurs or is attributable to something that happens after a warranty has been breached, but before the breach has been remedied.
- Insurance cover is suspended from when the insured breaches the warranty until it remedies the breach. Once the breach is remedied, the cover is reinstated.
- The insurers do not have to prove a connection between the breach and any loss that has occurred unless the warranty is intended to reduce the risk of loss of a particular kind, location or time (IA 2015 s.11).

Breach of condition precedent to the contract

- If a condition precedent is to the validity of the policy and is never fulfilled, the contract never comes into existence.

Breach of condition precedent to liability

- The insurers are not liable under the insurance contract unless the condition precedent to insurer's liability is satisfied.
- When a condition precedent to insurer's liability is breached, the insurer is automatically discharged from liability for the claim which is tainted by the breach.
- The policy remains in force. If the insured has claims in the future and complies with the condition precedent the claim may be covered by the policy.
- Under the IA 2015, the insurer may not rely on non-compliance with terms not relevant to the actual loss (or other than those which define the risk as a whole) to exclude, limit or discharge its liability if the insured shows that non-compliance with the term could

Key points

- not have increased the risk of the loss which actually occurred in the circumstances in which it occurred. This rule applies for the terms that aim to mitigate the risk.
- Beware: when a condition precedent to insurer's liability is a claim provision, i.e., it is not risk related, section 11 of IA 2015 doesn't apply and upon its breach, the insurer is not liable. There is no need to discuss s.11 of IA 2015 in relation to claims provisions (claim notification, claim co-operation and claim control clauses).
 - In other words, claims provisions are left intact by section 11 of the IA 2015.

Breach of collateral (or 'mere') condition

- The remedy depends on the seriousness of the breach (similar to innominate terms in contract).

Joint and composite insurance

- When there is more than one person insured it is important to decide whether the policy is joint or composite. The distinction between a joint and composite insurance hinges on the interests of the insured persons.
- A joint policy is 'indivisible', so that a breach by one insured (such as breach of the duty not to misrepresent material facts or duty to disclose material facts) may cause the whole policy to fail.
- By contrast, a breach or default by one insured under a composite policy may invalidate their own cover without affecting the right of other insured persons to claim, provided that the latter are innocent of the breach or default.
- A composite policy can, thus, be viewed as a bundle of separate contracts between the insurers and the various insured persons but contained in a single policy.

Self-test questions

1. How would you distinguish between a breach of the duty of fair presentation of the risk and a breach of condition or warranty in insurance?
2. What is the *eiusdem generis* rule?
3. What is the effect of the *contra proferentem* rule when interpreting an ambiguous term? How would this rule typically apply to a term in a consumer insurance contract?
4. What is a warranty in insurance and how does it differ from a warranty in a non-insurance contract?
5. What is a continuing warranty in insurance?
6. In what way can a warranty be created?
7. Distinguish between a condition precedent to the contract and a condition precedent to liability.
8. What are collateral (or 'mere') conditions?
9. May insurers reject a claim for breach of warranty but allow the policy to continue?
10. What are the changes introduced by the Insurance Act 2015 to the remedy for breach of a warranty?
11. What is the main way in which English law distinguishes between joint insurance and composite insurance?
12. Why is it important to establish whether an insurance policy covering two or more persons is joint or composite?

You will find the answers at the back of the book

8

Making the claim

Contents	Syllabus learning outcomes
Introduction	
A Who can claim on an insurance policy?	7.1, 7.6
B Notice and proof of loss	7.2, 7.6
C Causation	7.3, 7.4, 7.6
D Fraudulent claims	7.5, 7.6
E Scenario 8.1	
Key points	
Self-test questions	

Learning objectives

After studying this chapter, you should be able to:

- describe who can enforce an insurance contract and who can benefit from it;
- explain the rules governing notice and proof of loss;
- discuss the doctrine of proximate cause and the effect on its operation of specific policy wordings; and
- outline the main types of claims fraud, the requirements to demonstrate fraud and the remedies available.

Introduction

In the remaining chapters of the study text, we will look at legal issues that affect the claims process.

In this chapter, we will consider the question of who can make a claim under an insurance policy and who may benefit from the insurance policy. Some people who are named in an insurance policy may not be able to claim on it in their own name, whereas other people who are not named may be able to enforce the contract.

We then look at what the law requires of the insured in terms of notifying and proving the loss when they first make their claim. Whether the loss is covered by the policy is crucial. This may involve questions of construction (the meaning or scope of the words used in the policy) which we looked at in *Interpretation of insurance contracts* on page 7/4. There may also be questions of causation. In simple terms, what caused the loss, and was that cause covered by the insurance policy? In more technical language, we ask the question 'was the loss a direct result of a peril that the policy insures?' A peril can be something like a fire, or a windstorm.



Example 8.1

If I own a shop on the ground floor of a building and a fire breaks out on the floor above, can I claim under my fire policy if my own stock is damaged by water which the fire brigade use to put out the fire? And can I claim for smoke damage to my stock, even though there is no fire on my own premises?

Questions of this sort are governed by the insurance doctrine of proximate cause which we will look at in *Causation* on page 8/11.

A challenging area for claims departments is the management of fraudulent claims (when someone knowingly lies to obtain a benefit or an advantage) – both in terms of detection and in trying to avoid paying out on such claims. In *Fraudulent claims* on page 8/19, we will look at the main types of fraud, the requirements for establishing that a claim is fraudulent, and how the law protects insurers.

Once an insurer has determined that a loss is covered by the policy, it will then be necessary to quantify the loss and decide how much the insurers are liable to pay for it.

Here the controlling principle is that of indemnity – putting the insured back to the same financial position it was in immediately before the loss. This ensures that the policyholder is fully compensated for their loss, but does not make a profit from it (by being over compensated). This is considered in chapter 9.

Finally, it may be possible for the insurers to recover some or all of the claim payment from another person who was responsible for the loss, or call upon other insurers to share it with them (because there is another insurance policy covering the risk). These issues are governed by the principles of subrogation and contribution, which are connected with the principle of indemnity and support it. They are discussed in chapter 10.



Key terms

This chapter features explanations of the following ideas:

Burden of proof	Causation	Chain of events	Concurrent causes
Fraudulent device defence	Prevention costs	Proximate cause	

A Who can claim on an insurance policy?

At first sight this is an easy question to answer, because most people would say that 'the insured' is the person who has the right to claim.

Be aware

However, the position is not as straightforward as it might first appear, because the term 'insured' may cover a number of different people, some of whom did not make the original contract with the insurer. Some people who are not named in the policy at all may be able to enforce the insurance contract, or at least benefit from it.



The starting point is the common law doctrine of privity of contract.

Consider this...

Look back at *Privity of contract* on page 3/38 and remind yourself about the effect of this concept.



You will recall that this doctrine confines the rights and duties under a contract to the persons who originally made it. If this doctrine were strictly applied it would mean that the only person who could claim on an insurance policy would be the policyholder (or policyholders), that is, the person(s) who originally entered into the contract with the insurer. However, there are many well-established exceptions to this principle in the field of insurance, some of which we will examine shortly.

Before we look at these exceptions there is another complicating factor to consider.

Consider this...

Look back at *Contracts (Rights of Third Parties) Act 1999* on page 3/38. What piece of legislation changed the doctrine of privity of contract?



The **Contracts (Rights of Third Parties) Act 1999** has brought about a fundamental change in the common law. It provides that a third party (i.e. someone other than one of the original contracting parties) can enforce a contractual term if:

- the contract provides that they may do so; or
- the contract purports to confer a benefit on the third party.

This would seem to substantially increase the number of people who could possibly claim on an insurance policy. However, you may also recall that the 1999 Act provides that a third party will not be able to claim if 'on a true construction of the contract it appears that the parties did not intend the term to be enforceable by the third party'.

Be aware

This means that insurers can override the operation of the 1999 Act by making it clear in the contract that a particular third party cannot enforce the insurance policy, or they can exclude the operation of the Act altogether – which insurers frequently do in order to be sure.



This means that we must always look at the wording of the policy to decide whom the contract covers and who can claim under it.

We will now consider some circumstances where a person other than the person who made the contract with the insurers can claim on, or benefit from, an insurance contract. The subject is complex and only a high level overview is given here.

A1 Assignment

Refer to

Refer to [Assignment](#) on page 3/39 for assignment

We have seen that a contract, or the benefit of a contract, can be assigned to a third party. You will recall that if there is a legal assignment, the assignee can enforce the contract in their own name, whereas in the case of an equitable assignment the assignee must join the assignor in the action.

A2 Agency

A third party can gain the right to claim on an insurance policy under the rules of agency. These rules were discussed in chapter 4. The most straightforward situation is where a third party authorises the policyholder to insure on their behalf.

It is worth noting that the doctrine of the undisclosed principal, considered in [Undisclosed principal](#) on page 4/17, can apply in insurance.

Refer to

Refer to [Agency by ratification](#) on page 4/5 for ratification

Finally, you may recall that even if an agent has no authority to contract on behalf of their 'principal', the 'principal' can, nevertheless, take advantage of the contract by ratifying it subsequently. The rules governing ratification apply to insurance in the ordinary way.



Be aware

However, an important restriction arises from the rule that an undisclosed principal cannot ratify a contract. This means, in effect, that a third party can ratify an insurance contract only if they are named in it as the insured (or co-insured).

You may also recall that a marine insurance contract can be ratified even after a loss has occurred. This may also be the case in non-marine insurance, though the authorities are less clear.

A3 Trusts

Sometimes a person who insures is deemed to have established a trust for the benefit of a third party, who can enforce the policy. This arises frequently in the field of life insurance where a person insures their own life but does so expressly for the benefit of another.

There are distinct advantages if a trust can be established:

- on the death of the insured, the policy money goes directly to the beneficiary and is not counted as part of the insured's estate; or
- if the insured becomes bankrupt, the beneficiary can usually claim the policy money without being subject to the claims of the insured's creditors.

A trust can be created in various ways, but section 11 of the **Married Women's Property Act 1882** provides the easiest method. If a person insures their life for the benefit of their spouse and/or children, the policy automatically creates a trust in favour of the objects named therein' under the provisions of the Act.

What has been described as a 'commercial trust' can also arise in connection with the insurance of property.



Example 8.2

You may recall that a person who has an insurable interest in goods can insure them for their full value and, in the event of loss, recover the full amount of the loss. Then, having deducted the amount of their own loss, they hold the balance in trust for others with an interest in the goods.

Refer to

Refer to [Limited interests in property](#) on page 5/22 for bailees and carriers

In circumstances involving bailees and carriers, the third parties who own the goods clearly benefit from an insurance contract to which they are not a party although, at common law, they cannot claim on the insurance in their own names.

There are a number of statutory exceptions to the doctrine of privity of contract, which affect various lines of insurance. Some examples are given below:

- **Road Traffic Act 1988.**
- **Third Parties (Rights Against Insurers) Act 2010.**
- **Law of Property Act 1925.**
- **Fires Prevention (Metropolis) Act 1774.**

A4 Road Traffic Act 1988

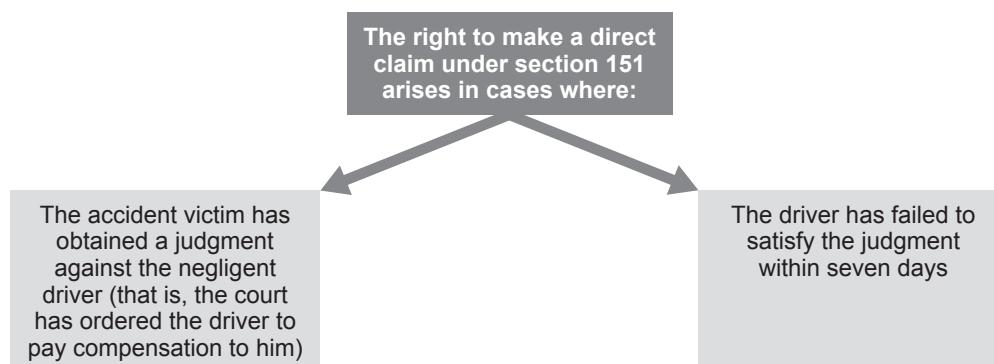
Motor insurance policies often cover persons other than the policyholder including, for example, various named drivers or, quite frequently, any person who uses the insured vehicle with the policyholder's permission.

Section 148(7) provides that:

...a person issuing a policy of insurance under section 145 of this Act shall be liable to indemnify the person or classes of person specified in the policy in respect of any liability which the policy purports to cover in the case of those persons or classes of persons.

The effect is to allow persons other than the policyholder (such as other persons who are permitted to drive the vehicle) to enforce the policy directly, although they were not parties to the original contract. They do not have to show that the insured acted as their agent or trustee in arranging the cover.

Another exception to the doctrine of privity is found in s.151 of the 1988 Act. In effect, this allows the victim of a road accident to make a direct claim against the motor insurer of the negligent driver who caused the accident. Obviously, a third party such as this cannot be a party to the original motor policy.



If the negligent driver has no insurance a direct claim can be made against the Motor Insurers' Bureau (MIB).

Be aware

Curiously, this right to claim against the MIB may not be technically enforceable by the road accident victim, because it arises under a series of agreements between the MIB and the Government, i.e. agreements to which the accident victim is, of course, not a party. However, the MIB has never relied on the doctrine of privity to escape its obligations.



A5 Third Parties (Rights Against Insurers) Act 2010



Consider this...

What would happen to an accident victim if the wrongdoer becomes bankrupt (or, in the case of a company, goes into liquidation) before the victim has recovered damages from them?

Any money payable under a policy covering the liability of the insolvent party is, at common law, simply added to their assets. So the injured party ranks with other ordinary creditors in competition for the assets that are available. If the insolvent party's debts are large in relation to their total assets, the accident victim may then receive only a small proportion of the damages awarded to them.

The root of the problem is again the doctrine of privity which, at common law, prevents the third party from making any direct claim against the liability insurers.

Under the **Third Parties (Rights Against Insurers) Act 1930**, the rights of an insolvent insured to an indemnity from its insurers under a liability policy were transferred to a third party claimant. However, the third party was required to establish the claim in proceedings against the insolvent insured prior to obtaining any rights under the insurance against the insurer.

An important point to note is that the rights transferred were those of the insured and it follows that the third party's claim against insurers under the 1930 Act was only as good as the insured's claim to indemnity.

The procedure required under the 1930 Act was cumbersome and time-consuming, and so the Act has been replaced by the new Third Parties (Rights Against Insurers) Act 2010. This makes it easier, quicker and less expensive for a third party claimant, such as an accident victim, to bring a claim directly against liability insurers, bypassing the insured and the insured's other creditors.

The 2010 Act came into force on 1 August 2016, six years after its adoption by Parliament. This delay was caused by the need for primary legislation to make a minor correction to the rules on administration. The **Insurance Act 2015 (IA 2015)** provided for the amendment of the 2010 Act by statutory instrument to correct the problem. The relevant amending secondary legislation was adopted and published in May 2016 in the form of the **Third Parties (Rights against Insurers) Regulations 2016 (SI 2016/570)**.

The amended 2010 Act provides for rights to be transferred to a third party in the case that the insured is facing financial difficulties and uses certain alternatives to insolvency, such as voluntary procedures between the insured and the insured's creditors. The 2010 Act retains the basic notion of the 1930 Act, but also introduces a number of changes in order to remove some of the procedural obstacles caused by the 1930 Act.

A6 Law of Property Act 1925

Under s.47 of the Law of Property Act 1925, the benefit of any insurance effected by the vendor of real property (houses and other buildings) is automatically assigned to the purchaser if, after exchange of contracts, the property is damaged or destroyed.

Thus, any insurance money received by the seller for such damage must be paid to the buyer on completion. In practice, this provision is of limited significance, because the usual arrangement will be for the buyer to arrange their own insurance on the property from the date of exchange of contracts.

A7 Fires Prevention (Metropolis) Act 1774

Section 83 of the Fires Prevention (Metropolis) Act 1774 allows a person who has a legal or equitable interest in buildings (such as a lessee, mortgagee or person who has exchanged contracts) to effectively compel the owner or their insurers to reinstate (rebuild) the property if it is damaged or destroyed by fire.

They can do this by serving notice on the insured of their interest, in which case the insurer must 'cause the insurance money...to be laid out in reinstatement' of the property. This does not mean that the insurers need necessarily reinstate the building themselves but,

failing this, they must withhold payment of the insured's claim until they are given a suitable guarantee that the insured themselves will do so. The third party who invokes the Act cannot claim on the policy as such, but they can influence the way in which the claim is settled.

A8 Policies with 'additional insureds'

Insurance policies, and especially liability insurance contracts, often grant an indemnity (i.e. protection) to persons other than the main insured, which is usually a company.

Example 8.3

An indemnity may be given to:

- any principal (usually another firm) that employs the insured (firm) to do work for them;
- owners of plant that is hired by the insured; and
- employees and directors of the insured firm (who could be sued personally, in place of the insured firm itself, if there is an accident).



Many other examples could be cited. Although the policy may clearly be intended to protect people such as those mentioned above, it does not follow that they can enforce the contract themselves. Whether they can do so depends on agency principles (as discussed above), the operation of the Contracts (Rights of Third Parties) Act 1999, and also the wording of the policy.

Since the contract appears to 'confer a benefit' on these additional insured persons, it would appear that they can claim directly against the insurers should the need arise. However, many, if not most insurers, exclude the operation of the 1999 Act altogether, which they are permitted to do.

Furthermore, insurers often restrict the right of additional insured persons to claim directly by providing that an indemnity in their favour will be granted only 'with the consent of the insured', or 'if the insured so requests'. This, which in itself is probably enough to override the effect of the 1999 Act, allows a claim to be made only with the permission of the main insured. If there is a dispute, or the amount of cover is insufficient to indemnify both the main insured and additional insureds, permission could be refused.

A9 'Noting the interest' of third parties

Property insurance policies often have the interest of various persons other than the policyholder 'noted' in them.

Example 8.4

The interest of a mortgagee (lender with security over the property) is often noted.



However, 'noting the interest' of a third party does not, in itself, make them a party to the insurance and it is unlikely to bring the Contracts (Rights of Third Parties) Act 1999 into play.

Be aware

In fact, it seems that 'noting' gives the third party little or no significant legal protection.



B Notice and proof of loss

When a loss occurs the insured will always be required, by a policy condition, to give notice of the loss.

Often, (and especially in the case of liability insurances) the condition will also require the insured to give notice of any incident or event which may give rise to a claim, so that the insurers are forewarned when a claim may be imminent.

Activity

Find a liability policy wording and look at the requirements for notifying a claim. Are there time limits? Is there a prescribed form for notification?



B1 Time limits for notification

Refer to

Refer to [Conditions precedent to liability](#) on page 7/12 for conditions precedent to liability

A time limit for notification, such as 15 or 30 days, may be given by the insurer. If the insured fails to comply with the time limit the insurers may, if the notification clause is a condition precedent to insurer's liability, have the right to deny liability for the loss. However, if the notification obligation is a mere condition, the insurer will indemnify the insured. However, in the case of a breach of a condition, if the insurer is prejudiced because of the insured's late notification (for instance the insurer might have lost the opportunity to investigate the cause of the loss when the fresh evidence was available), the insurer can make a deduction reflecting the prejudice (e.g. 15%) from the payment to the insured.



Be aware

In the case of the compulsory classes of motor and employers' liability insurance, English law specifically prohibits insurers from rejecting liability by relying on the breach of a notification or other claims condition. Late reported claims covered by the compulsory insurance legislation must always be met and the insurers may have a right of recovery against the insured.

Refer to

Refer to [Third Parties \(Rights Against Insurers\) Act 2010](#) on page 8/6 for the 2010 Act

The Third Parties (Rights Against Insurers) Act 2010 introduces some exceptions to the policy defences that can be brought against the third party. A policy condition may require the insured to provide continuing information and assistance to the insurer once notice has been given of the claim. However, s.9(3) provides that the transferred rights are not subject to such a condition if the insured no longer exists, either because it is an individual who has died or a company that has been dissolved and is therefore incapable of fulfilling the condition.

Section 9(4) adds that a condition requiring information and assistance does not include a condition requiring the insured to give notice of a claim to the insurer. That means an insurer may still rely on breach of a notification clause. However, if a third party complies with such notice requirements, its compliance is to be treated as having been done by the insured (s.9(2)).

B2 The burden of proof

It is the responsibility of the insured to prove whether a policy affords coverage for a loss by establishing that it was a covered peril that caused the loss, and the amount of loss. This is called the 'burden of proof'.

The policy may specifically state that the insured must give full particulars of the loss or provide 'such proofs and information as may reasonably be required'. Regardless of what formalities (if any) the policy lays down, the burden of proving the loss remains with the insured and it is obviously in their best interests to complete the claim form, provide as much information as possible and generally co-operate with the insurers in their investigation of the loss.

To discharge the *burden of proof*, the insured must be able to establish two things:

- that the loss was caused by the operation of an insured peril; and
- the amount of their loss.

These things must be established by the insured 'on the balance of probabilities'.

On the other hand, it is the responsibility of the insurer to prove that an exclusion to an insurance policy applies to the claim.

Example 8.5

So for example, in the case of a theft claim, the insured must prove that it is more likely than not that the property has been stolen and provide good evidence of value to support the amount claimed.

**B3 The loss must be fortuitous**

As suggested earlier, disputes may arise about the meaning of the words used in the policy or the exact cause of the loss. However, before discussing these questions we should emphasise that, whatever the peril (e.g. fire), the law requires that the loss must be accidental or fortuitous.

In other words, the loss must not be caused deliberately by the insured or brought about by the insured's own wilful misconduct. In these circumstances, the loss will not be recoverable under the insurance policy.

Example 8.6

There are many cases that confirm the (rather obvious) point that a fire policy does not provide cover if the insured deliberately sets fire to the property.

**Refer to**

Refer to *Joint and composite insurance* on page 7/19 for composite insurance

Deliberate acts by persons other than the policyholder are a different matter. Intentional damage by, say, members of the insured's family or their employees will be covered, provided that the insured has no involvement in their actions.

Insurers will not extend their policies to cover losses caused deliberately by the insured, except, perhaps, in the case of suicide under a life policy.

Although insurance policies do not cover deliberate losses, there is no general rule of law which prevents the insured from claiming for a loss which has been brought about by their own carelessness. In fact, many insurance claims involve an element of negligence by the insured. Indeed, in the case of liability insurance, the main purpose of the contract is to protect against the consequences of the insured's own negligence in the sense that third parties are compensated.

Although it is presumed that insurance policies cover losses caused by negligence, this general rule may also be modified by the wording of the policy.

Example 8.7

Insurers often seek to avoid liability for losses caused by excessive carelessness by including a 'reasonable precautions' clause in the contract.

For example:

- 'You must take all reasonable care to protect the property insured, prevent loss or damage and prevent accidents or injury.' (From a household policy.)
- 'The insured shall take all reasonable steps to safeguard from loss or damage and maintain in efficient condition any motor car for which indemnity is granted hereunder.' (From a motor policy.)



As you will read below, mere negligence is not sufficient for the assured to breach the above mentioned clauses. Recklessness of the assured will need to be established if the insurer wishes to deny liability for breach of a reasonable precaution clause.

In simple terms, negligence is failure to act reasonably, whereas recklessness means not giving attention to the consequences of one's dangerous actions.



Example 8.8

In *Sofi v. Prudential Assurance Company Ltd (1993)*, conditions requiring the insured to take 'reasonable care to avoid loss' in a personal all risks policy and a travel policy were interpreted in this way. The insured had been travelling to France and, arriving at the Dover ferry with time to spare, left his car in an unattended car park for 15 minutes. Valuables worth £50,000 were locked in the glove compartment of the car and these were stolen when the car was broken into. The Court of Appeal decided that the insured was entitled to claim because his conduct, although careless, was not reckless.

Finally, you should note that the burden of proof (of recklessness) rests on the insurer.

B4 Insurers' obligations in handling claims – the ICOBS rules

You will recall that the FCA Insurance: Conduct of Business (ICOBS) Rules place some restrictions on the right of insurers to avoid claims made by 'consumers' when there has been a breach of the duty to take reasonable care not to make a misrepresentation, or breach of warranty or condition.

The rules found in Chapter 8 of the ICOBS Sourcebook cover the general process of claims handling. In this connection, they are not always restricted to 'consumers', since some apply to 'commercial customers' or 'non-consumer (business) customers' also (i.e. to business insurances as well as private insurances).

In summary, the claims handling rules require insurers to:

- handle claims promptly and fairly;
- provide reasonable guidance to help a policyholder make a claim and provide appropriate information on its progress;
- not unreasonably reject a claim (including by termination or avoiding a policy); and
- settle claims promptly once settlement has been agreed.

The rules also place some duties on intermediaries (i.e. insurance brokers or agents) who handle claims.



Be aware

In particular, intermediaries must not put themselves in a position where their own interests, or their duty to another party (e.g. to an insurer), conflict with their duty to any customer (i.e. insured).



Activity

Look again at the FCA website www.fca.org.uk. Remind yourself of the requirements of the ICOBS, and in particular the claims handling rules.

Moreover, the new consumer duty – Principle 12 – should also be considered in the insurer's handling of the consumer assured's claim.

However, you should be aware that firms should ensure their customers are adequately supported throughout the lifecycle of a product or service after the point of sale – in particular, if they want to make an enquiry, claim, complaint or switch provider.

B5 Damages for late payment

Prior to the **Enterprise Act 2016**, claiming interest used to be the only option available to an insured who suffered loss as a result of an insurer's late payment of the insured amount. Claiming damages for such late payments was denied by the English courts. This is because the courts were of the view that the payment of the claim was in fact damages for breach of contract, as the insurer had failed to prevent the insured event occurring, and the position in law that a party cannot claim damages for failure to pay damages.

Example 8.9

In *Sprung v. Royal Insurance (UK) Ltd (1999)*, the insured's business was invaded by thieves or vandals and the machinery wrecked. The insured needed the insured amount to save his business. Initially, the insurer denied liability, but it then decided to pay the insured amount three-and-a-half years later. During this time, the insured lost his business.



The Court of Appeal rejected the insured's claim from the insurer for damages for late payment. The only option recognised by the court for the insured to be compensated for late payment was claiming interest.

The lack of remedy available to insureds when the insurer wrongly disputed a claim was subject to much criticism as it was not in line with the general position of commercial contract law. Therefore, the Enterprise Act 2016 added s.13A to the IA 2015, which allows the court to award damages for late payment where the insurer has acted unreasonably.

Section 13A of the IA 2015 came into force alongside the Enterprise Act 2016 on 4 May 2017. The law reform makes it an implied term under the insurance contract that the insurer must pay any sums due in respect of the claim within a reasonable time. Breach of this provision will result in contractual damages, in addition to the sums due under the policy and any interest on those sums.

It is apparent from s.13A(5) that the sums awarded by way of damages are in addition to the sums due under the policy and any interest on those sums. It is worth noting that the damages are available when a claim is made by the insured. It is understood from the Law Commissions' report No. 353 that the Law Commissions intended this to mean that damages for late payment cannot be awarded against an insurer where the claim is made by a third party, e.g. an assignee, or by a party with transferred rights under the Third Parties (Rights against Insurers) Act 2010. As appears from the wording of s.13A(5), damages are not capped and so they may exceed the amount covered by the policy. Section 29 of the Enterprise Act 2016 added s.16A to the IA 2015 to regulate contracting out of the IA s.13A. Contracting out of s.13A to the detriment of a consumer insured, is of no effect. For non-consumer insureds, it is not permitted to put the insured in a worse position than the IA provides in the case of the insurer being deliberate or reckless in breaching s.13A of the IA 2015. A breach meets that description if the insurer knew that it was in breach or did not care that it was in breach. For other cases, the insurer may contract out if the transparency requirement is satisfied.

C Causation

Consider this...

A policy may cover fire but exclude fire caused by earthquake. What happens if a fire breaks out during an earthquake?



There may be a dispute, not about the meaning of the words 'earthquake' or 'fire', but about whether the fire resulted from the earthquake.

Problems in relation to *causation* can take various forms.

- In some cases it may be difficult to separate the effects of a peril which is insured (e.g. fire), from the operation of another peril which is excluded (e.g. earthquake), because the two are linked together in some way.
- In other cases the operation of a peril that is insured (such as fire) may result in damage of a different sort (e.g. damage by smoke, or water used to put out the fire, or looters who take advantage of the chaos in order to steal).

Again, the insurance underwriter will want to know as precisely as possible the extent of their liability in such cases.

They will be unable to fix premiums accurately if there is uncertainty about the extent of their liability. Equally, the insured will wish to know how wide their cover is when a loss occurs.

There must be rules to distinguish between the operation of one peril and the operation of another, and to define how close the relationship must be between an insured peril and a loss.



Be aware

These issues are governed by the doctrine of **proximate cause**. According to the doctrine, to be covered, the loss in question must result directly from the operation of an insured peril.

Like many insurance principles, the doctrine is codified in the **Marine Insurance Act 1906 (MIA 1906)**, in this case in section 55(1):

...unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against, but...he is not liable for any loss which is not proximately caused by a peril insured against.

The doctrine is easy to state but sometimes hard to apply in practice. There are a vast number of cases on the subject but these are not always helpful, since the outcome of a case will usually depend on its own particular facts rather than on matters of law. Again, the facts of disputed cases are often finely balanced, so that different decisions are often reached in cases that appear to be very similar.

Of course, when an accident or loss occurs many things may help to bring it about.



Example 8.10

A road accident may be the combined result of careless driving, bad weather, a poor road surface, inadequate warning signs, a vehicle with poor safety features and many other chance factors.

That which we regard as the 'proximate cause' may well depend on who we are and the purpose of our enquiry.

For example, a policeman may take a different view from that of a motor vehicle engineer or road safety campaigner.

In insurance, however, we are concerned only with the proximate cause for the purpose of the agreement expressed in the insurance policy. In other words, our task is to establish whether the parties intended the loss to be covered.

To find the intention of the parties we will usually need to consider only the perils insured and perils excluded by the policy.

Examples of perils include:

- Earthquake, wind, hurricane, rain, freezing rain, landslide, mudslide, conflagration, drought, heat wave.
- Dust storm, rainstorm, hail, hailstorm, thunderstorm, windstorm, snowstorm, storm surge, tornado, cyclone.
- Bush fire, forest fire, brush fire, and wildfire.
- Civil commotion, vandalism, malicious mischief.

These perils may be insured or excluded depending on the type of the policy and the agreement between the insured and the insurer.

C1 Insured, excluded and uninsured perils

MIA 1906 states that the proximate cause of the loss must be a 'peril insured against'. Before exploring the concept of proximate cause we must first look at the way in which these insured perils are defined. This depends on how the policy is written.

In some cases there are specified or named perils, while in other cases the cover is written on an 'all risks' basis. In the former case, exclusions are used to limit the scope of the insured perils and losses from any other source than an insured peril are simply uninsured.

Example 8.11

A basic fire policy covers the risks of fire, lightning and explosion (to a limited degree) but excludes, for example, fire caused by earthquake, riot, war and a number of other risks. Loss of the insured property by theft can be described as an 'uninsured' peril, i.e. a peril which is obviously not covered by the policy but which it is unnecessary to exclude.



'All risks' policies are put together in a different way. Any peril that is not specifically excluded is automatically an insured peril and there is no third class of 'uninsured' perils. This is shown below:

Named perils policy (e.g. fire insurance)

1.insured perils	e.g. fire
2.excluded perils	e.g. fire caused by earthquake, or war risks, or nuclear risks
3.uninsured perils	e.g. loss by theft

'All risks' policy (e.g. personal 'all risks')

1.excluded perils	e.g. ordinary wear and tear, gradual deterioration, inherent vice
2.insured perils	any form of fortuitous (accidental) loss other than (1)

The significance of the distinction between an excluded (or excepted) peril and an uninsured peril becomes important when two such perils operate together. This will be explored later.

C2 What is the proximate cause?

There is no standard legal definition of proximate cause. It has been described, in various cases, as the 'direct', 'real', 'immediate', 'dominant', 'operative' or 'efficient' cause of the loss. We could simply say that it is the effective cause of the loss, or the cause that is most powerful in its effect. A remote or indirect cause of the loss is not the proximate cause of the loss.

To speak of an 'effective' or 'direct' cause, suggests that there are also 'indirect' causes – in other words, causes which play only a small part in bringing about the loss. These are generally described as remote causes – a 'remote cause' being more or less the opposite of a proximate cause. The law will normally disregard remote causes and consider only the proximate cause of the loss. However, as we shall see later, the wording of the policy may sometimes require the effect of remote causes to be considered also. If the policy covers losses caused directly or indirectly by theft, for instance, the word 'indirectly' includes remote causes in the scope of the insurance cover.

In looking for the proximate cause, insurance law has traditionally assumed that no matter how complicated the situation, one factor can be identified as the most powerful in bringing about the loss, this being the proximate cause (although, as we shall see, it has recently been accepted that there might be more than one proximate cause).

The burden of proof of what caused the loss is on the assured. The burden is satisfied on the balance of probabilities: the assured must show that it was more likely than not that an insured risk caused the loss. If the assured fails to satisfy the burden of proof, the insurer is not liable for the loss.

The courts have generally taken a common-sense approach when looking for the proximate cause. Causation is to be understood as by the man in the street, and not, for example, as by either the scientist or metaphysician.

In fact, finding the proximate cause of a loss is easy when the circumstances of a loss are simple and little time passes between the event which brings about the loss and the damage that results. It becomes more difficult when circumstances of the loss are complex, or there is a time lag between the loss and the damage.

Example 8.12

There can be little dispute about the proximate cause of the loss when thieves break into a shop and steal electrical goods or when slates are stripped from a roof during a violent storm.



Even more difficulty arises when the loss results from a series of events which are spread over time and more than peril is involved. In other words, where there are so-called 'concurrent events'.



Example 8.13

The leading authority on this, and on proximate cause generally, is the decision of the House of Lords in ***Leyleand Shipping v. Norwich Union Fire Insurance Society Ltd (1918)***. This concerned a ship that was damaged by a torpedo (excluded as a war risk) which, after reaching the port of Le Havre, sank while trying to move to an outer berth during a storm (the sinking from the storm insured as a 'peril of the sea').

The House of Lords held that the cause needed to be 'proximate in efficiency'. Causation was not a chain but a net. In such a net, the court emphasised that the most efficient cause is to be found to identify the proximate cause of the loss. Their Lordships also clarified that the proximate cause is to be found as a matter of common sense. On the fact, the House of Lords found that the effect of the torpedo never ceased. It continued from the moment the torpedo hit the ship until the ship sank.

As a result, the torpedo was treated as the proximate cause, because the damage caused had been effective throughout.

Concurrent interdependent causes

In some cases, more than one event causes the loss, and it may not be possible to single out one of those as the efficient, dominant, or direct cause. It is because neither of them could have caused the loss on its own, only their combination did. In other words, they are interdependent. In this respect, they each caused the loss on a 50%/50% basis, namely, each caused the loss in equal efficiency. In such cases the rule is as follows:

If one insured and one uninsured event are competing, the insured event prevails and the loss is deemed to have been caused by an insured risk. If one excluded and one insured event are competing, the exclusion prevails and the insurer may successfully reject liability.



Example 8.14

A building might be damaged by a fire that was raging and a storm that was battering it at the same time.

Under the rule of 'causa proxima', if it is possible to determine which of these causes is the most efficient cause on the balance of probabilities, that will determine the proximate cause and the liability (or not) of the insurers depending on whether the peril is insured or excluded.

Here, each cause is capable of causing the loss on its own. It was then possible to select, on evidence, as a matter of common sense, which of these two is the direct/efficient cause of the loss. These causes may be named as concurrent independent causes: each one is capable of bringing about the loss on its own.

In other cases, the perils may not only be independent but also interdependent, in the sense that neither peril would have caused damage on its own. Each of the causes contributed to the loss in equal efficiency and the loss would not have occurred without their interaction with each other. In this case, of course, it is impossible to attribute part of the damage to one peril and part to the other, because all the damage is caused by the two working together.

What caused the loss is determined as follows:

If one of the perils is insured and the other is uninsured, the insured peril prevails and the insurer will be liable.

If one of the perils is insured and one excluded, the exclusion prevails and the insurer will not be liable, so that each is a proximate cause. If this happens the result will depend on whether there is a combination of an insured peril and an excepted peril, or a combination of an insured peril and an uninsured peril.

Example 8.15

In *J. J. Lloyd (Instruments) Ltd v. Northern Star Insurance Co. Ltd (1987) ('The Miss Jay Jay')*. In this case, damage to a yacht was caused by two concurrent proximate causes. First, heavy weather (a peril of the sea which was insured) and, second, defective design (which was an uninsured peril – neither insured nor excluded). Neither cause would have brought about the loss on its own and, since the former was insured and the latter was not excluded, the insurers were liable in full.

The concurrent cause formula that tells us whether the insured or excluded peril prevails when two proximate causes compete with each other was *obiter dictum* (this is a Latin phrase meaning 'other things said', that is, a remark in a legal opinion that is 'said in passing' by a judge – it was not essential to the ratios of a specific decision).

In *Wayne Tank and Pump Co. Ltd v. Employers' Liability Insurance Corporation Ltd (1974)* where the insured company had built a storage tank at a plasticine factory. A fire started in the tank and destroyed the factory, so that they had to pay damages to the owners, Harbutt's Plasticine Ltd. The fire for which they were legally liable arose from a combination of two causes. First, from the defective state of the equipment installed (a source of liability which was excluded by the public liability policy) and, second, from the negligent act of an employee who switched on equipment so that it was left on all night (a source of liability which was insured). The court held that the proximate cause of the loss was the defective state of the equipment, but it was noted, *obiter dictum*, that had both causes been equally powerful, the insurers would still have escaped liability since one 'peril' was excluded.

The above may be summarised as follows:

Table 8.1: Concurrent perils

Independent perils combine to cause a loss: each would have caused some loss on its own	The assured will need to establish that the proximate cause of the loss is an insured peril. If the assured fails to satisfy the burden, the insurer will not be liable.
Interdependent perils combine to cause a loss: neither would have caused loss on its own	Insured peril plus excluded peril: insurer has no liability for the loss and exclusion prevails. Insured peril plus uninsured peril: insurer has full liability for the loss and insured peril prevails.

Insured v. excluded peril

Example 8.16

In *Midland Mainline Ltd and Others v. Eagle Star Insurance Co. Ltd (2004)*, the Court of Appeal considered claims under a business interruption policy arising out of the Hatfield rail disaster. In this case, the Court of Appeal had to consider whether train operators' business interruption losses were caused by unusual levels of wear and tear (an excluded peril) or speed restrictions (introduced by Railtrack as a result of the wear and tear). It was held that there were two possible ways of viewing the situation – (a) that wear and tear (an excluded risk) was the sole proximate cause of the loss, even though the speed restrictions were the immediate cause; and (b) that there were two causes of roughly equal effectiveness (the wear and tear and the speed restrictions) and, therefore, two proximate causes. Whether the wear and tear was the single proximate or both were proximate causes, the insurer was entitled to rely on the exclusion and refuse the claim.



Be aware

In the decision of *Financial Conduct Authority v. Arch Insurance (UK) Ltd (2021)* the UK Supreme Court dealt with a situation which does not sit easily in the concurrent independent or concurrent interdependent causes. But nevertheless the Supreme Court applied the 'insured versus uninsured causes' formula in the concurrent cause formula and determined in favour of the insured small businesses and enterprises.

The matter at stake was that all the cases of COVID-19 nationally caused the imposition of the Government restrictions which caused loss of profit to many small businesses and enterprises. While an individual case of COVID-19 independently could not cause the loss of profit, the combination of all the COVID-19 cases did. Assume that a business has business interruption insurance which provides cover for loss of profit caused by an infectious disease, such as COVID-19, if it occurred within 25 miles of the premises. For the insured business to recover under this insurance, it would be necessary to prove that only the cases occurring within 25 miles of the premises caused its business interruption.

Under the circumstances, this was practically impossible given that the businesses suffered loss of profit as a result of not only the national but also the global nature of the COVID-19 outbreak. The Government responses to the outbreak, the social distancing and lockdown measures taken in response to all of the COVID-19 cases occurred either within, or outside, the 25 mile radius stated in the insuring clauses as mentioned above. All the cases of COVID-19 made the loss inevitable.

The Supreme Court held that each case of COVID-19 was necessary to cause the business interruption losses and each COVID-19 case was a proximate cause of the loss. The COVID-19 cases that occurred outside the 25 mile radius were uninsured and here insured versus uninsured cases were in competition, as a result of which, insured peril prevailed and the insured would satisfy the burden of proof of loss by even one COVID-19 occurrence within the 25 mile radius.

C3 The burden of proof

Where the insurance is written on a named peril basis, the burden is on the insured to prove that an insured peril was the proximate cause of the loss. So, in simple terms, in the case of fire insurance the insured must prove that the property has been burned or, in the case of theft insurance, that it has been stolen.

However, where the insurance is written on an 'all-risks' basis (any peril that is not specifically excluded is automatically an insured peril), and no insured perils are named, the insured does not have the burden of proving the operation of any specific peril and need only prove that the loss was accidental. Hence the burden of proof is slightly easier for insureds under 'all-risks' policies.

Under either named peril or 'all-risks' policies, once the insured has established 'prima facie' ('on the face of it') loss by an insured peril the burden shifts to the insurers. If they wish to reject the claim they must prove in turn that an excepted excluded peril was the proximate cause of the loss. In other words, the insurer has the burden of proof when it comes to exclusions.

However, these general principles governing the burden of proof may themselves be modified by the terms of the policy.

C4 Efforts to avoid or reduce loss

Insurance policies usually require the insured to take reasonable precautions to avoid loss or damage and also to take reasonable steps to mitigate (i.e. minimise) any loss which actually occurs. Damage to the subject matter insured should be distinguished from costs incurred by the insured to prevent or minimise an insured loss.

Example 8.17

To take some obvious examples, fire insurers are liable to pay for damage caused by water which is used to extinguish a fire (because the water is used to mitigate the loss). They are also liable to pay for damage to the premises (such as the breaking down of doors) caused by the fire services in gaining access to a building that is on fire (because the action is taken in order to mitigate the loss).



C5 Prevention costs

The English courts have refused to allow recovery for mere **prevention costs** – unless the policy provides otherwise.

By this we mean, not damage to the subject matter itself, but expense incurred to prevent damage being caused to the subject matter by an insured peril.

For example, business owners in the path of an approaching storm may be aware of it for several days. Many businesses will take measures to protect their property such as boarding up their windows with plywood.

Example 8.18

In *Yorkshire Water Services Ltd v. Sun Alliance and London Insurance plc* (1997), the claimants incurred expense in repairing an embankment in order to prevent sewage sludge from escaping into the adjacent river. They tried to argue that there was an implied term that required them to take action to prevent or minimise insured losses, and that it was also an implied term that they would be indemnified for any expenditure involved in complying with this term.



The Court of Appeal rejected this argument on the basis that it was open to the parties to agree expressly that such expenses would be recoverable. In addition, there was an express term that required the insured to take reasonable precautions to prevent a loss event, maintaining buildings etc., at their own expense. The suggested implied term would therefore be inconsistent with the express wording of the contract.

This case established that it is not an implied term in an insurance contract that the insurer would indemnify the insured for the expenses incurred to prevent or minimise an insured loss. An express term to this effect is required.

The same approach is followed outside liability insurance. In *All Leisure Holidays Ltd v. Europaische Reiseversicherung AG* (2011), the passenger protection insurance policy was 'to indemnify the Insured Persons in respect of their net ascertained financial loss sustained arising from the cancellation or curtailment of the declared trip travel arrangements arising solely from the event of the insolvency of [Hebridean International Cruises Limited (HICL)]'.

HICL entered administration before it performed the contracts it had entered into with its clients to provide them with cruises on board *Hebridean Princess*. The cruise ship was sold to another company by HICL's administrators. The purchaser of *Hebridean Princess* offered to perform the contracts but requested the clients make a claim against HICL's insurers and pay the cost of the cruise from the insured amount. The court held that the beneficiary of a travel policy providing cover in the event of the cancellation of a cruise was not required to accept an alternative cruise on identical terms but offered by another provider.

Compared to other lines of business, marine policies are different in this regard – they often explicitly contain a clause which allows recovery of 'prevention costs'. Such clauses are named as sue and labour clauses, which entitle the insured to claim expenses incurred to prevent or minimise insured losses.

Marine insurance policies usually contain a sue and labour clause which entitles the insured to claim expenses incurred to prevent or minimise insured losses.

C6 Modification of the doctrine of proximate cause

The doctrine of proximate cause can be excluded or modified by the particular words used in the policy.



Example 8.19

Insurers may wish to exclude some risks (such as war risks) absolutely and be in a position to refuse payment even where the peril operates as a remote cause (i.e. a cause which makes only a minor contribution to the loss).

To achieve this, insurers sometimes exclude losses caused 'directly or indirectly' by the peril in question. Providing the clause is upheld by the courts, the effect will be to exclude any loss in which the peril operates, even though it does so only as a remote cause.

Most modern exclusions which are intended by insurers to operate as an absolute exclusion will routinely exclude losses caused 'directly or indirectly'.



Example 8.20

In *Coxe v. Employers' Liability Insurance Corporation Ltd* (1916) the insured was killed in the darkness by a train while inspecting sentries guarding a railway, the lights having been extinguished under wartime regulations. War was excluded as an indirect as well as a direct cause and so the insurers were not liable, even though war was only a remote cause of the accident. The effect was to widen the exclusion and reduce the scope of the cover.



Example 8.21

The case of *Dunthorne v. Bentley* (1996) provides a further interesting example of a case where the doctrine of proximate cause was modified by the words of the policy. In this case, however, the effect was to widen the scope of the cover rather than narrow it.

A Mrs Bentley had parked her car at the side of a major road, having run out of petrol. After about ten minutes a colleague stopped on the other side of the road. Mrs Bentley rushed across the road to talk to her colleague but ran into the path of a car driven by Dunthorne. Mrs Bentley was killed and Dunthorne was seriously injured.

Dunthorne brought an action in negligence against the estate of Mrs Bentley, and her motor insurers were called upon to pay the claim. The motor policy covered liability 'caused by or arising out of' Mrs Bentley's use of her motor vehicle. However, the motor insurers denied liability, pointing out that Mrs Bentley's car had been properly parked about ten minutes before the accident occurred and, therefore, the accident was not 'caused by or arising out' of her use of the car.

The Court of Appeal accepted that the accident for which she was liable was not 'caused by' the use of the car; that is, the use of the car was not the proximate cause of the accident. Nevertheless, the court held that the accident did 'arise out of the use of the car – and so the insurers were liable.

The inclusion of the words 'arise out of' indicated that the doctrine of proximate cause was not to be applied strictly and that cover operated where the use of the car was only a remote cause of the accident.



Consider this...

Assume that Mrs Bentley's policy covered losses 'caused directly or indirectly' by her use of her motor vehicle. In such a case would the policy cover the loss which occurred in the way the loss occurred as described above?

D Fraudulent claims

In this section, we will look at how the law applies to claims involving fraud, focusing on the types of fraudulent claim, the requirements to establish fraud and the remedies available to insurers. We will not be looking at the practicalities of identifying and managing fraudulent claims.

There are broadly four types of fraud involved in claims:

- **Falsification of a loss** – i.e. the insured makes a claim when they have suffered no loss.
- **Deliberate loss** – i.e. a policyholder deliberately causes the loss in order to bring a claim. For instance, in *Samuel v. Dumas* (1924), the insured deliberately sunk the ship he owned and insured. In *Suez Fortune Investments Ltd v. Talbot Underwriting Ltd (The Brillante Virtuoso)* (2019) the court held that the explosion in the engine room of the vessel was instigated by the insured shipowner.
- **Exaggeration of a loss** – i.e. if the insured exaggerates the amount of loss, the claim would be fraudulent. In *Galloway v. Guardian Royal Exchange (UK) Ltd* (1999), an assured who suffered a genuine loss of goods to the value of £16,000 was refused all recovery because he added an additional claim for £2,000 for a computer which had not been lost.
- **Lying about the circumstances of a genuine loss** to improve the chances of a claim being paid by the insurer. An insurer's rejection of a claim on this basis is referred to as the '**'fraudulent device' defence**'. However, this type of fraudulent claim should be approached with caution after the Supreme Court's ruling in the Versloot case which will be discussed below in *Fraudulent devices* on page 8/20.

Where it is established that an insured has committed fraud as part of a claim, an insurer will have remedies available under statute (the IA 2015) and in common law (the tort of deceit), and may also be able to recover losses as part of any criminal proceedings.

D1 Requirements to establish fraud

D1A Defining fraud

The ABI gives the following definition:

Insurance fraud is when someone invents or exaggerates a claim, or does not tell the truth in order to obtain cheaper cover.

There is, however, no single definition of fraud although there are various sources that insurers can use to support their approach to determining whether a claim is fraudulent. Insurers must apply common principles and relevant legislation when looking to establish that fraud has been committed.

The Fraud Act 2006

This notes that a person is guilty of the criminal offence of fraud if they:

- dishonestly make a false representation;
- dishonestly fail to disclose to another person information which he or she is under a duty to disclose; or
- dishonestly abuse their position.

For each of these, there must be an intention to make a gain for themselves or to expose another to the risk of loss.

The Insurance Act 2015

In the Explanatory Notes, Para 99 states that the Act does not define fraud, and that the remedies set out in Part 4 (see *First party claims* on page 8/21) will be available where fraud is established in accordance with common law principles.

Common law – the tort of deceit

In the case of *Derry v. Peek (1889)*, the House of Lords held that:

..in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made knowingly or without belief in its truth or recklessly, careless as to whether it be true or false.

D1B Burden of proof for fraud

For criminal prosecution of fraud to succeed, the prosecuting body will have to meet the criminal standard of proof – i.e. prove the case ‘beyond a reasonable doubt’.

In order to enforce its rights to a civil remedy following a fraudulent claim, an insurer will need to meet the civil standard of proof which requires that they establish that the person committed fraud ‘on the balance of probabilities’.



Be aware

It is, however, important to note that the standard for establishing fraud is likely to be higher than for other types of civil action. This was established in the case of *S. and M. Carpets Ltd v. Cornhill Insurance Company (1981)* in which it was held by the High Court that:

..if a defendant or plaintiff is to allege fraud, then the standard of proof is somewhat higher than that ordinarily applicable to civil matters, but not as high as that relating to criminal matters.

The nature of what is being alleged means that the burden of proof is very much with the insurer to prove that fraud has taken place.

This was confirmed in *Suez Fortune Investments Ltd v. Talbot Underwriting Ltd (The Brillante Virtuoso) (2019)* where the insurers bore the burden of proof of the assured's deliberate cast-away of the insured ship. Teare J held that the civil test of 'balance of probabilities' varied with the seriousness of the allegations charged so that in effect it was close to the criminal standard of beyond reasonable doubt. A strong suspicion of guilt did not suffice.

D1C Fraudulent devices

As mentioned in *Fraudulent claims* on page 8/19, the term 'fraudulent device' refers to fraudulent statements that are designed to increase the likelihood of a claim being paid out, where the underlying claim may be genuine (and valid under the policy). The historical position has been that where such fraud is established, the insured would forfeit their claim. For instance, in *Sharon's Bakery (Europe) Ltd v. AXA Insurance UK Plc (2012)*, the claim was for a loss that the insured genuinely suffered – he lost the machinery as a result of a fire in the bakery that he was running. However, he could not find the original receipt for the price he paid for it and issued a fake invoice. This was use of fraudulent means and device.

However, the recent Supreme Court decision in the case of *Versloot Dredging BV v. HDI Gerling (2016)* has cast doubt as to whether the insured forfeits the whole claim in every case of fraudulent device. It seems that the whole claim is only forfeited if the fraudulent statement has relevance to the insured's right to recover. In other words, what is now to be termed a 'collateral lie' in support of a claim (i.e. 'a lie which turns out when the facts are found to have no relevance to the insured's right to recover'), will not entitle the insurer to reject the claim.

Example 8.22



The Versloot Dredging case

In the *Versloot Dredging* case, the insured's loss was genuine. Water had frozen in the ship's pipes and, once the ship sailed towards a warmer climate, it flooded into the ship's engine room. The engine was repaired and the loss was caused by an insured peril. The insured was entitled to indemnity under the insurance contract.

The insured worried that the insurers might argue there was negligence on the part of the insured's senior management. Therefore, the insured claimed that an alarm had gone off on the ship before the flood had occurred and that the crew had ignored it. Hence, if there was any negligence in the case, it belonged to the crew. In fact, there had been no such alarm. Discovering this lie, the insurers argued the fraudulent means and device rule: that the insured told a lie to improve their situation towards the insured under the insurance contract.

The court initially held that where the insured had given a false representation in support of their claim, which turned out not to be relevant, the claim should fail. This position was upheld by the Court of Appeal on the basis of the need to deter fraud. However, the Supreme Court overturned this decision. In their judgment, the Supreme Court decided that the lie must be relevant to the existence or the amount of the insured's entitlement – this could only be determined at the end of a trial once all the facts were known rather than the situation as it was seen by the insured at the time the lie was told.

It was held that this was a collateral lie meaning that a lie which turns out when the facts are found to have no relevance to the insured's right to recover. In this case, the lie was dishonest, but the claim was not. The insured was entitled to be indemnified for their claim. While the lie was immoral, the judges felt that the likelihood of having to pay third party legal costs and the difficulty of obtaining insurance in the future amounted to an adequate punishment. The extension of forfeiture to a purely collateral lie was too large a sledgehammer for the nut involved.

D2 Remedies for insurers

Once an insurer has established that a claim is fraudulent, it must then decide what action it should take against the insured or third party claimant.

D2A First party claims

Prior to the introduction of IA 2015, there was a degree of uncertainty about how insurers should deal with policyholders once they had established fraud as a part of a claim. The common law had established the remedy for making a fraudulent claim as 'forfeiture of the entire claim' (for example, see *The Star Sea (2001)*). What was unclear was whether the insurer could terminate the contract and the validity of any other claims that had been made by the insured – whether before or after the fraudulent act. Part 4 of IA 2015 has codified and clarified the legal position for insurers. The key points are as follows:

Refer to

For more on *The Sea Star*, see [Good faith in the claims process](#) on page 6/17

- If the insured makes a fraudulent claim, the insurer is not liable to pay the claim. It may recover any sums paid in respect of the fraudulent claim and can treat the contract as having been terminated with effect from the time of the fraudulent act (s.12(1)).
- If the insurer terminates the contract, it does not have to return any premiums paid and it may refuse to pay any claims arising after the time of the fraudulent act (s.12(2)). This does not affect any claims relating to events occurring before the fraudulent act (s.12(3)).
- Section 13 regulates fraudulent claims in the case of group insurance. For example, when an employer takes out employers' liability insurance in favour of their employees as required by the **Employers' Liability (Compulsory Insurance) Act 1969**. Section 13 provides that when one of the insureds (e.g. an employee) makes a fraudulent claim, this does not have an effect on the other employees who are insured under the same insurance and whose claims were not fraudulent. Similarly, if the contract is terminated by the insurer against the fraudulent employee, the contract does not mean termination for the other insured employees who did not commit any fraud.

D2B Personal injury – the Criminal Justice and Courts Act 2015

In recent years, there has been a particular issue for insurers trying to defend third party personal injury claims against an insured's liability cover where it is established that the third party has fraudulently exaggerated their claim. The approach of the courts was generally to allow the genuine element of the claim in the event where it was established that the claim was partly fraudulent (as opposed to the claimant 'putting their best case forward').

This position has been changed by the **Criminal Justice and Courts Act 2015** s.57, which states where 'on the balance of probabilities that the claimant has been fundamentally dishonest in relation to the primary claim or a related claim', the court 'must dismiss the primary claim, unless it is satisfied that the claimant would suffer substantial injustice if the claim were dismissed'. The result of this is that where part of a claim is found to be 'fundamentally dishonest' (a term which is not defined by the legislation), the entire claim should be struck out by the court.

D2C The tort of deceit

An insurer can pursue a claim for its losses against a fraudulent insured or third party, where it can establish that the criteria for the tort of deceit has been met (see *Defining fraud* on page 8/19).

D2D The Proceeds of Crime Act 2002 (POCA)

Where the person who has committed the fraud has been convicted, a confiscation order can be made to recover the assets that have been fraudulently obtained, and the insurer which has paid out on a fraudulent claim may be able to recover their money through this route (POCA Part 2). Even where a conviction cannot be made, Part 5 of POCA makes it possible to recover criminal assets in limited circumstances (e.g. where the person has fled abroad).

E Scenario 8.1

E1 Scenario 8.1: Question

Apply the main legal principles governing the making of an insurance claim to practical situations (LO7.5)

Paul, who is insured with the insurance company you work for, fell off his mountain bike and injured himself. His injuries were serious and an air ambulance attended the scene. Paul refused to go in the air ambulance as he has a fear of flying. He was subsequently taken to the hospital by road. At the hospital, he received poor – but not negligent – medical treatment. He is now paralysed from the waist down. Paul makes an insurance claim.

How would you, the insurer, go about establishing whether they are liable to pay a claim?

When planning your answer, use the following four-step IRAC approach:

- provide an **introduction** that identifies the focus of the question;
- look at the **relevant** areas of law;
- **apply** the principles of the law to the scenario; and
- provide a **conclusion** to your answer.

Note: the M05 study text is based on English law. All scenarios included are set in England; therefore English law applies.

E2 Scenario 8.1: How to approach your answer

Aim

This fictional case study tests the reader's ability to apply the main legal principles governing the making of an insurance claim to practical situations (learning outcome 7.5).

It is recommended that you use the following four-step IRAC approach when planning your answer.

Provide an introduction that identifies the focus of the question

It is important to read the question in the context of the learning outcome. Although mountain biking is mentioned, this is not a question about the ability to insure what may be regarded as a 'dangerous' activity. Instead, the issues here are to do with causation and proximate cause of loss, and the nature of the insurance policy held.

Look at the relevant areas of law

The main legal issue is causation and the doctrine of proximate cause. According to the doctrine, the loss in question must result proximately from the operation of an insured peril if the insurance is to respond. You, the insurer, are concerned with the proximate cause only for the purpose of the agreement expressed in the insurance policy. Your task is to establish whether the parties intended the loss to be covered. In practice, these rules can be difficult to apply as much depends on the circumstances of each case.

Apply the principles of the law to the scenario

In order for you to know precisely what you are liable for, you will want to establish the proximate cause of the loss. You will need to read Paul's policy very carefully to precisely establish the nature of the perils, both insured and uninsured, and any exclusions – this will depend on how the policy has been written. Where there are a number of events that contributed to the ultimate loss the insured suffered – as is the case here – you will need to find out which one of those events in the chain is the most efficient cause. If the outcome is that the refusal to fly caused his loss, while 'accident' is likely to be an insured peril, a refusal to fly might not be.

There is also the 'poor' care in the hospital that might have caused the loss. If the treatment in the hospital is the efficient/proximate cause of the loss, the accident and the refusal to fly would become remote/indirect causes.

What caused the loss is proved as a matter of fact, i.e. the factual evidence and it is interpretation as a matter of common sense will decide what is the most efficient cause.

If there are two causes that have contributed to the loss in equal efficiency and without their interaction the loss would not have occurred, if one of the perils is insured and the other is uninsured, the insured peril prevails. If one is insured and the other is excluded, exclusion prevails.

If the proximate cause is found to be a peril insured against, it is likely that you will have to pay the claim.

Remember to provide a conclusion to your answer that directly links back to the question and relevant area(s) of the law.



Key points

The main ideas covered in this chapter can be summarised as follows:

Who can claim on an insurance policy?

- The doctrine of privity of contract means that only the parties to a contract can enforce its rights and duties.
- However, there are many well established exceptions to this rule in the case of insurance contracts including:
 - assignment, agency, trusts; policies with additional insureds; and
 - under statute: The Road Traffic Act 1988; Third Parties (Rights against Insurers) Act 2010; Law of Property Act 1925; Fire Prevention (Metropolis) Act 1774.
- Assignment:
 - a legal assignee or beneficiary of an insurance contract can claim on it in their own name; and
 - an equitable assignee can benefit from the contract through a claim made by the assignor, but not claim in their own name.

Notice and proof of loss

- Where a loss occurs the insured will be required by a policy condition to give notice of the loss.
- To discharge the burden of proof, the insured must be able to establish:
 - that the loss was caused by an insured peril; and
 - the amount of the loss.
- The loss must be fortuitous.
- ICOBS 8 sets out basic obligations on insurers when handling claims.
- The doctrine of proximate cause provides that the loss in question must result directly from the operation of an insured peril if the insurance is to respond.

Causation

- The proximate cause can be said to be the main cause of the loss or the cause that is most efficient or powerful in its effect.
- Where there is a 'chain of events' the insurers are liable where the loss flows in an unbroken chain directly from an insured peril – and equally there is no liability if the loss flows directly from an excluded peril.
- The chain will only be unbroken where each event is the natural and probable result of what happened before.
- Provided that efforts to avoid or reduce loss are reasonable efforts to prevent or limit the operation of an insured peril, insurers are liable to pay for any damage to the subject matter that results.
- However, unless the insurer expressly agrees by the contract, the courts will not allow recovery for mere prevention costs.
- Concurrent causes:
 - Independent perils combine to cause a loss: each would have caused the loss on its own: if the efficient cause can be determined, that will be the proximate cause. If insured, the insurer will be liable, if uninsured or excluded, the insurer will not be liable. The point here is either the proximate cause can be selected and that determines the point, or none of the causes is the proximate cause, which means the insured failed to satisfy the burden of proof of what caused the loss.
 - Interdependent perils combine to cause a loss: neither would have caused a loss on its own:
 - Insured peril plus excluded peril: no liability for the loss and exclusion prevails.

Key points

- Insured peril plus uninsured peril: full liability for the loss and insured peril prevails.
- The doctrine of proximate cause can be excluded or modified by particular words in the insurance contract.

Fraudulent claims

- There are broadly four types of fraud in claims:
 - Falsification of a loss whereby the insured makes a claim when they have suffered no loss.
 - Deliberate loss whereby a policyholder deliberately causes the loss in order to bring a claim.
 - Exaggeration of a loss.
 - Lying about the circumstances of a genuine loss to improve the chances of a claim being paid by the insurer. An insurer's rejection of a claim on this basis is referred to as the 'fraudulent device' defence.

However, the Versloot case has cast doubt about the fraudulent device rule. It seems that the whole claim is only forfeited if the fraudulent statement has relevance to the insured's right to recover.
- Fraud does not have a single definition but there are tests for determining fraud in the Fraud Act 2006 and in the case of *Derry v. Peek*.
- Where an insurer can establish that there has been fraud by the insured, the remedies available are set out in the Insurance Act 2015.

Self-test questions

1. When making a claim, what two things must the insured prove if the insurers are to be liable for the loss?
2. What degree of proof applies in the case of an insurance claim with regards to what caused the loss?
3. Do insurance policies cover losses caused by negligence?
4. In the context of the doctrine of proximate cause, what is an 'uninsured peril'?
5. What is a remote cause?
6. What was the impact of the *Versloot Dredging* decision?
7. If an insured is found to have committed fraud during a claim, what action can the insurer take with respect to the insured's policy, the claim and any other claims they may have made?

You will find the answers at the back of the book

9

Measuring the loss: the principle of indemnity

Contents	Syllabus learning outcomes
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A Meaning of indemnity	8.1, 8.7
B Measure of indemnity	8.2, 8.7
C Variations in the principle of indemnity	8.3, 8.7
D Methods of providing indemnity	8.4, 8.7
E Salvage and abandonment	8.5, 8.7
F Effect of claim payments on policy cover	8.6, 8.7
G Scenario 9.1	
Key points	
Self-test questions	

Learning objectives

After studying this chapter, you should be able to:

- explain the principle of indemnity;
- explain the methods of providing an indemnity;
- explain the measure of indemnity under the main forms of insurance policy;
- discuss the factors which limit, reduce, extend or modify the principle of indemnity;
- state how claim payments affect policy cover; and
- explain the doctrine of salvage and abandonment.

Introduction

We now turn to the rules concerning the amount to which the insured is entitled under their policy when a covered and valid loss occurs. In other words, this quantification analysis is generally made after the insurer has determined that the loss is covered and valid. The central concept here is the principle of indemnity which, in simple terms, requires that the insured should be fully compensated for their loss, but not over-compensated. Put simply, indemnification means that the insured must be put back into the financial position that they were in immediately before the loss. They must not be put into a worse financial position, or a better position, but just the same position.



Be aware

However, not all insurance policies are contracts of indemnity.

We must, therefore, first distinguish between indemnity insurances and non-indemnity insurances (or contingency insurances).

Indemnity insurances

Indemnity insurances are those where the insurers agree to pay only when the insured suffers a loss of a particular type, and only for the amount of the loss.

Most types of general (non-life) insurances are indemnity contracts, i.e. virtually all property, pecuniary and liability insurances, including motor, marine and aviation.

Non-indemnity (or contingency) insurances

These are policies in which insurers agree to pay a specified sum when a particular defined event occurs. The insured does not have to prove that they have suffered a loss, only that the event in question has happened.



Consider this...

What type of policy would fall into this description?

Life insurance policies provide the best example of this category. In this case, an agreed sum is payable in the event of death or after a certain number of years on 'maturity' of the policy. There is no question of having to prove a financial loss. Life insurances are not indemnity contracts because, first, it is impossible to place a value on human life and, second, because life policies are not always intended to cover financial loss: in many cases the main object is to provide a means of saving for the future.

Related contracts, such as accident and sickness insurances may also be classed as non-indemnity insurances. However, an accident or sickness policy can sometimes operate as a contract of indemnity. The policy may not pay benefit on a fixed scale but only make good certain losses or expenses which are actually incurred.



Example 9.1

- Employers sometimes insure their liability to pay wages to employees who are unable to work because of illness or injury.
- Alternatively, a person may insure against their own loss of earnings or insure medical expenses resulting from accident or illness.

The term 'contingency insurance' is an accepted legal term for a non-indemnity insurance.

Key terms



This chapter features explanations of the following ideas:

Agreed value cover	Average clause	Franchise	Indemnity
Limit of indemnity	Manufacturers' stock	'New for old' cover	Pecuniary insurances
Reinstatement	Repair	Replacement	Salvage and abandonment
Successive partial losses	Sum insured	Total losses	Underinsurance

A Meaning of indemnity

The word 'indemnify' means, literally, to save from loss or harm and, accordingly, '*indemnity*' means protection or security against damage or loss.

Therefore, when we describe insurance policies as contracts of indemnity, we mean that they are intended to provide financial compensation for a loss which the insured has suffered and put them in the same position after the loss as they enjoyed immediately before it.

The concept of indemnity thus implies that the object of insurance is to provide exact financial compensation for the insured. However, it also implies that the insured should not be over-compensated and should not 'make a profit' from their loss.

Example 9.2



These points, and the strong presumption that non-life insurance policies operate as contracts of indemnity are expressed in the words of Brett, L.J. in ***Castellain v. Preston* (1883)**:

The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy is a contract of indemnity and of indemnity only,...and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the insured from obtaining a full indemnity or which gives the insured more than a full indemnity, that proposition must certainly be wrong.

Be aware



The principle of indemnity referred to above can be varied if the parties to the insurance contract agree to do so. For instance, the parties may agree that the policy will pay less than a full indemnity in the event of a loss (underinsurance), or more than a full indemnity (overinsurance).

However, many factors may prevent the insured from receiving a full indemnity, and we will examine them in detail later.

Consider this...



In what situations would an insured receive less than a full indemnity?

A typical example is a policy which has a deductible for the assured to bear before recovering money from the insurer. For instance, if a motorist agrees to bear the first £250 of damage to their car, this is a clear contractual modification of the principle of indemnity.

On the other hand, in the case of a 'new for old' insurance policy, insurers agree to provide more than an indemnity. 'New for old' is the term used to describe the basis of how an insurer will replace insured items that are damaged or destroyed etc. Items will be replaced with a new one, irrespective of their age, and with no deduction for wear, tear or depreciation. In other words, the insurers pay the full replacement cost of the property and not just its current second-hand value. We consider this topic further below.

In practice, of course, insurers must be careful not to adopt too generous an approach to the measurement of loss. If insurers provide a great deal more than indemnity, the insured may be tempted to bring about a loss deliberately in order to improve their financial position. For example, to replace their old television with a brand new one.



Be aware

Indeed, it has been suggested that the availability of 'new for old' policies has increased the level of fraudulent claims, particularly in times of economic recession when people are short of money.

Refer to

Refer to [Limited interests in property](#) on page 5/22 for limited interests

Finally, you will recall that a claimant may be able to recover a sum greater than their actual loss if they are a person with a limited interest in the subject matter, such as a bailee of goods. However, you will also recall that if they do so, they hold the insurance money in excess of their own actual loss for others who have an interest in the property, such as the bailor of the goods.

B Measure of indemnity

A claim under a policy of indemnity may be described as a claim for unliquidated damages. This means that the exact amount of the compensation is not known in advance but is to be fixed afterwards on the basis of the loss actually suffered.

Unfortunately, where a policy operates on an indemnity basis, disputes sometimes arise concerning the correct method of valuing the loss and the exact sum of money which is necessary to provide the insured with a true indemnity.

The method by which indemnity is to be measured depends upon the type of insurance involved and the nature of its subject matter.

We shall look at each of the main categories.

B1 Property insurance

B1A General

The general rule is that the measure of indemnity for the loss of any property is determined by its value at the date of loss and at the place of loss (rather than its cost).

If the value has increased during the currency of the policy, the insured is therefore entitled to an indemnity on the basis of the increased value subject, of course, to the adequacy of the **sum insured**.

Similarly, if the value has decreased during the policy period, the insured will recover only the reduced value at the time of the loss, not the original value.

Under property insurance, the policyholder can recover only the amount of the value of the property itself: they cannot claim for loss of prospective profits or other consequential losses unless these are specifically insured.

For example, if a factory is destroyed by fire, the insured cannot recover under their fire policy for the resulting loss of profit (resulting from the fact that the factory is closed for six months and unable to produce any goods). However, if the policy was extended to cover business interruption, the assured would be able to recover that from the insurer.

Finally, property policies cover only the actual financial value of the subject matter: the insured cannot claim any amount for sentimental value.

The precise basis of settlement under an indemnity policy will often depend on the type of property insured. Some common types of property are considered below.

B1B Buildings

Where a building is damaged, the normal basis of indemnity will be the cost of *repair* or reconstruction at the time of the loss with, in many cases, a deduction for 'betterment'.

Consider this...

What is betterment? Why is a deduction made for it?



Betterment can take two forms:

- First, when a building is repaired, certain parts of the structure will often have to be renewed so that when the work is complete the building is likely to be in a better condition than it was before the loss. This will be the case where, for instance, the roof of a building which is in poor condition, with little useful life remaining, has to be replaced following a fire. Again, the reconstruction work may include new plumbing, new electric wiring and re-decoration.
- If no allowance is made for this betterment, the insured will obviously be in a better position after the loss than before because the value of the building will have theoretically increased – the insured in this case ends up with a building with a new roof, new plumbing, new electric wiring and re-decoration.
- The other way in which betterment can arise is where the quality of the building is improved in the course of carrying out repairs. For example, an extra storey may be added to a building or a sprinkler system installed during the reconstruction. Again, the insurer is not liable for this type of betterment under a basic 'indemnity only' policy: the extra cost has to be borne entirely by the insured.

In the case of a total loss (not necessarily complete destruction, but when the property is destroyed or so damaged as to cease to be a thing of the kind insured), or something very close to this, the cost of rebuilding the structure in its previous form may actually exceed the market value of the building or exceed the cost of replacing the old structure with a modern building of similar size and usefulness. This will often be the case with many old industrial buildings such as textile mills and factories, or old farm buildings.

These are often of massive construction and, therefore, very costly to repair. However, such buildings are often worth relatively little on the open market because they have outlived their original purpose and are now obsolete. It may, therefore, be quite uneconomical to restore or rebuild these properties, either in the original materials or in the original form. If buildings such as these are badly damaged or destroyed the correct basis of indemnity may present some problems.

In fact, the appropriate basis depends on a number of factors, including the intentions of the insured with regard to rebuilding, and whether rebuilding is a reasonable course of action.

Example 9.3



The case of *Reynolds and Anderson v. Phoenix Assurance Co. Ltd (1978)* provides a good illustration of these points. The claimants had bought, in 1969, an old maltings (buildings used for processes employed in the brewing of beer) and insured them for £18,000, which was a little more than the original purchase price. Subsequently, the sum insured was increased to £628,000 to cover the probable cost of rebuilding in the event of the building being totally destroyed. A fire then occurred which destroyed a substantial part of the building and a dispute arose as to the appropriate basis of indemnity. The judge outlined three alternative bases:

- market value;
- the cost of erecting a modern replacement building (around £50,000); and
- the cost of **reinstatement**, i.e. rebuilding the damaged part in its original form (which would amount to more than £250,000).

The market value of the building would have been difficult to assess, but would probably have been far less than the cost of rebuilding. The cost of a modern replacement would also have been much lower than the rebuilding cost. Nevertheless, the court held that the appropriate basis of indemnity was the third alternative: the cost of rebuilding in the original form. This was because the insured had a genuine and reasonable intention of rebuilding.



Example 9.4

Reynolds contrasts with the decision in *Leppard v. Excess Insurance Co. Ltd (1979)*.

In this case, the court held that the claimant was not entitled to claim for the costs of rebuilding (circa £14,000), as their cottage was up for sale at the time it was destroyed by fire. The correct basis of indemnity was the market value (circa £4,500), which was considerably less than the cost of rebuilding. The judge held that if the claimant recovered the cost of reinstatement he would not only be indemnified against his loss but would also recover a windfall because he had been willing to sell the property for £4,500.

The aforementioned principles were reiterated in *Great Lakes Reinsurance (UK) SE v. Western Trading Ltd (2016)* (see *Cover on a reinstatement basis* on page 9/11). At the time of the trial, no reinstatement had occurred as the insurers denied all liability and asserted that the insured was not entitled to be compensated on the basis of reinstatement. The court held that, in most cases, the insured's loss was the cost of reinstatement although it recognised that the position would be different if the insured was trying to sell the property at the time of the loss, intending to destroy it or if no one in their right mind would reinstate. It was doubtful whether a claimant who had no intention of using the insurance money to reinstate was entitled to claim the cost of reinstatement as the measure of indemnity unless the policy so provided. Hence, the intention of the insured as to how they will use the building in the future (together with the policy language) is of utmost importance.

B1C Machinery and equipment

Indemnity is generally valued as:

- the cost of repair less wear and tear, if applicable; or
- if repair is not possible, the cost of replacement, less wear and tear.

In the latter case, it is assumed that there is a ready second-hand market where the insured can purchase a replacement. In some cases, however, there is no ready second-hand market for such property because when it is disposed of, it is destroyed or sold as scrap (and hence no value).

In this case the insured may be obliged to purchase new equipment (which is likely to be superior in quality) and a deduction for betterment will normally be appropriate.

Examples of objects where the retail price of second-hand goods is used are motor cars and certain office equipment. In the case of motor cars, indemnity for a 'write off' (meaning the cost to repair the vehicle is more than its value) will normally be the market value of a vehicle of the same make, model, age, mileage and condition.

B1D Manufacturers' stock

Manufacturers' stock generally consists of raw materials (ready to use in production); work in progress (in our example stocks of unfinished cars in production); and finished stock (for example, finished cars, not yet sold).

The measure of indemnity will not necessarily be the cost to the manufacturer of producing the stock. It will be what it will cost them, at the time and place of the loss, to replace the goods or return them to the condition they were in before they were destroyed.

In the case of raw materials, this will be the replacement cost including delivery to site.

In the case of other stock, it will be the same raw material costs plus labour and other costs which will be incurred in reproducing the half-made or fully completed goods which were lost.

B1E Wholesale and retail stock

Indemnity will be based on the cost at the time of loss of replacing the stock (i.e. manufacturer's or wholesale price) including transport and handling costs to the insured's premises. A complication may arise if stock is obsolete. In this case, the replacement cost may well be higher than the market price for the goods. The market price is, therefore, likely to be the appropriate basis of indemnity.

B1F Farming stock

In the case of both livestock and produce, the local market price is the normal basis of an indemnity. With other commodities, as we have seen, the insured is not entitled to any

potential profit on sale. Farming stock is different: whereas in other markets there is a buying price set by the merchant and a higher selling price, in the case of farming stock, there is one market price on any particular day whether one is buying or selling. This means that the replacement cost is the same as the selling price.

From time to time, government minimum price guarantees may be available to a farmer and, if the farmer cannot sell goods because they have been destroyed, their real loss may be the guaranteed price rather than the market price (which may be lower). If this is the case, indemnity will require that the insurer pays the guaranteed price. The higher price must naturally be reflected in the sum insured.

B2 Pecuniary insurances

Pecuniary insurances cover various types of financial loss and can be contrasted with property (or material damage) insurances which cover some form of tangible property, such as buildings or goods.

Consider this...

What types of pecuniary insurances have you come across in your insurance career?



Pecuniary insurances include business interruption insurances which cover loss of 'profit' as a result of physical damage (such as by fire) to the insured's property, and credit insurances which cover bad debts arising from the insolvency or default of the insured's trading partners.

In the case of credit insurance, indemnity will be easy to assess, being the amount of the bad debt, less any recoveries. However, in practice insurers will rarely grant 100% cover for this line of business.

Business interruption policies operate on the basis that the assured can recover financial losses caused by the relevant insured peril for an indemnity period as laid down by the policy. To ascertain the amount of that loss it is necessary to work out what the assured's revenue would have been had the insured event (for example, a fire) not occurred.

That is typically done by looking backwards to see how the business had performed before the occurrence of the insured peril. Sometimes a fixed period – e.g. a year – is laid down to provide a comparator, in other cases there is no period.

Trends clause

In addition to the general practice mentioned above, in business interruption insurance, most policies if not all contain a 'trends' clause or its equivalent. The trends clause's purpose is to allow, in assessing the amount to be awarded, to take account of exceptional events that may have depressed or increased revenue in the earlier comparator, and also to take account of anticipated exceptional events in the indemnity period.

One example is where a restaurant whose star chef had given notice to leave *before* the insured peril, with that notice to expire *after* the insured peril. It is apparent that the revenue of the restaurant may have declined, and so the measure of revenue in the indemnity period is adjusted downwards. That is the function of the trends clause. The question in every case is to ask what the assured had lost by reason of the occurrence of the insured peril.

One of the trends clauses tested in the FCA test case, **Financial Conduct Authority v. Arch Insurance (UK) Ltd (2021)**, which was mentioned in previous chapters in the following words:

'Standard Gross Revenue adjustments shall be made as may be necessary to provide for the trend of the Business and for variations in or other circumstances affecting the Business either before or after the Incident or which would have affected the Business had the Incident not occurred so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results which but for the Incident would have been obtained during the relative period after the Incident.'



In the FCA test case, the insurers argued that the businesses would have suffered loss of profit irrespective of the occurrence of an insured peril, given the circumstances arose out

of the coronavirus outbreak, namely, the people would have been hesitant to go out to a restaurant or to stay in a hotel.

As a result, the businesses would have suffered loss anyway, which was not necessarily caused by an insured peril (for instance, in the case of an insured peril being the occurrence of a disease within 25 miles of the insured premises or the closure of business because of the public authorities' order).

The Supreme Court rejected the insurers' argument. The Court ruled that the trends clauses that appeared in the selected policy covers did not define the insured peril, and could only be taken into account in order to quantify the indemnifiable loss. The indemnity is calculated by reference to what would have been earned without the impact of COVID-19. This formula also disregarded any demonstrable revenue drop prior to the policy being triggered due to COVID-19 or its effects. The trends clause was to capture only the matters external to the pandemic e.g. a Michelin restaurant that lost its famous chef just before the outbreak.

B3 Liability insurance

Liability insurance is an insurance product that provides protection for the assured against claims resulting from injuries and damage to other people or property for which the assured is found liable. Liability insurance policies may cover, depending on the policy terms, legal costs and payouts an insured party is responsible for if they are found legally liable.

The measure of indemnity will be the amount of any court award or negotiated 'out of court' settlement plus costs and expenses arising in connection with the claim (such as lawyers' fees, court fees, and payment for medical reports or the services of expert witnesses), plus any other expenses which have been incurred with the agreement of the insurers.

B4 Marine insurance

Refer to

Refer to [Agreed value cover](#) on page 9/12 for valued policies

The measure of indemnity under marine policies is complex and based on rules which differ from those which apply to insurance generally. Only a brief description is necessary here.

The **Marine Insurance Act 1906** provides for both unvalued and valued policies. In fact, most marine policies are valued. In the case of an unvalued marine policy, the basis for the measure of indemnity (unless another basis has been agreed) is the 'insurable value', which is the value of the subject matter at the commencement of the risk. This is the amount recoverable in the event of a total loss.

The amount recoverable for a partial loss depends on what is insured. For a ship, the measure will usually be the reasonable cost of repairs. However, if the vessel is not fully repaired, the measure of indemnity is the depreciation in its value. In the case of goods which are delivered in a damaged state, the insured is entitled to a proportion of the insured value, based on the difference between the 'sound' and 'damaged' values at the place of arrival.

C Variations in the principle of indemnity

As mentioned before, indemnity is an insurance principle which can be contractually varied. In other words, the parties may agree, if they wish, that the policy will provide either more or less than a strict indemnity. We will now look at some examples of these variations, beginning with cases where the insured may receive less than a full indemnity.

C1 Less than a full indemnity



Consider this...

What factors can you identify which could limit an insured's entitlement to a full indemnity?

C1A The sum insured or limit of liability

The maximum amount recoverable under many policies is limited by the sum insured or the **limit of indemnity** (or limit of liability). In those policies which have a sum insured or indemnity limit, the insured cannot recover more than this amount even where the loss, measured by the indemnity principle, is a higher figure.

An exception to this general rule is sometimes found in liability insurance, where costs and expenses incurred in connection with liability claims may be payable over and above the limit of liability.

Activity

Look again at the liability insurance wording that you reviewed earlier. Is the limit of indemnity expressed to be costs-inclusive or costs-exclusive?



Be aware

In some cases, insurers will be prevented by law from imposing any limit.



Example 9.5

The **Road Traffic Act 1988** requires motor insurers to grant unlimited cover for liability in respect of death or bodily injury arising from the use of motor vehicles on the road.



Again, some motor insurers choose not to stipulate any fixed sum insured for loss or damage to the insured's own vehicle. Instead, they simply state that the 'market value' of the vehicle will be paid in the event of a total loss. There is no real danger in doing this since, because motor vehicles are mostly mass produced objects, the market value for any vehicle of a given type and age will not vary much. In any case, most motor insurers ask the insured to supply an estimate of the value of the vehicle when the insurance is arranged and state that this will be their maximum liability in the event of a claim. The estimate effectively operates as a sum insured.

C1B Other policy limits

Within the overall sum insured or limit of indemnity, there may be further separate limits for particular types of loss or particular types of property.

Example 9.6

A household contents policy will often restrict cover on individual 'valuables' (defined as gold or silver items, jewellery, antiques, works of art etc.) to, say, 5% of the total sum insured.



Consider this...

Where the restriction in example 9.6 stated above applies to the policy, if a work of art valued at £7,000 is destroyed in a household fire where the contents sum insured was £60,000, how much will the policyholder receive?



The policyholder will receive only £3,000 (being 5% of the total sum insured £60,000), which is less than a full indemnity because the work of art is valued at £7,000.

In practice, it would normally be possible to arrange for the painting to be specifically insured for its full value of £7,000 subject to an increased premium.

C1C Underinsurance and average clauses

If the sum insured or limit of indemnity is not large enough to meet the loss, the insured will clearly not obtain a full indemnity.



Example 9.7

If goods which are insured for only £10,000 are totally destroyed in a fire and cost £15,000 to replace, the insured will obviously receive only two-thirds of their value. In our example, the insured will be paying a premium based on the sum insured of £10,000.

However, basic principles of insurance require the insured to pay a premium into the 'common pool' which is in line with the size of the risk which they introduce. This means that where there is *underinsurance*, as in our example, the policyholder is not paying their fair share into the pool. Logically, therefore, their entitlement to draw on the pool when they have a loss should be scaled down to take into account this under-contribution, whatever the size of the loss.

This can be achieved by introducing an *average clause* into the policy.

An average clause provides that where the sum insured is less than full value, the insured will be considered their own insurer for the uninsured part of the risk and the claim payment for any loss will be scaled down proportionately.

The precise wording of an average clause will vary according to the type of cover granted. However, under the simplest form of average clause (known as 'pro rata' average, and used on various non-consumer (business) insurances arranged on a simple indemnity basis) the formula applied is as follows:

$$\frac{\text{Sum insured}}{\text{True value} \times \text{the loss}} = \text{amount payable by the policy}$$



Example 9.8

If the sum insured is £80,000 and the true value is £100,000 under a policy subject to average, and there is 50% damage (= £50,000), then the insured and the insurer are deemed to be co-insurers in the respective proportions 2/10: 8/10 (or 20% to 80%). The insured will therefore recover only 80% of their loss. In terms of the formula: £80,000 divided by £100,000 times £50,000 = £40,000.

Can average operate as an implied term?

Average clauses appear in many types of insurance, including most commercial lines. However, when a claim occurs, they are not applied in every case. In some classes of insurance, such as house and contents policies, such clauses are uncommon.

This raises the question as to whether average can operate as an implied term. In other words, can insurers scale down a claim payment for underinsurance where there is no average clause in the policy? In the case of marine insurance the answer is yes: average applies automatically by virtue of s.81 of the Marine Insurance Act 1906.

Where the policyholder is insured for an amount less than the insurable value, or in the case of a valued policy, less than the policy valuation, they are deemed to be their own insurer in respect of the uninsured balance.

The position regarding types of non-marine insurance is less clear. It is probably safe to assume, in relation to household insurance at least, that average cannot be applied unless there is an express average clause in the policy. However, when a person arranges a household policy, they are usually required to confirm that the sum insured which they request represents the full value at risk. If, therefore, the proposer supplies a figure which is clearly too low the insurers might argue breach of the pre-contractual information duty.

C1D Excess (or deductible)

An excess clause, or deductible, is a clause which provides that the insured must bear the first amount of any loss, expressed as a sum of money (say, £250).

These clauses are common in many types of policy, including household, motor and various non-consumer (business) insurances. In some cases, there may be an aggregate excess which applies not to individual losses but *total losses* in any one period of insurance.



Example 9.9

If a non-consumer (business) fire policy is subject to an aggregate excess of £10,000, the insurers will not be liable to pay for any losses until the total for all losses for the policy year exceeds £10,000.

The effect of an excess is to relieve insurers from having to deal with small losses (where handling costs are likely to be high in relation to the amount claimed) and to reduce the size of every claim payment which is made.

The effect is, thus, to reduce the overall cost of the insurance which benefits both insurer and insured.

C1E Franchise

A *franchise* is similar to an excess in that there is no liability for any loss which is less than the franchise figure. However, once the franchise has been exceeded, the loss is payable in full.

The distinction between an excess and a franchise is illustrated below.

	Loss of £950	Loss of £1,045
Policy subject to £1,000 excess	insurers pay nothing	insurers pay £45
Policy subject to £1,000 franchise	insurers pay nothing	insurers pay £1,045

Franchises are not very common because they may introduce an element of moral hazard.



Example 9.10

If an insured suffers a loss of £950 and their policy is subject to a £1,000 franchise, they might be tempted to deliberately inflate the loss to, say, £1,050 in order to be paid in full. If the policy was subject to a £1,000 excess, there would be little point in taking the risk of doing so as they would recover no more than £50.

C2 Extensions in the operation of indemnity

There are a number of instances where the insured may, depending on the precise circumstances, recover more than a strict indemnity. Some examples are given below.

C2A Cover on a reinstatement basis

From what we have said earlier it will be clear that cover on an ordinary indemnity basis may not provide the insured with enough money to restore their property in the event of damage, because a substantial deduction for wear and tear may leave them seriously out of pocket.



Example 9.11

When a building which is in less than perfect condition is destroyed or seriously damaged it generally cannot be rebuilt without making good existing wear and tear. While the insured will be left with a better building than they had previously, this will be of little comfort if the insurance money is not enough to pay for the work.

Reinstatement cover solves this problem by providing that, in the event of a loss, the insurers will pay a sum equivalent to the cost of rebuilding or replacing the property to a condition 'equivalent to or substantially the same as but not better or more extensive than its condition when new' (to quote the words used in the 'reinstatement memorandum' which is added to the policy to achieve this cover).

In other words, no deduction is made for wear and tear and the insurance pays for the full cost of rebuilding 'as new' (including any increased costs resulting from inflation between the date of the damage and completion of the rebuilding work). It is also possible to insure against extra costs which might be incurred by the insured in the course of rebuilding if they have to comply with new building regulations or other legal requirements. Such regulations might, for instance, require the new structure to be built in a different form from the old one or incorporate different materials, resulting in considerable extra expense.

Reinstatement cover is obviously beneficial to the insured. However, it is likely to be more expensive than simple indemnity insurance because the sum insured (on which the premium is based) will generally need to be higher to cover the cost of rebuilding 'as new'. Furthermore, the insured will not obtain the benefit of reinstatement cover unless they actually rebuild the property in question. The effect of the usual reinstatement clause is to restrict the cover to simple indemnity (thus allowing a deduction for wear and tear) unless the rebuilding work is commenced without unreasonable delay and is subsequently completed.



Example 9.12

Great Lakes Reinsurance (UK) SE v. Western Trading Ltd (2016) which was mentioned above, provides a recent example of reinstatement cover. Western Trading was the occupier and manager of premises belonging to the company's controller; it insured these premises for rebuilding costs of £2,121,800. The policy provided that the insurers would indemnify the insured against loss or damage. However, they would only pay reinstatement costs if the reinstatement work had been commenced and carried out without unreasonable delay.

The insurer refused to pay reinstatement costs as the work did not start immediately. The Court of Appeal, however, held that the claimant was entitled to reinstatements as there was evidence that they intended to rebuild the premises and they had not therefore failed to act without unreasonable delay.

Reinstatement cover can be appropriately applied to buildings and to plant, machinery and other contents.

However, the question of rebuilding and the making good of wear and tear does not normally arise in the case of stock, and ordinary indemnity cover is, therefore, likely to be adequate.

C2B 'New for old' cover

Cover on a reinstatement basis, described above, is really a type of '**'new for old' cover**' on buildings and machinery. However, the term 'new for old' is more often associated with insurances of household goods and personal possessions, including household contents and personal 'all risks' policies.

Quite simply, the insurers agree to pay the full replacement cost 'as new' of any insured item which is lost or destroyed, with no deduction for wear, tear or depreciation.

The cover may be a little more restrictive for items with a limited life, such as clothing and linen, and pay 'new for old' only when the items are less than, say, three years old at the date of the loss.

At first sight 'new for old' cover may seem to contradict the principle of indemnity and allow the insured to make a 'profit' out of their loss. However, the reality is that most people are reluctant to buy second-hand replacements when household goods or personal effects are lost or destroyed, and normally expect to replace them with new ones. This accounts for the low second-hand price of such items and means, in turn, that 'indemnity only' cover will give the insured very little to spend in the event of a loss. 'New for old' cover simply reflects a non-consumer (business) necessity.



Be aware

Of course, where insurance is arranged on this basis, the sum insured needs to reflect the total replacement cost of all items 'as new'. This results in a much higher sum insured than an equivalent 'indemnity only' policy and means that a more substantial premium must be paid.

C2C Agreed value cover

The principle of indemnity operates in a much modified form in the case of insurances written on an agreed value basis (often known simply as valued policies). We have seen that for a loss under a policy written on an ordinary indemnity basis, the insurers are liable to pay a sum equivalent to the value of the property at the time and place of the loss.

In the case of a valued policy, the parties agree that in the event of a loss a particular sum, fixed at the outset of the insurance, will be paid, regardless of the actual value of the property at the time.

You will recall that a claim under a policy of indemnity may be described as a claim for unliquidated damages. In the case of a valued policy, the claim is effectively for a liquidated (i.e. agreed) amount.

The object of a valued policy is to avoid disputes as to the value of the property at the time of the loss. This form of cover is, therefore, often employed where the property is unique or of a type for which there is a limited market. Here the question of value is likely to be more subjective than is normal and more likely to give rise to a dispute.

Consider this...

What sort of items might be insured on this basis?



Works of art and veteran, vintage or 'classic' cars are frequently insured on an agreed value basis. We have already noted that valued policies are common in the marine market.

Under a valued policy, the insurers must pay the agreed value regardless of the actual value at the time of the loss, even if they can prove beyond doubt that the value of the property has declined since the insurance was opened.

The insured may, therefore, receive more than a full indemnity (although they may, of course, receive less than indemnity if the actual value has increased). If the initial valuation is grossly excessive, the insurer may argue breach of the pre-contractual information duty or the policy may even be void as a gaming policy. However, the insured will normally be required to substantiate the value for which they seek to insure by providing an expert valuation at inception and so problems rarely arise in practice.

C2D Partial losses under valued policies

Where there is a total loss under a valued policy, there is no doubt that the insurers are liable to pay the agreed value whether this is greater or less than the actual value of the property at the time.

Example 9.13

In the case of a partial loss, the rule established in *Elcock v. Thomson (1949)* may be applied. In this case, a large house was insured under a fire policy for an agreed value of £106,850 although its actual value was only £18,000 at the time when it was damaged by fire. The effect of the fire was to reduce the value of the building to £12,600: a reduction of 30%. The court held that the insured was, therefore, entitled to 30% of the agreed value, namely £32,055. Under the rule, the insured is thus entitled to a proportion of the agreed value which is equivalent to the degree of depreciation in actual value caused by the loss.



Be aware

It may be worth noting that it would now be unusual to issue an agreed value policy on a house, or on buildings generally.



Again, insurers could probably overrule the 'Elcock principle' by including a specific provision in the policy about the basis of settlement for a partial loss. The insurers might state, for example, that cost of repair was to be the basis of settlement in such a case. Where there is a claim under marine insurance for damage to a ship, the Elcock rule is in any case automatically modified by s.69 of the Marine Insurance Act 1906. In this case, the agreed value is disregarded and settlement is based on the cost of repairs which is on the same basis as an unvalued marine policy. Finally, it should be noted that whether the policy is valued or unvalued, the insurers will usually have the option of paying nothing at all to the insured and settling the claim simply by repairing the building or other property. This question – the method of providing an indemnity – is considered next.

D Methods of providing indemnity

When a claim occurs there are often several methods which insurers can use to provide indemnity. The wording of the policy will usually give the insurer the right to choose which method to adopt. Insurers will, of course, generally wish to choose the method most economical to them. However, they are conscious of the need to give a good service and often comply with an insured's request for indemnity to be provided in a specific way, provided it does not substantially increase their costs.

The methods of providing indemnity which are available are usually set out in the insuring clause (the 'working part' of the policy).

The following is a fairly typical example of the language used in the policy of insurance:

We may choose to indemnify you by paying the amount of your loss or damage or by repair, reinstatement or replacement.

D1 Payment of money

An insurance contract is essentially a contract to pay money.

If there is no clause in the policy (such as the one above) giving the insurers the right to settle in some other way, the insured has a legal right to insist on money payment.

In fact, in the vast majority of cases, the method of providing indemnity under an insurance policy will be a money payment, simply because this is likely to be the most convenient and satisfactory method for both parties.

In liability insurance, cash payments (by way of electronic transfer or cheque) are always made although, in the majority of cases, the money is paid to the third party rather than the insured. This is because liability claims are normally settled by direct negotiation between the insurers and the third party, and it is the third party which has suffered some kind of loss or damage.

D1A Can the insured spend the money as they wish?

Where insurers make a cash payment, there is no general obligation on the part of the insured to spend the insurance money on restoring the property in respect of which the claim was paid. However, the insured may be required to do so by virtue of their relationship with a third party.



Example 9.14

- The insured may be obliged to expend their insurance money on repairing or rebuilding a house or other building because of a clause in a lease, or mortgage deed.
- Again, they may be compelled to repair or replace a motor car (or other property) under the terms of a hire-purchase agreement.

Furthermore, a failure by the insured to restore the property may affect the amount of a claim settlement. For example, we saw in '*New for old*' cover on page 9/12 that insurances on a 'new for old' or 'reinstatement' basis generally pay the full cost of replacement or reinstatement only where the insured actually replaces or reinstates the property concerned. If they do not do so, settlement is made on an ordinary indemnity basis. In which case, a deduction for wear and tear may reduce the size of the claim payment.

D2 Reinstatement



Be aware

We have to be careful when using the word 'reinstatement' in connection with insurance, because it is used in a number of different contexts. In *Cover on a reinstatement basis* on page 9/11, for example, we discussed cover on a reinstatement basis, a form of 'new for old' cover where the insurers agree to pay the full cost of rebuilding without deduction for wear and tear. Here, however, we are discussing reinstatement as a method of providing indemnity.

In simple terms, it is where the insurers choose to settle the claim by actually rebuilding the property that has been damaged instead of paying money to the insured.

The choice of rebuilding the property instead of paying money is given in the insuring clause of most fire policies and many other property insurance contracts. However, insurers rarely exercise this option, because if they decide to reinstate they become responsible for any problems that arise in the reconstruction process.

If insurers do choose to reinstate, the original contract to pay money becomes a contract to provide a restored building (or machinery).

If, then, the restored property is defective or in any way inferior to the old property, or there is an unreasonable delay in handing it over, the insurers may have to pay compensation to the policyholder for breach of contract.

Example 9.15

In *Brown v. Royal Insurance Co. (1859)*, the insurers elected to reinstate a partial loss but were prevented from doing so because the Commissioners of Sewers, using their statutory powers, ordered that the buildings should be demolished owing to their dangerous condition. The court held that the insurers were liable to pay the full value of the building to the insured as damages for breach of the contract to reinstate.



At common law, insurers cannot limit their expenditure to the sum insured. In fact, insurers usually seek to protect themselves against at least some of these pitfalls by stating in the policy that if they do choose or become obliged to reinstate, they will only do so 'as circumstances permit and in a reasonably sufficient manner'.

Policies usually also provide that 'in no case shall [the insurers] be obliged to expend more than the sum insured' on reinstatement.

Yet again, once insurers elect to reinstate, they must do so within a reasonable time and, if they fail, they may be liable to pay damages to the insured for loss of use. Finally, once they have elected to reinstate, insurers are their own insurers during reconstruction. In other words, they are responsible for any further damage (such as a fire on the building site) which may occur during reconstruction.

In view of these potential difficulties, insurers almost invariably choose to pay money rather than reinstate.

However, insurers have occasionally chosen to reinstate where they have suspected, but have been unable to prove, fraud on the part of the insured (e.g. a fire that may well have been caused deliberately by the policyholder). Although the cost of the claim is still met by the insurers in such a case, at least the dishonest intent of the insured is defeated. Furthermore, where there has been a large number of possibly fraudulent claims within the same sector of industry (which sometimes occurs when a particular trade is hit by recession), insurers have sometimes adopted a general policy of reinstatement in order to discourage other policyholders from following suit.

D2A Statutory reinstatement – the Fires Prevention (Metropolis) Act 1774

You will recall from *Fires Prevention (Metropolis) Act 1774* on page 8/6 that in some cases insurers may become subject to the provisions in s.83 of the **Fires Prevention (Metropolis) Act 1774**.

This Act requires insurance companies to lay out the insurance money, as far as it will go, towards rebuilding or reinstating buildings which have been destroyed or damaged by fire.

There are two circumstances where insurers must do this:

- if they suspect fraud or arson by the insured; and
- upon the request of any person(s) interested in the buildings.

With regard to the second point, the Act may be invoked against the insurers by any person (other than the insured) who has a legal or equitable interest in the insured building, such as a lessee, mortgagee or person who has contracted to buy. The object is to protect such

persons by ensuring that the insurance money is properly used to restore the building in which they have an interest and not spent on something else by the insured.



Be aware

In practice, the insurers do not themselves have to reinstate but may simply withhold payment from the insured until they have done so, or give an adequate guarantee that they will do so.

The Act applies to:

- fire insurance of buildings only;
- England, Wales and some other countries where it has been adopted, but not to Scotland or Ireland; and
- policies written by insurance companies but not to policies issued on behalf of Lloyd's underwriters.

D3 Repair

Insurers make quite extensive use of repair as a method of providing indemnity. Motor insurance is perhaps the best known example, where motor repairers are commonly authorised by insurers to carry out repair work on damaged vehicles.



Consider this...

Why do you think that an insurer would want to specify in which garage the car should be repaired?

For the insurer, having a network of approved repairers can help them to reduce repair costs, and ensure that the quality of the work is maintained. Some insurers have taken this process a step further by acquiring ownership of garages which are used to repair their policyholder's vehicles. This practice is currently more common in continental Europe than in the UK.

D4 Replacement

The most common situation where insurers choose to settle claims by 'replacing' the insured property is where they arrange for the replacement of broken glass for their policyholders. Insurers can obviously negotiate very favourable discounts with glazing firms because of the large volume of business which they can offer. They will often have a standing arrangement with a number of such firms. Similar agreements with suppliers sometimes exist for the replacement of other property, including household goods.

E Salvage and abandonment

The following section looks at *salvage and abandonment* for both marine and non-marine insurance. We will look first at marine insurance.

E1 Marine insurance

In marine insurance, there is a long established principle that, where the insured has been paid for a total loss, the insurer is entitled to claim, for their own benefit, anything that remains of the insured subject matter.

The action of giving up the subject matter to the insurer is referred to as abandonment, and the right of the insurer to take over the subject matter is known as salvage.

In marine insurance, salvage and abandonment are particularly important because marine insurance recognises not only actual total losses (where the subject matter is destroyed, or ceases to exist, or the insured is irretrievably deprived of it) but what are known as 'constructive total losses'.

E1A Constructive total loss

Constructive total loss applies when the subject matter is damaged or the insured is deprived of the possession of their ship or goods but the subject matter is not destroyed. In addition:

- it is unlikely that the insured can recover the ship or goods; or
- in the case of damage to a ship, the cost of repairing the damage would exceed the value of the ship when repaired; or
- in the case of damage to goods, where the cost of repairing the damage and forwarding the goods to their destination would exceed their value on arrival.

In the case of a constructive total loss, the insured must serve a notice of abandonment on the insurers if they wish to be paid for a total loss.

This is a formal notice indicating the insured's willingness to give up the subject matter to the insurers.

The notice of abandonment must be tendered within a reasonable time after the assured discovers that the subject matter insured has become a constructive total loss. There is no formal requirement for the notice but to prove that it has been tendered, a written form is advisable. It should clearly state that the assured intends to claim for a constructive total loss and abandons the subject matter insured to the insurer. Informing the insurer that 'the ship has probably become a constructive total loss' does not suffice for this purpose.

Be aware

If the assured fails to give notice of abandonment, the assured can claim for partial loss but loses the right to claim for a total loss. The Marine Insurance Act 1906 also lists circumstances under which notice of abandonment, exceptionally, is not required. For instance, if the insurer waives notice of abandonment, later, the insurer may not argue that the assured failed to provide it.



E2 Non-marine insurance

In non-marine insurance, the concept of a constructive total loss is not recognised. Losses are either actual total losses or partial losses, and the points made above about notice of abandonment are, therefore, not applicable.

However, when insurers pay an (actual) total loss under a non-marine policy, the doctrine of abandonment and salvage will apply.

The doctrine of abandonment and salvage supports the principle of indemnity and prevents the insured from 'making a profit from their loss'.

When insurers pay a total loss under a non-marine policy, there will often be little of value remaining because the property will either be lost, totally destroyed or completely useless. Nevertheless, if the insured does not agree to treat the property as wholly destroyed, they cannot insist on the loss being wholly made good to them.

Furthermore, property insurers are entitled to any materials left by the fire (or other peril) where they have agreed to pay a loss in full.

In some cases, property is recovered intact after the insurers pay for a total loss. This is particularly common in the case of theft claims but may apply in other situations as the insured ceases to be the owner and the insurer is entitled to claim the property.

In the case of motor claims where vehicles have been 'written off' the insurers are entitled to sell the remains of the insured vehicle to reduce their loss.

Be aware

In practice, insurers often agree to sell the property back to the owner and, in some cases (such as fine art insurance), the policy may contain a clause giving the insured 'first refusal'. The Financial Ombudsman Service has taken the view that the insured should always be given the chance to repurchase.



E2A The effect of underinsurance

In some cases where there is a total loss, the insured will not receive a full indemnity because of underinsurance or the operation of a policy excess. It has not been clearly established whether the insurers can keep the whole of the salvage if they have not provided a full indemnity but the probability is that they cannot.

F Effect of claim payments on policy cover

When insurers pay a claim they are, of course, performing their part of the agreement. But what effect does this have on the policy cover? Is part of the cover 'used up', as it were, when insurers pay a claim, or are they liable to go on paying any number of claims which occur in the period of insurance? The subject is complex but the broad rules are as follows.

F1 Successive partial losses

First, where a policy grants a fixed amount of cover (such as a theft policy on goods with a sum insured of £500,000), the cover reduces by the amount of any claim payment. So, unless the sum insured is restored by the insured paying an extra premium (known as a reinstatement premium), the policy will lapse once all the cover is used up.



Example 9.16

Fire insurance provides a good example of a class where a reinstatement premium is required to restore the sum insured in the event of a claim.

However, in practice, it is not collected in cases where the loss is trivial in relation to the total sum insured and the extra premium involved is insignificant.

In some cases (such as stock declaration policies), restoration of the sum insured is automatic and the insured is obliged by the terms of the contract to pay the extra premium.

Some policies do not provide a fixed amount of cover and normally have no sum insured as such. We have seen, for example, that under a UK motor policy the insurer's maximum liability for loss or damage is generally expressed to be the 'market value' of the vehicle at the time of the loss, provided this does not exceed the estimate of value given by the insured at inception. Third party cover under a UK motor policy is also unlimited in respect of any one accident for personal injury claims. A motor policy, therefore, cannot terminate by virtue of its sum insured or liability limit being exhausted by a series of claims for personal injury. A motor policy may limit liability to £1,200,000 'in respect of all such liabilities as may be incurred in respect of damage to property caused by, or arising out of, any one accident involving the vehicle' (Road Traffic Act 1988 s.145(4)).

In marine insurance, s.77 of the Marine Insurance Act 1906 provides that the insurer is liable for successive losses, even though the total amount of such losses may exceed the sum insured (s.77(1).) Thus, although no one partial loss could give rise to a right of indemnity in excess of the insured value, the aggregate of more than one such partial loss could do so. If a ship is damaged and repaired and became a total loss subsequently, the insured may recover for both the cost of repair and the total loss of the vessel. Under the same policy, if a partial loss, which has not been repaired or otherwise made good, is followed by a total loss, the insured can only recover in respect of the total loss (s.77(2)).

F2 Total losses

In this section we will deal with the termination of insurance policies following a total loss.

F2A Termination of the policy by payment

In some cases, such as life insurance, it is fairly obvious that payment of the full sum insured will usually end the contract. Again, in the case of property insurance, a payment on the basis of a total loss normally ends the insurer's liability. In contract law generally, it is presumed that a person need do only once what they have promised in the contract to do.

In many cases (but not life insurance) the subject matter will be restored after a total loss. This will be common in the case of property policies where the property in question is often rebuilt or replaced. If this is done, a fresh insurance contract must be effected on the restored property and must be supported by fresh consideration (i.e. a further premium payment).

F2B Termination by destruction of the subject matter

Quite apart from the question of payment, cover may cease automatically if there is a total loss, simply because the subject matter which supports the insured's interest will, as a result, no longer exist or, even if it does, the insured will have no rights in respect of it. You should bear in mind what we have said about insurable interest in *Insurable interest* on page 5/10, and salvage in *Salvage and abandonment* on page 9/16 of this chapter.

The automatic right to terminate cover following a total loss can, of course, be modified by the terms of the policy. The insurers may, for example, allow the old policy to remain in force and permit the insured to substitute new property for that which has been destroyed.

Example 9.17

Many motor insurers will accept the substitution of a replacement vehicle under the existing policy when the original insured vehicle has been stolen or 'written off'.



On the other hand, some insurers are less generous and always cancel when there is a total loss. In some cases, the right to cancel is reinforced by an express clause in the policy, such as the following, taken from a motor policy:

In the event of any claim under Section 3 (Loss or Damage)...for the total loss or destruction of the Insured Car and for which a full indemnity is paid hereunder, this insurance shall be cancelled with no return of premium and this document and the 'Certificate of Motor Insurance' shall be returned to the Underwriters forthwith.

F2C The effect of termination in the event of a total loss

As we have seen, where a policy lapses following a total loss, the insured will be required to effect a new insurance contract in respect of the replacement property and pay a further premium for it. Where the loss occurs at the beginning of the policy year, the insured will, therefore, lose almost a whole year's premium. In some classes of insurance, such as marine and aviation, premiums are high and this loss may be quite substantial. In fact, this risk (of having to pay another premium following a total loss) can sometimes be insured under a special 'premium insurance'.

G Scenario 9.1

G1 Scenario 9.1: Question

Apply how losses are measured and the principle of indemnity to practical situations (LO8.7)

Martin is an antiques dealer, whose stock is kept in his warehouse. Martin insured the warehouse and the contents under a commercial insurance policy with your company. The warehouse and the content (some valuable antiques) were destroyed by fire which was an insured peril under the insurance contract.

Although the warehouse had been in good repair, it was due to be replaced next year with a more modern building. Your view, based on the initial loss adjuster's assessment, is that Martin's warehouse was underinsured.

Discuss, with justification, what legal issues might have to be dealt with when Martin makes a claim.

When planning your answer, use the following four-step IRAC approach:

- provide an **introduction** that identifies the focus of the question;
- look at the **relevant** areas of law;
- **apply** the principles of the law to the scenario; and
- provide a **conclusion** to your answer.

Note: the M05 study text is based on English law. All scenarios included are set in England; therefore English law applies.

G2 Scenario 9.1: How to approach your answer

Aim

This fictional case study tests the reader's ability to apply how losses are measured and the principle of indemnity to practical situations (learning outcome 8.7).

It is recommended that you use the following four-step IRAC approach when planning your answer.

Provide an introduction that identifies the focus of the question

The destruction of the building is said to be due to a fire whose cause has been validated as an insured peril. The question, therefore, is not about causation. The issues here relate to indemnity and the measurement of losses.

Look at the relevant areas of law

The relevant principle is that of indemnity. In insurance, this means putting the insured back in the position they were in immediately before the loss. In many cases, there will be a full indemnity but the measure of indemnity can be affected by a number of factors. For that reason, the measurement of loss is also relevant.

Apply the principles of the law to the scenario

There are three factors:

- The valuable stock of antiques – this raises the issue of whether there may be any agreed values in relation to items such as antiques.
- The reinstatement of the building – this raises the issue of betterment as well as the intention to replace it with a modern building next year.
- The potential underinsurance – in the case of a total loss, this raises an issue of whether the full cost of replacement will be paid and in the case of a partial loss this raises the issue of whether there is an average clause in the policy.

Excluding any excess or deductible but taking into account any underinsurance, Martin may receive payment for the valuable antiques at their agreed value. The building may be reinstated but the underinsurance and betterment have to be considered.

Remember to provide a conclusion to your answer that directly links back to the question and relevant area(s) of the law.

Note: the key to answering this scenario (and other scenarios in which there are several elements to discuss) is to first separate out the issues. You can then address each one individually and avoid too many overlapping comments.



Key points

The main ideas covered in this chapter can be summarised as follows:

Meaning of indemnity

- Indemnity insurances are those where the insurers agree to pay only when the insured suffers a loss of a particular type, and only for the amount of the loss.
- Non-indemnity (or contingency) insurances are policies in which insurers agree to pay a specified sum when a particular defined event occurs. The insured does not have to prove that they have suffered a loss, only that the event in question has happened.
- The concept of indemnity means that insurance should provide exact financial compensation for the insured; it also means that the insured should not be over-compensated.

Measure of indemnity

- The measure of indemnity depends upon the type of insurance involved and the nature of its subject matter.

Variations in the principle of indemnity

- Factors which could limit the insured's entitlement to a full indemnity include the sum insured or limit of liability; other policy limits; underinsurance and average clauses; the excess or deductible; and operation of a franchise.
- In some situations the insured can receive more than a full indemnity; including where cover is provided on a reinstatement basis; new for old cover; agreed value cover; and partial losses under valued policies.

Methods of providing indemnity

- The methods by which the insurer will provide indemnity are usually set out in the insuring clause of the policy; the main methods are payment of money; reinstatement (including statutory reinstatement under the Fires Prevention (Metropolis) Act 1774); repair and replacement.

Salvage and abandonment

- The action of giving up the subject matter to the insurer is referred to as abandonment, and the right of the insurer to take over the subject matter is known as salvage.
- In marine insurance (but not recognised in non-marine insurance) a constructive total loss is where the subject matter is not destroyed but the insured is deprived of the possession of their ship or goods and it is unlikely that they can recover the ship or goods; or the cost of recovering the ship or goods would exceed their value when recovered.
- In marine insurance the insured may claim successive partial repaired losses although the claim may exceed the policy amount in the aggregate.

Self-test questions

1. Why are life insurance policies not indemnity contracts?
2. What is 'betterment'?
3. Suggest three circumstances where a person insured under a property policy may receive less than a full indemnity in the event of a loss.
4. Can average operate as an implied term?
5. Distinguish between an excess (or deductible) and a franchise.
6. What is a valued policy?
7. What kinds of policy are subject to the provisions of s.83 of the Fires Prevention (Metropolis) Act 1774?
8. Explain the terms 'salvage' and 'abandonment'.
9. What is 'notice of abandonment'?
10. What is the effect on policy cover when insurers pay a total loss?

You will find the answers at the back of the book

10

Subrogation and contribution

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Learning objectives

After studying this chapter, you should be able to:

- explain the principles of subrogation and contribution as corollaries of the principle of indemnity;
- describe how and when contribution and subrogation arise;
- explain the extent of rights of subrogation;
- discuss the application of the principle of contribution to basic insurance situations; and
- understand the modification of the principles of subrogation and contribution by policy conditions and market practices.

Introduction

The principles of subrogation and contribution are sometimes described as corollaries of the principle of indemnity. This means that they support the principle of indemnity – they apply automatically and only to insurances which are contracts of indemnity.

We have seen that the principle of indemnity prevents the policyholder from recovering from their insurer a greater amount than their loss. What happens, however, if the insured is in a position where they can claim twice (or more than twice) for the same loss?



Consider this...

In what situation might an insured be able to claim more than once for the same loss?

They may be able to do so if:

- they have more than one insurance policy covering the loss; or
- they have a claim under one insurance policy only but can also make a claim for compensation against another person who allegedly caused the loss.

In either case, it appears that they will be able to 'make a profit from their loss' and achieve more than an indemnity. However, the law prevents this. In the first case (where there is double insurance), the right to claim twice is denied and the loss is shared between the two (or more) insurers under the principle of contribution – in other words, each insurer contributes to the loss payment. In the second case, the right to claim twice is also denied. If the insured makes a claim under their policy they must give up their right to claim from the other person and, instead, allow the insurers to recover their own claim payment from the other. This is the doctrine of subrogation and we will consider it first.



Key terms

This chapter features explanations of the following ideas:

Co-insurance cases	Common interest	Contribution	Double insurance
Double recovery	Ex gratia payment	Market agreements	Maximum liability method
Public policy	Recovery equal to the loss	Sharing the recovery	Subrogation

A Subrogation

We can define *subrogation* as:

The right of one person, having indemnified another under a legal obligation to do so, to stand in the place of that other and avail themselves of all the rights and remedies of that other, whether already enforced or not.

In the context of insurance, subrogation refers to the right of an insurer who has indemnified an insured in respect of a particular loss (i.e. paid a claim) to recover all or part of the claim payment by taking over any alternative right to indemnity which the insured possesses. It follows that subrogation will arise only where the insured has suffered a loss and has another means of recovering it, i.e. a claim on their insurance policy and a legal right or claim against some other person for the same loss. If the insured chooses the first option (a claim on their policy), then the alternative right, the claim against another, passes to the insurers. The effect is to prevent the insured from recovering twice for the same loss and so preserve the principle of indemnity.

Example 10.1

A house has been damaged in a fire which was started by the negligence of a plumber who had come to repair a pipe. The damage amounts to £5,000 and the house owner has a household policy which covers fire damage. The house owner has two means of recovering this loss: (a) they can claim under their own household policy; or (b) they can make a claim against the plumber, based on negligence (discussed in *Negligence* on page 2/9).



The easiest course for the house owner in this situation is likely to be the claim against the household insurers.

If the house owner receives an indemnity from their insurers (i.e. payment of the claim) their right to recover from the plumber (because he is responsible for the damage – in other words the negligence of the plumber has caused the loss) is now transferred to the household insurers, who can sue the plumber. The assured does not lose their right of action against the plumber, however, the principle of indemnity (mentioned in chapter 9 and also below (see *Castellain v. Preston*)) does not allow the assured to recover twice for the same loss.

Therefore, the insurer steps into the insured's shoes and can claim the losses from the plumber. The insurer's claim has to be brought in the name of the insured – unless the right is assigned to the insurer. The insurer simply, as a matter of law, is allowed to claim it by stepping into the assured's shoes. Subrogation is not the same as 'assignment' as the former arises as a matter of law. Assignment can have effect only if the parties agree to assign the relevant claim. If the assured has assigned the right to claim against the plumber, the insurer's claim will be in the name of the insurer, not the assured.

If, in our example, the house owner pursued the claim against the plumber themselves and did actually obtain compensation from the plumber after receiving an insurance claim payment, they would have to pass on the money received from the plumber to their insurance company.

The plumber may have their own insurance to protect them against claims of this sort – in other words, public liability insurance. In which case the plumber can make a claim against their own insurer to meet the losses suffered as a result of the plumber's negligence.

B Nature of subrogation

Why does the law allow subrogation? It is sometimes suggested that subrogation prevents the 'guilty' party who causes the damage (such as the plumber in example 10.1) from being 'let off the hook', and ensures that they do not escape their financial responsibilities simply because the party who suffers the loss or damage has been careful enough to arrange insurance. As mentioned above, the plumber may also have public liability insurers who ultimately bear the loss.

Refer to

Refer to *Development of English law* on page 1/11 for the principles of equity

The main purpose of subrogation is simply to prevent what is known as the 'double indemnity' of the insured – in other words to prevent the insured from unfairly profiting from their loss.

Example 10.2

To quote Brett, L.J. in *Castellain v. Preston* (1883), subrogation is:

a doctrine in favour of the underwriters or insurers in order to prevent the insured from recovering more than a full indemnity.



B1 Indemnity policies only

Since subrogation supports indemnity, the doctrine does not apply to non-indemnity contracts, such as life insurance or personal accident insurance.



Example 10.3

This means that a life insurance company which paid a claim for the death of a policyholder who was killed in a road accident would have no subrogation rights against a driver whose negligence caused the accident.

C Operation of subrogation

The principle of subrogation can operate in two ways.

Firstly, the insured may have actually succeeded in '**recovering for the same loss twice**', i.e. collected a claim payment from their insurers and also recovered compensation for the same loss from another source.



Example 10.4

We have seen that the householder in our case above may have actually received a payment from both the plumber and their insurers. In this case the insurers can call upon the insured to pay back to them the 'profit' which has resulted from the *double recovery*. The insured would be guilty of 'unconscionable (unfair) conduct' if they did not ensure that sums paid by the third party were handed over to the insurer.

Moreover, the courts have held that insurers have an enforceable equitable lien or charge over such money. This means that the insurer may be able to secure an injunction requiring the money to be paid over. An injunction in this context is a court order compelling a person to carry out a certain act – in this case handing over the money.

Secondly, where the insured has not received compensation from another source, insurers who have indemnified the insured in respect of the loss may themselves bring an action against the third party who is legally responsible for it. We will look at each of these situations in turn.

C1 Where the insured has 'recovered for the same loss twice'



Example 10.5

A good example is provided by the leading case of ***Castellain v. Preston (1883)***. Here, the seller of a house recovered £330 from his insurer when the property was damaged by fire between the signing of the contract and the completion of the sale. The buyer afterwards completed the purchase and, despite the fire, paid the full price of £3,100, which he was bound to do by the terms of the contract. It was held that the seller had to pay to his insurer £330 from the money that he had received from the buyer, otherwise the seller would have 'made a profit from his loss'. In effect, the seller had received £330 from his insurer, and also £330 from the buyer – as part of the selling price.

The rule that the insured cannot recover in respect of the same loss twice is subject to some qualifications.

C1A The insured must be indemnified

The insurer can claim the right of subrogation only after the insurer has paid. The parties to the insurance contract may agree otherwise but the wording of that agreement must be clear.

In other words, the insured is only accountable to the insurers if they have been indemnified for their loss.

Example 10.6

In the case of *Scottish Union and National Insurance v. Davies* (1970) insurers had paid £409 to the motor vehicle repairers who had carried out repairs on the insured's car. However, even though three attempts had been made to repair the car, the work was not satisfactory, so the insured sued the person who caused the damage and recovered £350, which they used to get the work done properly. The motor insurers attempted to claim this £350 by way of subrogation but failed because the repairs they had paid for were useless and no satisfaction note had been signed by the insured. The judge held that the insurers were not entitled to recover and stated:

'So far as the insured was concerned, they (the insurers) might have thrown £409 in bank notes into the Thames.'



In many cases the insurers will have made a payment to the insured but will not have provided a full indemnity. For example, the policy may be subject to a deductible, or there may be under-insurance, or it may be that some of the loss is simply not covered by the policy. The implications of this for the operation of subrogation are considered in *Sharing the recovery* on page 10/6.

C1B Gifts

In some cases the insured may receive a gift (i.e. voluntary payment), after having suffered a loss, usually from somebody other than the wrongdoer. In general terms, it appears that where the giver intends the money to be for the sole benefit of the insured it cannot be claimed by way of subrogation.

C2 Where the insurers bring an action against the third party

As we have seen, where the insurers have indemnified the insured and the insured has not enforced their alternative rights to compensation, the insurers may 'step into the shoes' of the insured and pursue any right of action available to the insured to reduce the loss insured against.

The action will normally lie against a third party whose negligence (or other tort) has caused the loss. However, subrogation can arise in other ways, and these are discussed in *Source of subrogation rights* on page 10/8 of this chapter.

C2A Action in the name of the insured

The action must be brought in the name of the insured and legally it is regarded as the insured's own action although, as we have seen, the insurers will, effectively, have the benefit of it. If the assured does not allow the insurer to use their name in the action against the third party, the insurer can sue the assured and the third party in the same action. The insurer would ask the court to order the assured to allow their name to be used in the legal action and it would claim the loss against the third party.

Be aware

There is one exception to this rule, which is actions brought by insurers under the **Riot Compensation Act 2016**, where the insurers may sue in their own name. This is discussed in *Statute* on page 10/9.



C2B One action only – for the whole loss

When an action is taken by insurers in the name of the insured, it must be for the whole loss and not just for the portion which has been borne by the insurers. This is because, as a general rule, the law only allows a person to sue once for a wrongful act that has been committed against them.



Example 10.7

If a motor car is damaged by the negligent action of another motorist, and the cost of repair is £5,000, the owner will be able to claim for this loss if they have a comprehensive policy. However, the policy may be subject to a deductible (say £250), and the owner may also need to hire another vehicle while their car is in the garage for repair. This latter cost (say £500) may not be covered by their insurance. Therefore, the owner will have to recover these uninsured losses from the other motorist. Since the insurers have the right to sue in the insured's name for the £4,750 which they have paid, it is important that they claim, in addition, for the £250 excess and £500 hire charges on behalf of their insured: otherwise the right to recover this expense may be lost.

The same principle would apply if the insured, rather than the insurers, initiated the claim against the motorist whose negligence caused the loss. That is, the insured would be obliged to claim for the whole loss of £5,500 and not just the £750 which they could not recover from their own insurers. Of course, they would then have to return £4,750 to the insurers, assuming that they had already paid the insured this amount.

C2C The time when subrogation rights arise

At common law the insurers must indemnify the insured (i.e. pay the claim) before they can exercise subrogation rights. However, this means that insurers do not have complete control from the date of the loss and their ability to recover could be seriously prejudiced by delay or by some other action taken by the insured.

Insurers include a 'duty of assured' clause by which they require the insured to take steps to preserve the insurer's subrogation rights. The insured might be obliged to start legal proceedings against the third party even though the insured has not yet been paid by the insurer. This legal action would protect the insurer's right, e.g. if there is a risk of the claim being time barred.

Equally, the insured will be in breach of their duty to the insurers if they prejudice their rights in any way (e.g. by waiving their rights against the third party or entering into a compromise with them). In this respect, the clause reinforces and supplements the common law duty of the insured to act in good faith when proceeding against the third party.



Activity

Find a non-marine policy wording and locate the express subrogation clause.

C3 Sharing the recovery

The operation of the principle of subrogation, and the way in which any recovery from a third party is shared between the insured and the insurers, depends on two factors:

- the amount of the recovery in relation to the loss; and
- whether the insurance covers the loss in full.

We will consider three possible situations.

C3A Recovery equal to the loss

Quite often, the amount of the recovery from the third party will be exactly the same as the loss suffered by the insured. In this case the position is straightforward and no problem about sharing the money recovered will arise because, in effect, the whole of the loss will be borne by the third party.



Example 10.8

If insurers pay in full for a loss of £5,000, and then recover £5,000 from the third party, they will be entitled to keep the whole of that £5,000. However, if the insurers pay £4,750 only because, for example, the policy is subject to an excess of £250, the insurers will be allowed to retain £4,750 only and will hold the balance of £250 for the insured. Equally, as explained earlier, if the insured, rather than the insurers, was to recover the £5,000, they would be able to retain only £250 from this and would hold the rest for the benefit of the insurers.

C3B Recovery greater than the loss

If there is any surplus after the insurers have recovered their money the insured is entitled to keep it. Again, the insurer is not entitled to recover more than it has paid out.

Example 10.9

Although a surplus is very unlikely to arise, it did do so in ***Yorkshire Insurance Co. Ltd v. Nisbet Shipping Co. Ltd (1962)***. In this case insurers had paid an agreed value of £72,000 for the loss of a ship in a collision in 1945. The insured sued the Canadian Government, who owned the other ship, and damages of £75,000 were awarded. This sum was converted into Canadian dollars at the exchange rate prevailing in 1945. However, when the dollars were converted into sterling they produced £126,000, because the pound had been devalued in 1949. It was held that the insurers were entitled to £72,000 only, the sum they had paid out. The insured thus benefited from the £55,000 surplus (and the insurers, effectively, lost the interest that they could have earned on their money over 13 years).



Refer to

Refer to [Salvage and abandonment](#) on page 9/16 for abandonment and salvage

The *Nisbet* case confirmed that insurers can never recover by way of subrogation a greater sum than they have paid out. However, as we shall see in [Subrogation, salvage and abandonment](#) on page 10/10, insurers may be able to recover more than they have paid under the doctrine of abandonment and salvage.

Again, insurers may, in theory, be able to recover more than they have paid if, instead of relying on the doctrine of subrogation, they stipulate in the insurance contract that the insured shall assign to them any right of recovery against a third party, or persuade the insured to assign the right after a loss has occurred.

In this case the **Nisbet** principle will not apply, because the right to sue will now belong exclusively to the insurers. Furthermore, the insurers will not have to first indemnify their insured before pursuing the third party. However, it seems that insurers rarely use the device of assignment in these circumstances.

C3C Recovery less than the loss

In some cases, the recovery from the third party will be less than the loss that has been suffered by the insured. This may happen, for example, if the third party is insolvent or simply unable to pay. If the insurers have paid for the whole of the loss they will obviously be entitled to keep the whole of the sum that has been recovered. However, if the insurers have not paid the whole of the loss, because, for example, the policy is subject to an excess, a difficult question arises.

Example 10.10

Let us suppose, for instance, that the insured has suffered a loss of £5,000, but the insurers have paid £4,750 only because the policy is subject to an excess of £250. If the insurers recover, say, £4,000 only, can they keep all of this (because they have paid out more than £4,000) or do they have to give £250 to the insured so that the insured is indemnified in full?



Until ***Napier v. Hunter (1993)*** there was no clear answer. It appears from the decision, however, that the insurers could keep the whole £4,000, even though the insured has not been fully indemnified. Apparently, this is because the insured, in accepting an excess, has 'agreed' to bear the first £250 of any insured loss, giving the insurers first claim on the money that is recovered. The assured is self-insured for the first £250.

The same principle applies in a case of under-insurance. For instance, in our example above, the insurers might have paid only £4,750 of the £5,000 loss because the sum insured was limited to the former amount. In this case the insurers could again keep the whole of any recovery that was less than £4,750.

In *North of England Iron Steamship Insurance Association v. Armstrong* (1969–70) the insured ship, H, valued at £6,000, was run down and sunk by another ship, U. The insurers paid the owners the whole sum of £6,000 for a total loss. When the £5,000 was recovered from the owners of U, the insured argued that the real value of H was not £6,000 but £9,000; and therefore the amount received from the owner of U should cover the shortage of the recovery from the actual value of H.

H's owner's argument was rejected by the court who held that as between the insurers and the insured, the value of H must be taken to be £6,000 for all purposes. Therefore, the damages recovered, which were in the nature of salvage, belonged entirely to the underwriters.

It seems unlikely that this principle would apply to uninsured losses that were completely outside the policy cover and would not have been paid even if there had been no excess or under-insurance.

Finally, it is clear that the insured can deduct from any amount to which the insurer is entitled by way of subrogation, any legal costs or other expenses reasonably incurred in attempting to recover the loss that was insured.

C4 *Ex gratia* payments

So far we have dealt with situations where there is a valid claim under a policy. What happens if an insurer makes a payment when it is not strictly bound to do so by the policy terms?

In fact, subrogation arises only from payments made under the terms of the policy. If the insurers make a payment outside the terms of the policy, making it clear that no legal obligation to pay is accepted, and that payment is made merely as a favour (known as an '*ex gratia*' payment), they are not entitled to subrogate against a third party. The insured is entitled to retain any amounts secured in this way.

D Source of subrogation rights

We have seen that the effect of the doctrine of subrogation is to pass to the insurer a right to recover from a third party who is legally responsible for the loss suffered by the insured.

D1 Tort

Refer to

Refer to chapter 2 for the law of torts

Subrogation rights most frequently arise in tort, a branch of the law. In most cases, the third party will have negligently damaged property belonging to the insured which is covered under the latter's property insurance.



Example 10.11

A lorry driver might negligently drive their vehicle into a building, causing damage. If the owners of the building claim for the impact damage under their property insurance, the insurer will, on the face of it, be able to exercise subrogation rights against the lorry driver in the name of the insured.

Although subrogation rights will usually be founded on the tort of negligence, there are other possibilities.

Example 10.12

A person's house might be damaged by tree roots that encroach from a neighbour's garden, causing subsidence. If the owner of the damaged property makes a claim under their household buildings policy, the insurers may have subrogation rights against the neighbour which, in this case, could be based on the tort of nuisance. The tort of nuisance is the unreasonable use by a person of their land to the detriment of their neighbour – in this case, allowing their tree roots to grow to such an extent that they cause subsidence.



D2 Contract

Subrogation rights may exist in contract. If the insured has an alternative contractual right of recovery, in addition to that provided by their own insurance, the insurers will be able to enforce this right for their own benefit.

Example 10.13

Property insurers who pay a claim for damage to buildings may have rights of recovery against a tenant of the insured, who is legally responsible for the damage under the terms of the lease.



Again, marine insurers who pay shippers for damage to cargo may have subrogation rights against the carrier that arise from the contract of carriage.

Subrogation rights in contract can also arise from indemnity (or 'hold harmless') clauses whereby one party to a contract (A) agrees to pay back another (B) if the latter (B) should suffer a particular sort of loss. In other words, a hold harmless clause is used as a release of liability in a contract that protects one party from, say, property damage caused by another party. By signing the clause, the other party is agreeing not to hold business owners legally responsible for the risks involved in certain services.

Clauses of this sort are very common in contracts associated with complex construction or engineering projects, where many firms and many groups of workers are involved.

Refer to

Refer to [Market agreements](#) on page 10/10 for knock for knock agreements and [Lister v. Romford](#)

An important subrogation case involving contracts of this sort arose from the Piper Alpha disaster. These indemnity clauses effectively formed a network of 'knock for knock' (or 'hold harmless') agreements whereby the rig owners and each firm working on the rig accepted responsibility for injuries to their own employees.

A final, unusual, example of subrogation arising in contract is found in [Lister v. Romford Ice and Cold Storage Ltd \(1957\)](#). See example 10.15 further on in this chapter.

D3 Statute

Finally, a recovery by way of subrogation may be founded on a statutory right belonging to the insured.

The most common example is the statutory right of property owners to recover damages from the police authority if their property is damaged in the course of a riot. This right arises under the Riot Compensation Act 2016 (RCA). The RCA replaced the **Riot (Damages) Act 1886**, which was generally seen as antiquated and difficult for policing bodies to apply following the 2011 UK riots.

Under the doctrine of subrogation, the right passes to insurers who pay a claim for riot damage and is enforceable by them against the policing body in the district in which the riot occurred. Unusually, the Act allows insurers to sue the relevant authority in their own name.

D4 Subrogation, salvage and abandonment

In *Salvage and abandonment* on page 9/16, we discussed the doctrine of salvage and abandonment, which allows insurers who have paid a total loss to claim for their own benefit anything which remains of the subject matter. Abandonment is often linked with subrogation and has the same general purpose of preventing the insured from recovering more than an indemnity.

However, there are important differences, as follows:

- subrogation gives the insurer the right to pursue a claim against a third party for the loss of the subject matter, whereas abandonment and salvage confer rights only over the subject matter itself;
- an action by way of subrogation cannot be brought in the insurer's own name (with one exception), whereas an insurer who accepts abandonment becomes the owner of the goods;
- the insurer can make a profit on the abandoned property, whereas subrogation allows the insurer to recover no more than their own payment; and
- subrogation operates automatically as a result of the principle of indemnity, whereas abandoned property need not be accepted by the insurer.

D5 Modification or denial of subrogation rights

Sometimes insurers agree not to enforce their subrogation right, and on other occasions they are prevented by law from exercising rights of subrogation that would otherwise exist. Some of the main examples are discussed below.

D5A Market agreements

Subrogation rights are often affected by voluntary market-wide agreements between insurance companies. Sometimes insurers agree among themselves to waive (i.e. give up entirely) their rights of subrogation against third parties. This is particularly common where the third party is insured. As we have seen, if the third party (e.g. a plumber) is covered by their own liability insurance, the consequence is that one insurer will end up claiming from another. This can result in extra administrative costs and, possibly, wasteful and expensive litigation between the two insurers if they cannot agree which of their policyholders is to blame for the damage. Furthermore, over a period of time neither of two insurers who regularly claim from each other is likely to be much better off – they will simply be 'pound-swapping'.



Example 10.14

The most well-known examples of waiver of subrogation rights are found in the field of motor insurance, where a network of 'knock-for-knock' agreements developed in the UK and in some other countries. The general effect of these agreements is as follows. When an accident (such as a collision) occurs involving vehicles covered by different insurers, each insurer pays for the damage to its own policyholder's vehicle (provided the policy covers the damage) and gives up any subrogation rights that may exist against the other motorist. The development of these agreements in the UK goes back to the First World War (1914–18). Insurance offices were understaffed because so many men had gone to fight and the agreements became necessary in order to cut down on paperwork.

Recent dissatisfaction with 'knock for knock' agreements has led to a withdrawal by a number of insurers, causing the system to break down in the UK.

Various other agreements exist. For example, there are 'immobile property agreements' between motor insurers and property insurers that cover impact damage by motor vehicles. Under these agreements losses are shared in a predetermined proportion.

Another interesting example is found in the field of employers' liability insurance.

Example 10.15

The agreement in question arose from the case of *Lister v. Romford Ice and Cold Storage Ltd (1957)* where a worker injured a fellow employee (who was his father) in the course of his employment. The injured employee recovered damages from the employer because the latter was vicariously liable (see *Vicarious liability* on page 2/22) for the son's negligence. Having indemnified the employers, the employers' liability insurers brought a successful action against the negligent employee to recover what they had paid. The court accepted the argument that the son had broken an implied term of his contract of employment (to take reasonable care) in injuring his father, giving the employer a right of recovery in contract which the insurers pursued by way of subrogation. Concern at the harsh effects of the decision, particularly in view of the relationship between the parties (because the compensation given to the father was taken back from the son), and accompanying criticism of the industry led insurers generally to agree to give up their subrogation rights in such cases.



Therefore, other than in exceptional circumstances, insurers do not pursue rights of recovery against persons who negligently injure their fellow employees.

D5B Contractual waiver of subrogation

Quite often, insurers agree with a particular insured that they will not exercise subrogation rights against certain other parties or persons who are associated with the insured. They can do this by including a 'subrogation waiver clause' in the policy.

The clause may, for example, expressly state that subrogation rights will not be exercised against affiliated or subsidiary companies of the policyholder, the intention being to prevent a subsidiary from having to pay back sums which had been paid to the parent company under an insurance claim.

Even if there is no such 'subrogation waiver clause' in the insurance policy, a non-consumer (business) contract between the insured and another person may be construed in such a way as to bar the insurers' rights of subrogation.

Example 10.16

If a contract (e.g. a construction contract) between A and B states that certain property shall be 'at the sole risk of A', the courts may assume that A had agreed not to sue B for any damage to the property, thus depriving A's insurers of subrogation rights.



Again, the way in which two or more parties have arranged their insurance may persuade a court that there should be no subrogation rights. For example, if a non-consumer (business) contract states that a person 'shall have the benefit' of the insurance arranged by another, the courts may assume that the intention was to exempt that person from any liability for a loss to be covered by the insurance.

D5C Co-insurance cases

Refer to

Refer to *Joint and composite insurance* on page 7/19 for composite and joint insurance

We have seen that two or more persons can be insured under the same policy and that the policy in question can be either joint or composite. A question then arises as to whether an insurance company, having indemnified one co-insured for a loss covered by the policy, can exercise subrogation rights against another co-insured who was legally responsible for the loss. In some cases there may be an express 'waiver of subrogation' clause in the insurance contract (see above), to the effect that no subrogation rights will be exercised against a co-insured. It used to be the position that, even if there is no such clause, subrogation will usually be denied.

The theories behind this principle (no rights of subrogation against a co-insured) are complex and beyond the scope of this course. However, it is worth mentioning that subrogation in co-insurance has been a topic which has come before the English courts several times in recent

years. It should be first noted that in cases in which a subrogation action in co-insurance is discussed, there are normally two contracts involved:

1. The underlying contract between the parties. For example: a construction contract which could require the contractor to take out insurance insuring both the employer and the contractor.
2. An insurance contract.

In *Tyco Fire & Integrated Solutions (UK) Ltd v. Rolls Royce Motor Cars Ltd (2008)*

Rix LJ held that (in the absence of an express subrogation waiver clause) whether the insurer has subrogation rights depends on the underlying contract between the contractor and the subcontractor. If the underlying contract exempts the sub-contractor's liability, there will be no subrogation rights but otherwise, the insurer subrogates into the contractor's rights despite the co-insurance.

The Supreme Court, by majority, recently rejected Rix LJ's view as stated above. In ***Gard Marine & Energy Ltd v. China National Chartering Co. Ltd (formerly China National Chartering Corp.) (The Ocean Victory) (2017)***, the owners of the vessel *Ocean Victory* chartered the vessel by a demise charterparty dated 8 June 2005 to Ocean Line Holdings Ltd. On 2 August 2006, Ocean Line Holdings Ltd time chartered the vessel to time charterers. All of the charters contained a safe port clause under which the vessel was to be used at safe ports. Clause 12 of the demise charter required the demise charterer to put insurance in place for the joint account of the owners and demise charterers. On 24 October 2006, the vessel was lost in a storm at Saldanha Bay. The insurers indemnified the owners and demise charterers, and took an assignment of the demise charterers' rights against the time charterers and sought damages for breach of the safe port warranty in the time charter.

The Supreme Court unanimously rejected the claim on the basis that the port was safe. On the basis that there had been a breach, the Supreme Court divided 3:2 on the question of whether the demise charterers had a claim that was capable of being assigned.

The majority held that there was no such claim – the insurance arrangements in the demise charter operated on the basis that there was an implied term in the demise charter so the owners had no course of action against the demise charterers for risks covered by the insurance. The minority view was that the safe port warranty took priority, and that although a payment by the insurers discharged the liability of the demise charterers to the owners, the insurance could not be relied upon by the time charterers to resist a claim by the demise charterers.

It should be noted that if one co-insured ceases to be covered by the insurance, subrogation may then be allowed.

Alternatively, if the underlying insurance requires a co-assured to purchase a separate insurance to the co-insurance contract, so far as covered by that separate insurance, a subrogation action may be allowed towards that co-assured. It would mean that regarding the areas that the separate insurance covers, the parties were not meant to be co-insured under the co-insurance policy.

D5D Public policy

Refer to

Refer to [Market agreements](#) on page 10/10 for *Lister v. Romford*.

You will recall that following ***Lister v. Romford Ice and Cold Storage Ltd (1957)***, insurers have generally agreed to give up their subrogation rights against negligent workers who injure their fellow employees in the course of employment. The following example shows how the Court of Appeal has refused to allow subrogation in a similar (but not identical) situation.

Example 10.17

In *Morris v. Ford Motor Co. (1973)*, the injured claimant worked for a cleaning firm (Cameron) that was contracted to clean at a Ford location. The claimant successfully recovered damages from Ford, which was vicariously liable for its employee's negligence. Ford then sought an indemnity from Cameron, relying on the indemnity clause in the contract, which led to Cameron trying to bring (through subrogation) a legal claim directly against the negligent Ford employee. The Court of Appeal rejected Cameron's claim, on the grounds of **public policy**, and highlighted that industrial relations would be harmed if there was a right to sue employees in such cases.



E Double insurance and contribution

Like subrogation, *contribution* supports the principle of indemnity which effectively prevents the insured from 'making a profit from his loss'. In this case, however, the possibility of making a profit arises from the existence of *double insurance* (see ensuing section).

Contribution is concerned with the sharing of losses between insurers when such double insurance exists, the overriding principles being that the insured cannot recover for the same loss twice and that the insurers should share the loss in a fair way.

Contribution can be defined as follows:

Contribution is the right of an insurer to call upon others similarly, but not necessarily equally liable to the same insured, to share the cost of an indemnity payment.

Like subrogation, contribution applies only to insurance policies that are contracts of indemnity. As an example, a person is entitled to buy as many life insurance policies as they can afford and each insurer must pay in full when the time for payment comes.

Contribution is governed by common law rules (although, as in the case of subrogation, the central principle behind them is one of equity). However, these common law rules are frequently modified by clauses in the policy known as contribution conditions. In practice, contribution is often further modified by internal **market agreements** between insurers.

E1 Double insurance

Double insurance can arise in various ways. In the past, deliberate double insurance was not unknown, a second insurance being arranged in case the first insurer should be insolvent and unable to pay. This would be rare nowadays, when the motive for deliberate double insurance is more likely to be an attempted fraud. In fact, double insurance will usually be unintentional. In some cases, for example, a person may effect insurance without having cancelled a policy which the new contract was intended to replace. More frequently, there may be some overlap in cover between two different types of policy which the insured has arranged.

Example 10.18



- If a camera is stolen from a car, the loss might be covered under the owner's motor policy (which may cover personal effects in the vehicle) and a household contents or personal all risks policy. If the owner was on holiday at the time then there might be additional cover under a separate travel insurance.
- In the field of non-consumer (business) insurance, a person might have a policy covering stock in a particular warehouse only and hold, in addition, another insurance on a 'floating' basis covering stock in a whole series of warehouses, to cater for peaks and troughs of trading. Each could be placed with a different insurer.

F When contribution arises – the common law rules

Contribution will arise only when the following conditions are satisfied:

- each policy is liable for the loss;
- each insures the same interest in the subject matter;
- two or more policies of indemnity exist;
- each insures the subject matter of the loss; and
- each insures the peril which brings about the loss.

F1 Two or more policies of indemnity

Cases where there are more than two policies are not unknown but, from now on, we will generally assume that only two policies are involved.



Example 10.19

In *Body Corporate 74246 v. QBE Insurance and Allianz Australia Insurance Ltd* (2017), a policy which ended at 4pm on 4 September 2010 was not renewed with QBE, and the insured took out a new policy with Allianz that started at 4pm that day. The QBE policy included an 'excess' clause, under which, if there was any other insurance in place, the other insurance would respond first and QBE would only be liable for loss in excess of the cover of the other policy. There was a similar clause in the Allianz policy.

At 4.35am on 4 September 2010, the property was severely damaged by an earthquake. QBE paid the claim but it sought 50% contribution from Allianz on the basis that Allianz had been on risk at the same time. The judge dismissed the claim and held that the Allianz policy should be construed as incepting at 4pm on 4 September 2010. The intention had been to provide seamless continuing cover rather than overlapping cover. If necessary, a term would be implied to that effect.

It is important that the policies in question must be indemnity contracts, and both be in place at the time of the insured incident.

As we have already seen, contribution does not apply in the case of life or other non-indemnity insurances.

F2 A common subject matter

The subject matter that is affected by the loss must be common to both policies.

However, the policies need not cover exactly the same subject matter.



Example 10.20

- A person may have one policy covering goods in a particular warehouse only, and another policy covering goods in all warehouses which they own.
- Alternatively, a person might have a household policy covering all personal possessions and a separate 'all risks' policy covering a small number of specified items only.

To put this another way, the range of the property covered by the policies does not have to be the same, provided there is some overlap in what they cover.



Be aware

Finally, you should bear in mind that the subject matter may be something other than property. Liability policies or pecuniary insurances may be drawn into contribution where each policy covers the source of legal liability or financial loss in question.

F3 A common peril

Just as the range of property or other subject matter covered by the two policies need not be the same, so the range of perils need not be identical, provided there is overlap between the two. As such, an 'all risks' policy may be drawn into contribution with a fire policy where the source of the loss is fire, despite the broader cover provided by the former.

F4 A common interest

Example 10.21

The leading English case is *North British and Mercantile Insurance Co. v. London, Liverpool and Globe Insurance Co. (1877)* (the 'King and Queen Granaries case'). In this case, merchants had deposited grain with a granary, the owners of which were treated as bailees of the grain. The grain was damaged by fire and, as the granary owners were strictly liable by custom of trade, they claimed against their own insurance. The insurer then tried to bring a claim against the merchants' insurer under contribution but the claim failed because the interests of the bailee and owner of the grain were different.



Different interests in the same property may exist in the case of landlord and tenant, mortgagor and mortgagee or seller and purchaser of a building. If each takes out a policy which covers their own interest only there will be no double insurance and, therefore, no contribution. However, if either (or both) of the parties insures for the benefit of the other as well as themselves, contribution may arise.

F5 Each policy liable for the loss

Contribution will arise only where both insurers can be called upon to pay under their policies. This may not be the case if one insurer has the right to avoid the contract, for example, for breach of condition or where an exclusion applies. Insurers cannot, however, always rely on breach of a condition to deny a claim for contribution as indicated by the case below.

Example 10.22

In *Legal and General Insurance Society v. Sphere Drake Insurance Co. Ltd (1992)*, the insured had two similar motor policies with the claimant and defendant insurers. He was involved in an accident in which a third party was injured and Legal and General negotiated a settlement of £65,000 with the third party. Having settled, they claimed a 50% contribution from Sphere Drake.



Their claim failed at the Court of Appeal because the Legal and General policy included a 'rateable proportion' clause, the application of which meant that Legal and General should only have paid 50% of the loss (£32,500), and had therefore paid the other 50% on an ex gratia basis. Just as no subrogation rights exist in respect of a voluntary payment so there are no rights of contribution. The judges also considered whether Sphere Drake could rely on the fact that the insured had failed to notify them of the loss, in breach of a policy condition, to reject a contribution claim. The court's view was that this argument would not have succeeded, as contribution was based on an equitable right and on balance allowing recovery would have been less unfair.

G Operation of contribution at common law

An insured whose loss is covered by two or more policies cannot recover more than an indemnity. However, at common law, they can claim against the insurers in any order and for such proportion of the loss as they think fit. In particular, they may choose to claim from one insurer only and recover in full from that insurer. Having satisfied the loss, the insurer who pays may then, and only then, claim a contribution from the other insurer(s). Insurers have always regarded this as an unsatisfactory state of affairs, because the insurer that is called upon to pay has the full burden of handling the claim and paying the loss, plus the further inconvenience of claiming from another insurer. It may be some time before the paying insurer is able to make a recovery and the process of doing so may involve extra cost and, perhaps, even lead to a dispute with the other office.

For this reason, insurers may include contribution conditions in their policies.

A contribution condition is a clause that sets out how the loss is to be met if the insured has another policy which covers it. The effect of the condition will be to change or override the common law rules described above.

G1 Contribution conditions

There are many different types of contribution conditions and only the more common varieties are described here. The 'rateable proportion' condition is the most common of all and therefore the most important. We will begin, however, by looking at some conditions that are more drastic in their effects.

G1A 'Escape' clauses

An escape clause is a condition that effectively forbids the insured from taking out another policy without the consent of the insurers. It does this by providing that the insurance will be avoided if the insured takes out any further insurance on the same risk without notifying the insurers and obtaining their consent. The original purpose of these clauses was to prevent the insured from secretly arranging double or multiple insurances and so guard against possible fraud. The clause may also state that the insurance will be invalid if the insured already has cover on the same risk with another insurer.

What happens if a person takes out two policies and both prohibit other insurances? The second policy never operates because of the existing policy in force. This means that the first insurers are liable for the loss because no insurance other than their own has ever come into effect.

Finally, it seems that a purely accidental overlap in cover will not bring conditions such as this into operation.

G1B Other non-contribution clauses

The clause in question may not prohibit other insurances from being arranged without consent in the way described above, but simply state that there will be no liability for any loss which is insured by another policy.



Example 10.23

There shall be no liability under this policy in respect of any loss for which the insured is entitled to indemnity under any other policy.

These clauses are valid in law and their effect is to push the whole of any such loss onto the other insurer. However, there is again the possibility that both contracts will have a similar clause, stating that there will be no liability if another policy covers the loss, so that the insured appears to have no cover at all. In fact, the courts have rejected the possibility of the two policies cancelling each other out in this way.



Example 10.24

In *Gale v. Motor Union Insurance Co. (1928)* Loyst had caused an accident while driving Gale's car and his liability was insured under Gale's Motor Union policy, which gave 'any driver' cover. However, Loyst was also insured under the 'driving other vehicles' extension of his own policy, issued by General Accident. Although both policies excluded liability for losses that were insured elsewhere, the judge ruled that the loss should be shared equally by the two insurers.

Previous cases have shown the courts are not enthusiastic about non-contribution clauses and that, where there is double insurance, identical non-contribution clauses will, effectively, cancel each other out rather than cancel the cover. The courts should invoke the equitable principle of contribution between co-insurers to avoid the absurdity and injustice of holding that a person who has paid premiums for cover by two insurers should be left without insurance cover because each insurer has excluded liability for the risk against which the other has indemnified them.

In some cases, insurers will exclude liability for the amount of the loss covered by the other policy but agree to contribute to the balance of any loss that is not insured by the first policy. In other words, they will pay once the cover provided by the other policy has been exhausted.

Example 10.25

A typical clause might read as follows:

This policy shall not apply in respect of any loss where the insured is entitled to indemnity under any other insurance, except in respect of any excess beyond the amount which would have been payable under such other insurance had this insurance not been effected.



In this case the insurance operates like an excess of loss policy, providing an extra 'layer' of cover above that provided by the 'primary' insurance. If both policies have a similar wording the clauses will cancel each other out in the way described above. If no payment is made under the primary insurance because the primary insurer is insolvent the excess insurer will not usually 'drop down' to cover loss in the primary layer, although this will depend on the exact wording of the clause.

G1C 'More specific insurance' clauses

In some cases, a policy will provide that where a loss is covered by another more specific insurance, the policy will respond only when the cover provided by the more specific insurance has been exhausted. In other words, the policy operates like an excess of loss policy (above), but only where the 'primary' cover is more specific. The term 'more specific' may or may not be defined in the policy. However, a policy is likely to be regarded as more specific if it describes or identifies the subject matter more precisely.

Example 10.26

A policyholder may have a household contents policy covering household goods and personal effects in general and a separate 'all risks' policy covering specified items only, such as jewellery, cameras and other valuable possessions. The loss of, say, a camera could be covered under both policies, but if the household insurance carried a 'more specific insurance clause' (which is likely) the 'all risks' insurers would be primarily liable and the household insurers would contribute only if cover under the all risks policy was insufficient.



Again, if a loss is covered by two policies, but the range of property covered by one is narrower than the other, the former may be regarded as more specific.

Example 10.27

If Policy 1 insures stock in building A only, and Policy 2 has a 'floating' item on stock in building A, B, C and D, the former is a more specific policy. If Policy 2 carried a more specific insurance clause, it would operate only once the cover provided by Policy 1 was used up.



G1D 'Rateable proportion' clauses

Rateable proportion can be calculated in two ways. If calculated in the simplest way then the amount of insurance provided by this policy is divided by the total amount of insurance in force on the property damaged at the time of loss, and this is multiplied by the actual loss incurred.

A clause of this type is now included in virtually all indemnity insurances, and it is sometimes found in conjunction with other contribution conditions. The clause states that the insurers will be liable for a 'rateable proportion' only of any loss that is also insured by another policy.

Example 10.28

A typical clause might read as:

If at the time of any loss, damage or liability there is any other insurance covering such incidents we will pay only our rateable proportion.



The effect is to prevent the insured from recovering in full under a policy that includes the condition. Almost invariably, both policies will carry a clause of this type, so the insured will be obliged to separately claim an appropriate proportion from each insurer.

H Basis of contribution

As we have seen, contribution may arise at common law (i.e. under policies with no contribution condition) or, much more frequently, under a standard 'rateable proportion' clause. In either case, the question arises as to exactly how the loss should be shared by the insurers. Unfortunately, there is little legal authority on this issue. The Marine Insurance Act s.80 (1) states that:

Where the assured is over-insured by double insurance, each insurer is bound, as between himself and the other insurers, to contribute rateably to the loss in proportion to the amount for which he is liable under his contract.

However, the Act does not say exactly how this rateable proportion is to be calculated. Moreover, there is very little case law on the subject. For this reason, the assessment of the insurers' liability in cases of double insurance is often based on market practice rather than established principles of law.

In fact, there are two main methods of calculating the ratio of contribution: the *maximum liability method* and the independent liability method.

H1 Maximum liability method

Under the maximum liability method, the loss is shared by the insurers in proportion to the maximum amount of cover that is available under each policy which, in the case of property insurance, is usually equivalent to the sum insured.



Example 10.29

So, to take a simple case, if property is insured for £10,000 with insurer A, and for £20,000 with insurer B, A will pay 1/3 of any loss and B will pay 2/3, as in the following example:

Loss of £6,000

$$\text{A pays } \frac{\text{£ } 10,000}{\text{£ } 30,000} \times \text{£ } 6,000 = \text{£ } 2,000$$

$$\text{B pays } \frac{\text{£ } 20,000}{\text{£ } 30,000} \times \text{£ } 6,000 = \text{£ } 4,000$$

Unfortunately, there are many circumstances where this method will not operate fairly, or simply not work at all.



Example 10.30

- If the terms and conditions of the policies are not the same the maximum liability method will not operate fairly (for example, one policy may be subject to an average clause or policy excess).
- If the range of the two policies is different, it will be difficult to compare the sums insured.

For example, policy A above may cover stock in building 1 only, whereas B covers stock in buildings 1, 2 and 3.

- If one policy provides unlimited cover (as in the case of some liability insurances), the method will not work at all.

H2 Independent liability method

Under the independent liability method, the liability of each insurer for the particular loss which has occurred is assessed as though its policy were the only one in force. The figure that results in each case represents the independent liability of the insurer for the loss. The loss is then shared in proportion to the independent liabilities of the two insurers.

Some examples, using the two policies described above, will help to make this clear.

Example 10.31



Policy A	sum insured	£10,000
Policy B	sum insured	£20,000
Loss		£6,000

(Neither policy is subject to average)

Step 1 Calculate independent liability of policy A (the amount payable if A were the only policy in force)
This is £6,000

Step 2 Calculate independent liability of policy B
This is also £6,000

Step 3 The loss is shared in proportion to the two independent liabilities (i.e. the proportion of the loss which the independent liability of each policy bears to the total of the independent liabilities), i.e.

$$\text{A pays } \frac{\text{£ 6,000}}{\text{£ 12,000}} \times \text{£ 6,000} = \text{£ 3,000}$$

$$\text{B pays } \frac{\text{£ 6,000}}{\text{£ 12,000}} \times \text{£ 6,000} = \text{£ 3,000}$$

(In this case the independent liabilities are the same so the loss is shared equally.)

Example 10.32



Policy A	sum insured	£10,000
Policy B	sum insured	£20,000
Loss		£15,000

(Neither policy is subject to average)

Step 1 Calculate independent liability of policy A (the amount payable if A were the only policy in force)
This is £10,000

Step 2 Calculate independent liability of policy B
This is £15,000

Step 3 The loss is shared in proportion to the two independent liabilities

$$\text{A pays } \frac{\text{£ 10,000}}{\text{£ 25,000}} \times \text{£ 15,000} = \text{£ 6,000}$$

$$\text{B pays } \frac{\text{£ 15,000}}{\text{£ 25,000}} \times \text{£ 15,000} = \text{£ 9,000}$$

(In this case the independent liability of B is greater, so B bears a greater part of the loss.)



Example 10.33

Policy A	sum insured	£10,000
Policy B	sum insured	£20,000
	Loss	£6,000

(Neither policy is subject to average, but policy A is subject to a £2,000 excess)

- Step 1 Calculate independent liability of policy A (the amount payable if A were the only policy in force)
This is £4,000 (£6,000 less £2,000 excess)
- Step 2 Calculate independent liability of policy B
This is £6,000
- Step 3 The loss is shared in proportion to the two independent liabilities

$$\text{A pays } \frac{\text{£ 4,000}}{\text{£ 10,000}} \times \text{£ 6,000} = \text{£ 2,400}$$

$$\text{B pays } \frac{\text{£ 6,000}}{\text{£ 10,000}} \times \text{£ 6,000} = \text{£ 3,600}$$

(Because policy A is subject to an excess the independent liability of B is again greater and B bears a greater part of the loss.)



Be aware

Whether the maximum liability method or independent method is used will depend on the circumstances and the class of business concerned. A distinction can be made between property and liability insurances.

H3 Property insurance

There is little legal authority on the basis of contribution in property insurance and the choice of method will usually depend on market practice.

In the case of property policies that are not subject to average and in which the subject matter of insurance (the property) is identical, the maximum liability method is normally used.

Where non-average policies are in contribution but they are not concurrent (in other words the property covered is not identical), the ratio of contribution is often based on a rather complicated 'mean method' which is outside the scope of this course.

In the case of policies that are subject to average, or where a lower loss limit applies within a greater sum insured, the independent liability method is used to calculate the proportions. In fact, the vast majority of non-consumer (business) property policies are now subject to average and limits within a greater sum insured are increasingly common. This means that the independent liability method is becoming almost universal in use.

H4 Liability insurance

It is now established in law that the independent liability method is the proper basis for the calculation of contribution in the case of liability insurance.

I Market agreements

Refer to

Refer to [Market agreements](#) on page 10/10 for market agreements

We have seen that the way in which the ratio of contribution is calculated may sometimes be based on market practice rather than established legal rules. Furthermore, in some cases market agreements between insurers will modify the application of contribution itself. This can happen in two ways:

1. Insurers may agree to share losses in cases where, strictly speaking, contribution does not arise in law.
2. They may sometimes agree to waive rights of contribution in cases where such a right clearly exists, so that the whole of the loss is borne by one insurer.

The purpose of these agreements, like that of 'knock for knock' and the other claims sharing agreements, is to prevent disputes between insurers and reduce operating costs.

An agreement of the first sort is found in the field of fire insurance, where UK fire insurers have agreed to share certain losses where their policies cover the same subject matter against the same peril, even though the policies may not cover the same interest. In other words, they agree to disregard the principle established in the *King and Queen Granaries* case discussed in [A common interest](#) on page 10/15.

Example 10.34

A good example of an agreement of the second sort (waiver of contribution rights) is found in the motor market. In the common situation where one person (A) drives a car belonging to another (B) and injures a third party (C). Contribution may arise in law if A is an insured driver under B's policy and A also has their own policy with a 'driving other vehicles' extension. This is the situation that arose in *Gale v. Motor Union Insurance Co. (1928)*, discussed earlier. Under the market agreement, B's insurers (who insure the vehicle involved in the accident) will provide the indemnity to A and not seek a contribution from A's own insurers. A's insurers would be called upon to pay only where A was not an insured driver under B's policy.



J Scenario 10.1

J1 Scenario 10.1: Question

Apply the principle of contribution to the main lines of insurance and to practical situations (LO9.6)

Imran recently went on holiday to Thailand. While he was there he accidentally dropped his new tablet computer which was worth £2,600 and he had to have it replaced. He claimed for the loss under his household contents policy as he had paid an additional premium to cover his personal possessions while they were outside the home. The claim was accepted but only up to the value of £2,000, which was the policy limit. Imran then tried to recover the remaining amount from his travel insurance.

Discuss, with justification, whether Imran is likely to receive the outstanding amount from his travel insurer.

When planning your answer, use the following four-step IRAC approach:

- provide an **introduction** that identifies the focus of the question;
- look at the **relevant** areas of law;
- **apply** the principles of the law to the scenario; and
- provide a **conclusion** to your answer.

Note: the M05 study text is based on English law. All scenarios included are set in England; therefore English law applies.

J2 Scenario 10.1: How to approach your answer

Aim

This fictional case study tests the reader's ability to apply the principle of contribution to the main lines of insurance and to practical situations (learning outcome 9.6).

It is recommended that you use the following four-step IRAC approach when planning your answer.

Provide an introduction that identifies the focus of the question

This question is about double insurance in which more than one insurance policy covers a loss, and contribution. Contribution prevents an insured from profiting from their loss by recovering for the same loss twice. It only applies in cases of indemnity and it allows insurers to share the losses in cases of double insurance.

Look at the relevant areas of law

The relevant law on double insurance and contribution requires two issues to be considered:

- Is this a case of double insurance (applying common law rules on contribution that require a common subject matter, a common peril and a common interest between the two (or more) relevant insurance policies)?
- If so, how do the terms in the two contracts apply? While contribution is governed by common law rules, these rules are frequently modified by clauses in the policies known as contribution clauses. These clauses will attempt to prevent a contribution being made.

Apply the principles of the law to the scenario

It seems that this is not a situation in which an insured has taken out two (or more) policies in an attempt to commit fraud. Imran's claim has been accepted by his household contents insurer even though it is only partly paid. His claim to the travel insurer seems genuine because he is only seeking to recover the remaining – not the full – amount. The travel insurer will be providing an additional layer of insurance cover. Both insurance policies will need to be read carefully as the presence and detail of non-contributions in one or both policies could result in a different effect to his entitlement. It is, however, likely that the claim should be paid as the courts are not keen on non-contribution clauses, and there is no suggestion of fraud.

Imran cannot claim the full loss from both travel and house insurance and cannot recover more than £2,600 for the loss by so doing. Otherwise, it would be an indemnity for more than what Imran lost and the principles of indemnity do not allow that.

Remember to provide a conclusion to your answer that directly links back to the question and relevant area(s) of the law.

Key points



The main ideas covered in this chapter can be summarised as follows:

Subrogation

- The principles of subrogation and contribution are sometimes described as corollaries of the principle of indemnity. This means that they support the principle of indemnity – they apply automatically to insurances which are contracts of indemnity and apply only to contracts of indemnity.
- Subrogation can be defined as the right of one person, having indemnified another under a legal obligation to do so, to stand in the place of that other and avail themselves of all the rights and remedies of that other, whether already enforced or not.

Nature of subrogation

- The main purpose of subrogation is simply to prevent what is known as the ‘unjust enrichment’ of the insured – in other words to prevent them from unfairly profiting from their loss and so to preserve the principle of indemnity.
- Since subrogation supports indemnity, the doctrine does not apply to non-indemnity contracts, such as life or personal accident.

Operation of subrogation

- The principle of subrogation can operate in two ways:
 - the insured may have actually succeeded in ‘recovering for the same loss twice’, i.e. collected a claim payment from their insurers and also recovered compensation for the same loss from another source who is legally responsible for it; or
 - where the insured has not received compensation from another source, insurers who have indemnified the insured in respect of the loss may themselves bring an action against the third party who is legally responsible for it.
- The way in which any recovery from a third party is shared between the insured and the insurers, depends on two factors:
 - the amount of the recovery in relation to the loss; and
 - whether the insurance covers the loss in full.

Source of subrogation rights

- Subrogation rights can arise in tort, in contract or under statute.
- Insurers’ subrogation rights can be modified or restricted by market agreements; contractual waivers; in coinsurance cases or as a matter of public policy.

Double insurance and contribution

- Contribution is the right of an insurer to call upon others similarly, but not necessarily equally liable to the same insured, to share the cost of an indemnity payment.
- Contribution is governed by common law rules. However, these common law rules are frequently modified by clauses in the policy known as contribution conditions.

When contribution arises – the common law rules

- Contribution will arise only when the following conditions are satisfied:
 - two or more policies of indemnity exist;
 - each insures the subject matter of the loss;
 - each insures the peril which brings about the loss;
 - each insures the same interest in the subject matter; and
 - each policy is liable for the loss.

Key points

Operation of contribution arises at common law

- A contribution condition is a clause that sets out how the loss is to be met if the insured has another policy which covers it.
- Different types of contribution conditions include escape clauses, non-contribution clauses, 'more specific insurance' clauses and 'rateable proportion' clauses.

Basis of contribution

- There are two main methods of calculating the ratio of contribution: the maximum liability method and the independent liability method.

Market agreements

- In some cases, market agreements between insurers will modify the application of the contribution itself. This can happen in two ways:
 - Insurers may agree to share losses in cases where, strictly speaking, contribution does not arise in law.
 - They may sometimes agree to waive rights of contribution in cases where such a right clearly exists, so that the whole of the loss is borne by one insurer.

Self-test questions

1. Provide a simple definition of subrogation.
2. Why does the law allow subrogation?
3. Can insurers claim money which the insured receives as a gift by way of subrogation?
4. What are the three main sources of subrogation rights?
5. What conditions must be satisfied for contribution to arise at common law?
6. What is an 'escape clause'?
7. What is a 'more specific insurance clause'?
8. What are the two main methods for calculating the ratio of contribution?
9. What method for calculating the ratio of contribution is employed in the case of liability insurance?

You will find the answers at the back of the book

Appendix 1

Disclosure summary

This is an appendix to chapter 4.

	Consumer insurance	Non-consumer (business) insurance
Statute	Consumer Insurance (Disclosure and Representations) Act 2012	Insurance Act 2015 (IA 2015)
Disclosure	There is no duty of disclosure. (Consumer Insurance (Disclosure and Representations) Act 2012)	The insured is under the duty to disclose material facts to the insurer before the contract is concluded.
Misrepresentation	The insured (consumer) is under the duty to take reasonable care not to make a misrepresentation .	The non-consumer (business) insured is under the duty not to make a material misrepresentation .
Test of materiality	There is no test of materiality. The test is whether the insured took reasonable care not to make a misrepresentation . The standard of care required is of a reasonable consumer.	There is a test of materiality which is an objective test. Section 7(3) of the IA 2015 and case law explain the test of materiality; namely, that it is a prudent underwriter test . The materiality test is to be satisfied in order to prove that the assured breached the duty.
Inducement	The Act requires proof of inducement to seek a remedy for the breach.	The test is subjective. Inducement is a statutory requirement of the Act. If the inducement test is not satisfied, the insurer is not entitled to a remedy for breach of the duty of fair presentation of the risk (s.8(1)).
Contracting out	It is not permitted to agree on a term which renders the insured's position worse than that which the Act provided.	The parties can contract out of the duty if the requirements under sections 16 and 17 of the IA 2015 are satisfied.
Insurer's knowledge of the facts	This is taken into account when assessing the level of reasonable care that the insured exercised (s.3 (4)).	The insurer's knowledge is taken into account in assessing the insured's duty . Any circumstance which is known or presumed to be known to the insurer need not be disclosed. (See s.3(5) of IA 2015).
Insurer's duty	The Act does not refer to an express mutual duty.	The duty is imposed on the insured only .
Agent's duty	The Act provides some guidance to determine if the agent is acting for the insurer or the insured (Schedule 2). The insured is responsible for the agent's misrepresentation .	There is no separate duty imposed on the agent . The Act refers to agents with regards to the insured's knowledge given that the agent's knowledge is imputed on the insured (subject to the exceptions under s. 4(4) of IA 2015).

	Consumer insurance	Non-consumer (business) insurance
Duration of the duty	The duty is pre-contractual. The Act is silent about post-contractual duty.	The duty is pre-contractual; it comes to an end when the contract is concluded. If the insurer wishes to impose any post-contractual information duty on the assured, they may do so by an express contractual term in which case the post-contractual duty will be a matter of contract. Otherwise, there is no post-contractual information duty under IA 2015. Can a circumstance be assessed under the general duty of 'good faith' under the MIA 1906 s.17? This has not been tested by the courts yet. If the assured is found having not acted in a commercially fair and businesslike way, the duty of good faith might be discussed.
Basis of contract clauses	The Act has abolished the basis of contract clauses. A representation cannot be converted into a warranty by means of any provision of the consumer insurance contract.	It is not permitted to convert the statements made by the insured in to a warranty. It is not possible to contract out of the IA 2015 in this respect.
Remedy for breach	Remedy is available only if the misrepresentation is a qualifying misrepresentation under s.4. Remedy depends on whether the misrepresentation is deliberate, reckless or careless: <ul style="list-style-type: none">• The insurer can avoid the policy only if the (qualifying) misrepresentation is deliberate or reckless.• Proportionate remedy was introduced by Schedule 1, Part 1 of the Act for (qualifying) careless misrepresentation.	Remedy is available only if the breach of the duty of fair presentation of the risk is qualifying under s.8. Remedy depends on whether the misrepresentation is deliberate, reckless or careless: <ul style="list-style-type: none">• The insurer can avoid the policy only if the (qualifying) misrepresentation is deliberate or reckless.• Proportionate remedy was introduced by schedule 1, part 1 of the Act for (qualifying) careless or innocent breaches.

Appendix 2

The main types of liability insurance

The main types of liability insurance are:

1. Professional indemnity

This covers the cost of compensating clients for loss or damage resulting from services or advice provided by a business or individual. Professional liability can arise from several sources:

- an undertaking to achieve a desired result;
- a contractual duty to exercise reasonable skill and care (either expressly provided for in the professional's terms of engagement or implied by law (Supply of Goods and Services Act 1982, subsections 13, 16; Consumer Rights Act 2015, ss 49 and 57);
- a concurrent duty of care owed to the client in tort (Henderson v Merrett (1995) 2 AC 145); and
- or a duty of care owed to a third party who is not a client (Hedley Byrne & Co Ltd v. Heller & Partners Ltd (1964) AC 465; Caparo v. Dickman (1990) 2 AC 605; White v. Jones (1995) 2 AC 207).

Some professionals are required by statute or the rules of their professional bodies to provide evidence of professional indemnity insurance cover before they can carry out any services.

Professional indemnity insurance is generally written on the basis of 'claims made' rather than 'loss occurrence' – claims made means that the claim has to be made against the insured during the policy period, irrespective of when the event leading to the claim occurred. Loss occurrence policies only cover loss occurrences during the policy period, irrespective of when damages arise. Damage may actually occur years later.

Some professional liability policies are triggered by negligence, errors and omissions, while others are wider and cover 'any act, error or omission, breach of contract or duty, or allegation thereof'. Common exclusions are:

- any fines, penalties, punitive, or exemplary damages;
- claims where there is fraud or dishonesty by an insured;
- claims made in the US or Canada (because the amounts won are often incredibly high); and
- liability for personal injuries and property damage.

2. Product liability

This covers the cost of compensating anyone who is injured by a faulty product that a business manufactures or supplies. The policy also covers legal costs. The product is often bought as a package together with general liability insurance and public liability insurance. The product is not compulsory, but it makes sense to have this cover for businesses, which sell or supply products because of the high cost of litigation and damages awarded.

The Consumer Protection Act 1987 introduced statutory and strict liability for defective products – meaning that a claimant does not have to establish fault on the part of the manufacturer, only that the product was defective, the claimant suffered damage and there is sufficient causal link between the defect and the damage caused. According to case law, a product is defective where the safety of the product is not what a consumer would expect – this is an objective test. This strict liability operates alongside liability in negligence (and will operate regardless of the provisions in any contract which attempt to limit liability).

The Consumer Rights Act 2015 imposes additional obligations on manufacturers and producers – goods must be of satisfactory quality and fit for purpose.

The cover is against sums awarded in respect of bodily injury and loss or damage to property. It does not indemnify against liability for pure financial loss, which is not a direct consequence of the physical damage. The injury and/or property damage must be 'accidental'. Many policies cover injury or damage occurring anywhere in the world. The policy is often on a claims-made basis rather than losses occurring.

Common exclusions are:

- contractual liability assumed by the insured;
- provision of advice, design and specification for a fee (without a resulting product);
- deliberate acts of the insured; and
- products supplied for incorporation into aviation products.

3. Directors' and officers' liability

The difference between a director and an officer is that directors are theoretically appointed by shareholders to oversee the management of the corporation (they advise company executives on company strategy). Officers are appointed by directors to manage the day-to-day activities of the company.

A directors' and officers' (D&O) policy is designed to provide protection to a company's directors and officers in respect of many forms of civil liability and defence costs in relation to their activities or arising out of their capacity as a director or officer of a company.

A typical D&O policy will have two insuring clauses. The first, sometimes known as 'Side A', provides direct indemnification by the insurer to the director or officer. The second, sometimes known as 'Side B', provides that the insurer will reimburse the company to the extent that the company has already indemnified its directors or officers. Most standard D&O policies do not provide any 'entity cover' to the company in respect of its own exposure to civil liability or defence costs, although this type of cover may be available on payment of additional premium, sometimes known as 'Side C' (but this is not very common).

Side A and Side B may be purchased together because the insured directors and officers may benefit from company indemnity. Side B therefore indemnifies the company to the extent that the company indemnifies the director or officer, and Side A indemnifies the director or officer in the event that the company is unable to do so.

The trigger for cover under a D&O policy is a 'wrongful act' by the director or officer. This is generally widely defined to include any act, error or omission committed by directors or officers in their capacity as such.

D&O policies do not typically contain many exclusions. Perhaps most materially, loss is excluded if it arises out of the insured director or officer obtaining personal financial profit or acting dishonestly. Virtually all D&O policies are written on a 'claims made' basis (covering claims notified during the policy period).

Directors owe fiduciary duties to the company on whose board they sit under the Companies Act 2006. These duties include:

- to exercise reasonable care, skill and diligence;
- to exercise independent judgment;
- to act in the way that they consider would be most likely to promote the success of the company;
- to act in accordance with the company's constitution;
- to avoid conflicts of interest; and
- to not accept benefits from third parties;

Either the company or the shareholders can bring claims against directors or officers in practice.

Essentially, before a person accepts a position as a director or officer, they must consider whether the company has sufficient insurance in case what they decide is called into question, and they face litigation. New potential directors need to understand their duties and responsibilities as stipulated in the Company Act 2006 and ensure that there are no conflicts of interest between their current role and the new director role. Their fiduciary duties remain the same irrespective of a paid directorship or a voluntary one.

4. Employers' liability

The Employers' Liability Act 1969 made it compulsory for employers to insure against liability to employees. It could be said that the growth of personal injury claims in the early 1900s led to this development.

In more detail, every employer in the United Kingdom is required to take out and maintain insurance against liability for bodily injury or disease sustained by its employees arising out of and in the course of their employment in United Kingdom. This includes death ensuing from an injury at work and mental illness arising from work.

The policy must be issued by an insurer authorised to conduct insurance business for the class in question. The policy must be 'approved' - that is, not narrower in scope than required by the Act. There are also compulsory insurance requirements in respect of motor vehicle accidents involving employees in the 'course of their employment' (that is, going about the employer's business at the time – commuting to work does not count unless the job requires travelling between sites or offices).

The amount of cover to be purchased is set under the Employers' Liability Act 1969 at £5m in respect of claims relating to any one or more employees arising out of one occurrence. In practice, higher levels of cover may be purchased.

The policy follows the pattern of general liability policies – so negligence is important.

English law imposes a variety of common law and statutory duties upon employers to secure the safety of their employees, beyond the Employers' Liability Act 1969:

Common law liability:

- **Direct liability:** an employer owes a duty of care to its employees to take reasonable care for their safety.
- **Vicarious liability:** in addition, the employer may be held vicariously liable for the negligent acts of fellow employees and independent contractors working on its premises.

Liability under statute:

- **Health and Safety at Work Act 1974:** this contains penal sanctions relating to general duties requiring safety in the workplace.

An 'employee' is generally not an independent contractor, but this depends on the economic reality of the partnership between the two parties, so is not clear cut.

Various categories of local authority employees are excluded from coverage.

5. Public liability

Insurance protects companies against legal liability for injury to third parties or damage to their property arising out of and in the course of business.

Although it's not legally mandatory like employers' liability insurance, public liability insurance is still crucial because it protects against potential injury or property damage claims made by clients, visitors, or the general public. The cost of legal battles can be high, and this insurance helps cover those expenses. Many businesses bundle public liability insurance with employers' liability and sometimes product liability insurance. This insurance is often a central part of comprehensive business insurance packages designed to address all of a company's insurance needs in one policy.

Public liability generally covers damages or compensation arising from:

- (a) accidental personal injury to any person;
- (b) accidental damage to tangible property; or
- (c) accidental nuisance, accidental trespass or accidental interference with any easement or right of air, light, water or way.

The event must be accidental and occur during the period of insurance and in the course of the insured's business. Generally, there is also coverage for defence costs (defending claims brought by third parties, but subject to the insurer's prior consent) and legal liability for claimants' costs and expenses in connection with claims arising from the events.

Public liability insurance does not cover injuries to employees, for which employers' liability insurance is needed. It does not cover claims against directors and officers, for which directors' and officers' liability insurance is needed. It does not cover claims against the company for negligent acts or omissions, for which professional indemnity insurance is

needed, and in the majority of cases, cyber liability, pollution liability, and product liability will also not be covered.

It is commonplace for policies to have large numbers of extensions that are generally sub-limited, such as:

- defence costs associated with defending criminal proceedings arising from breach of health and safety at work legislation;
- liability for compensation and defence costs arising from claims under relevant provisions of the Data Protection Act 2018 and the General Data Protection Regulation (EU) 2016/679;
- liability by virtue of s 3 of the Defective Premises Act 1972; and
- the extension for data protection claims can be important but does not provide very broad cover when compared to a cyber liability policy.

6. Cyber liability

In today's world, virtually all sizeable businesses depend on information technology (IT) and data to run critical business functions such as email, payments, and their website, and to automate their processes.

However, incidents such as ransomware and data breaches show that this use of IT can expose a business to various internal and external cyber risks – whether malicious or non-malicious – such as:

- stolen data;
- loss of access to data (e.g. because the data is encrypted);
- business interruption;
- damage to computer hardware/software; and
- disclosure of confidential information belonging to third parties.

Such incidents which compromise a company's information technology and/or the data that it holds, can cause significant financial loss and damage to reputation.

The most common types of insured cyber losses are currently:

- **Data breach:** an incident where sensitive, protected or confidential data is copied, transmitted, viewed, stolen, altered or used by an individual unauthorised to do so.
- **Ransomware:** insertion of a type of malware that threatens to publish the victim's personal data or permanently block access to it unless a ransom is paid. While some simple ransomware may lock the system without damaging any files, more advanced malware encrypts the victim's files, making them inaccessible, and demands a ransom payment to decrypt them.

As stated, cyber risks may be deliberate (malicious) or accidental (non-malicious). Hence there are two types of cyber exposure:

- Losses arising from malicious attacks, e.g. cyberattacks or the introduction of malicious code.
- Losses arising from non-malicious acts, e.g. inadvertent loss of data by pressing the wrong button.

Most people focus on malicious attacks (e.g. IT system breach) not realising that non-malicious acts (e.g. losing a client's data) can be just as damaging.

Managing cyber risk is a balancing act for companies. On the one hand, companies need to embrace new technology to outmanoeuvre their competition, drive performance and execute on their business strategies. On the other hand, executive decision makers must not take on too much cyber risk; they must strive to understand the nature of cyber exposure and effective mitigating factors such as insurance and investing in security/vigilance so as not to exceed their cyber risk appetite (the level of tolerance that an organisation has for cyber risk). However, cyber risk cannot be completely eradicated.

The demand for cyber insurance

The demand for cyber insurance has increased dramatically between 2018 and 2023. As of mid-2023, it is estimated that there is about US \$14bn in gross written premium for cyber. Some commentators expect the market for cyber insurance to increase to US \$20bn by the end of 2025. This is a huge increase from approximately US \$4bn in 2017. If the cyber

market continues to grow at its current pace, some even think it will double in size every three years. At present, overall market penetration of stand-alone cyber insurance is still very low, especially outside the US, accounting for the triple-digit growth projections.

The following factors have been shown to have increased demand for stand-alone cyber insurance coverage:

- Increased regulatory oversight – the General Data Protection Regulation 2016 /679 (GDPR) came into force in the UK on 25 May 2018, alongside the Data Protection Act 2018. This requires personal data to be processed in a manner that ensures appropriate security, and requires data controllers to be able to demonstrate compliance with the various GDPR principles. The UK Information Commissioner can impose fines on data controllers and processors of up to 4% of their total worldwide turnover or EUR 20 million, and it provides data subjects with an automatic right to compensation when data is breached.
- Highly publicised data breach incidents (such as the Target breach in 2013 which affected over 40 million credit and debit card holders), as well as reported breaches having risen by about 425% between 2006 and 2016, and by 20% between 2017 and 2022.
- Greater awareness of cyber risks.
- Increased costs in dealing with data breaches - 60% higher on average than in 2006.
- Highly publicised cyber-attacks, such as NotPetya (mass wiperware attack) in 2017 and MOVEit in 2023 where criminals exploited a vulnerability in Progress Software's MOVEit file transfer app, which is used by thousands of organisations around the world.

In addition, the regulator – the PRA – has led a strong effort to reduce unintended or 'silent cyber' exposure by stating clearly in non-cyber policies (such as property insurance) whether cyber risks are covered or not. This has often been achieved by cyber exclusions in non-cyber policies – although some policies have writebacks to the exclusions to make it clear that certain cyber exposures are covered (e.g. directors and officers may make poor decisions in the context of cyber, so such losses should not be excluded).

Coverage

Cyber insurance is unusual in that the coverage encompasses both:

First-party liabilities: the first party is the policyholder – first-party cyber-liability risks refer to risks that directly endanger the insured organisation. For example, if a business cannot operate for three days because it is hit with a malware infection, the three days of downtime inflicted by the cyberattack is first-party liability. First-party cyber insurance, therefore, typically covers the costs of actions needed by an insured business after such things as a data breach, ransomware attack, or other hacker malfeasance.

Third-party liabilities: as stated above, a 'third party' is a party who is neither an insured named in the policy (the first party) nor an insurer (the second party). Third-party cyber-liability risks refer to the risk of third parties claiming that a specific business is liable to them for damage that the third party suffered as a result of either:

- the insured company having suffered a cybersecurity incident (e.g., the third party's data held by the policyholder has been stolen and published on the dark net); or
- the third party having suffered a cybersecurity incident as a result of a weakness in the defences of the policyholder's systems e.g., a supply chain attack – this refers to when the policyholder is an outside provider or partner that has access to other companies' data and systems.

This ensures comprehensive protection for businesses.

There is no standard policy, but the following is typically covered:

First-party coverage

Costs: the many costs incurred following a cyber incident such as legal expenses, fees for public relations consultants, technical and IT forensic services. We can view these as crisis management costs – trying to investigate what happened and mitigate the effects of the incident. This includes data recovery costs – costs of recovery or restoration (but not recreation) of data lost or corrupted in a cyber incident. Usually, the providers of services are listed in the policy so that policyholders do not waste time after a cyber incident.

Cyber extortion costs: this includes potential ransomware payments, which are essentially extortion to unfreeze the files. Including the cost of retaining ransom negotiators.

Business interruption loss caused by cyber-attacks: this is essentially loss or diminution of business profits (and extra expenses) due to the unavailability of computer systems or data. Contingent business interruption is also covered – this reimburses lost profits and extra expenses resulting from an interruption of business at the premises of a customer or supplier to the insured entity.

Funds transfer fraud: funds transfer fraud is a cyber-attack that causes a victim's funds to be sent to the attacker's account instead of to the proper recipient. The financial loss is covered.

Third-party coverage

Data breach and/or security breach liability: this includes data breach response costs, the costs of notification to third parties potentially affected by the breach, potential legal/regulatory damages for actual or alleged breaches of the insured's legal and regulatory duties, plus associated defence costs (e.g. breach of data protection laws).

Media liability: to pay legal damages arising from the insured's advertising/media activities.

Regulatory defence and penalties: costs of responding to regulatory investigations following data or security breaches and payment for regulatory fines if these are insurable – generally under English law, regulatory fines for wrongdoing are contrary to public policy so are not insurable.

Tech errors and omissions: errors and omissions of tech and software products/services providers.

Cyber insurance policies are continuing to evolve – based on the evolution of cyber risks, the risk appetite of insurers, and the demands of the policyholders. Typical exclusions include the following systemic losses – meaning losses which impact multiple policyholders at once:

War: typical words used may be 'Loss or Damage directly or indirectly occasioned by, happening through or in consequence of war, invasion, acts of foreign enemies, hostilities (whether war be declared or not), civil war...'. There is an ongoing debate as to whether such an exclusion only applies to physical war or also excludes cyber war which could be very costly in the context of cyber insurance. Note: there is no agreed definition of cyber war. In the context of cyber insurance, in simple terms we can think of cyber war as cyber operations which have a military objective, and perhaps also cyber operations which cause systemic losses similar to a physical war.

To ensure that cyber war is also excluded, Lloyd's and other markets introduced so-called cyber war exclusions in 2021. These exclude:

- War (physical war).
- Cyber operations as part of war.
- State-backed) Cyber operations.
- Over a certain threshold (not part of war), e.g. exceeding a 'major detrimental impact' on essential services which lead to a response being authorisation of physical force/declaration of war.

Critical infrastructure outage: this includes but is not limited to utilities such as electricity which may be subject to cyber-attack.

The effect of progress in AI on Cyber Risk

The rapid advancements in artificial intelligence (AI) have significantly influenced the landscape of cyber risk. While AI offers tools to enhance cybersecurity, such as advanced threat detection and automated response systems, it also introduces new vulnerabilities. Cybercriminals increasingly exploit AI to execute sophisticated attacks, including deepfakes, AI-powered malware, and automated phishing campaigns.

For the insurance industry, this dual role of AI – as both a defence mechanism and a source of new risks – poses unique challenges. Insurers must adapt policies to address emerging threats while leveraging AI to assess, mitigate, and manage cyber risk more effectively. This evolving dynamic underscores the critical interplay between technological innovation and risk management in modern insurance law.

Below we look in more detail at certain aspects:

Vulnerability discovery (identifying weaknesses in systems or networks that can be exploited by cyber attackers): automated vulnerability discovery, especially in domains which elude human experts, is likely to significantly increase the pool of options for threat actors. Threat actor tooling is likely to outpace defensive tools created by the security industry due to asymmetric incentives.

Campaign planning and execution (designing and carrying out targeted cyberattacks or strategies to compromise systems): cyber-campaign targeting and scoping is likely to become cheaper, more fine-tuned, and broader due to automation of target discovery. This would mean threat actors could generate bespoke attack materials for many potential targets.

Risk-reward analysis (evaluating the potential gains of a cyberattack against its likelihood of success and associated risks): threat actors' ability to evade attribution and achieve their desired outcomes (exfiltration of funds, etc) is likely to be enhanced. This could shift risk-reward calculations in their favour and embolden them.

Single points of failure (an element in a network/infrastructure/system that, if compromised, could lead to widespread operational failure or data breaches. Similar to a bottleneck): the rise of a new class of service provider linked to the provision of Large Language Models, could generate a new type of single points of failure. Losses arising from interruption or compromise of these single points of failure are likely to be different from what we expect today.

Note

The updater has used their own knowledge where possible; however, the following source has been used as part of their research: www.bloomsburyprofessional.com/uk/insurance-law-handbook-9781526515926/

Appendix 3

The FCA Consumer Duty in the context of insurance law

The Consumer Duty was introduced as a new FCA Principle for Business (Principle 12), which states as follows: 'A firm must act to deliver good outcomes for retail customers'.

In essence it is increased consumer protection in the retail financial services sector. The new duty sets higher and clearer standards of consumer protection across retail financial services and requires firms to put their customers' needs first.

The duty is made up of an overarching principle and new rules firms will have to follow. We have set out the structure of the Consumer Duty below.

It was intended to be deeper than just a firm's policies and procedures – to go right to the heart of its culture, strategy, and business.

The Consumer Duty structure

The Consumer Duty is supplemented by two further elements: the 'cross-cutting rules' and 'four outcomes', which together set out in more detail the FCA's expectations for firms subject to the Consumer Duty.

The cross-cutting rules, or obligations, are:

- A firm must act in good faith towards retail customers.
- A firm must avoid foreseeable harm to retail customers.
- A firm must enable and support retail customers to pursue their financial objectives.

Finally, these cross-cutting rules, which form 'inputs' to the work that firms do, are linked to 'four outcomes'. The four outcomes are:

- **Products and services:** this covers elements of product governance for providers, distributors and advisers.
- **Price and value:** this does not imply a price cap, or a requirement to be the cheapest in the market. It does, however, mean that firms cannot simply charge as much as they think they can get away with. The FCA has said: 'Firms should avoid designing products and services to include elements that exploit consumer lack of knowledge and behavioural biases to increase the price paid.'
- **Consumer understanding:** the FCA makes clear that this does not mean firms must: 'Verify that all individual consumers have in fact understood the information provided.' However, it suggests that 'one question firms can ask themselves is whether they are applying the same consumer support standards to deliver good consumer outcomes as they are to generate sales and revenue.'
- **Consumer support:** this requires firms to 'enable consumers to get what they paid for... without unreasonable barriers.'

It means that consumers should receive communications they can understand, products and services that meet their needs and offer fair value, and they get the customer support they need, when they need it.

The new Consumer Duty reinforces and complements the existing FCA Handbook requirements.

Why it was introduced

The reason it was introduced can be summed up by the FCA's comment: 'We want to see a higher level of consumer protection in retail financial markets'. According to the FCA, consumers were unable to make informed decisions in retail financial services in the UK –

'Some firms present information in a way that is misleading or difficult to understand, which makes it harder for consumers to make a timely and informed decision. Some firms sell products or services to consumers that are not right for them or which don't offer fair value or provide poor customer service and support.'

Although the FCA had previously addressed these poor practices with their regulatory and supervisory tools, under the Consumer Duty, firms now need to assess and evidence the extent to which and how they are acting to deliver good outcomes – so it gives the FCA a more effective tool to protect consumers from new and emerging harms.

As part of its consultation on the Consumer Duty, the FCA published a series of case studies highlighting poor practice. For example, an insurance product was updated over the course of several years, but the documents for this product had not been reviewed as a whole to make sure they continued to explain the product's features in a way that supports the consumer.

The policy summary set out upfront what is covered by the insurance and some specific exclusions to the cover. However, some newer, but equally important, exclusions were covered elsewhere in the full policy conditions. This makes it difficult for customers to assess the scope of the insurance and understand when they will, and will not, be covered.

The duty forms part of the FCA's transformation to becoming a more assertive and data-led regulator. With firms assessing how they're meeting their customers' needs, the FCA is able to quickly identify practices that don't deliver the right outcomes for consumers and take action before practices become entrenched as market norms.

When it was introduced: the final rules and guidance were published and came into effect on:

- 31 July 2023 for open products; and
- 31 July 2024 for all products.

Whom it affects

The Consumer Duty applies to products and services offered to retail customers, and to all firms which determine or have a material influence over customer outcomes – not just those with a direct customer relationship.

For the purposes of the duty, retail customers include some commercial customers. The duty does not apply to reinsurance, contracts of large risk sold to commercial customers or other contracts of large risk where the risk is located outside the UK. Nor does it apply to activities connected to the distribution of group insurance policies or the extension of these policies to new members.

What does this new duty require of firms in the insurance sector?

In essence, the requirements are the same as for any other retail financial services sector. The key element is that the duty requires firms to act to deliver good outcomes for retail customers. Firms must act in good faith towards customers, avoid causing them foreseeable harm, and enable and support them to pursue their financial objectives. Firms should consider the diverse needs of their customers – including those with characteristics of vulnerability.

What the duty means for the handling of claims

Firms must provide support that meets the needs of consumers, throughout the life of the product or service. The FCA has stressed that it should be at least as easy to make a claim as it is to buy the product or service in the first place.

The consumer support outcome requires firms to ensure their customers are adequately supported – at every stage of the lifecycle of the product or service – whether the customer makes an enquiry, claim or complaint. Firms should also ensure they have processes in place to avoid causing foreseeable harm.

During the claim lifecycle, the following are areas where insurers and/or distributors may cause harm to policyholders:

- Consistently poor or excessively slow service.
- Under-resourced customer helplines, e.g. where firms disproportionately focus on pre-sales, over after-sales, claims support.
- Phone systems, menus or webchats that are difficult to navigate, badly designed websites that make it difficult for customers to find key claims-related information online.

The means of making a claim should be easy to find and the firm should not impose unreasonably restrictive, rigid or arbitrary administrative requirements on customers that create barriers to them making a claim.

Effect: the FCA's Consumer Duty has increased the level of consumer protection in the retail financial services market. With it, the FCA has signalled a 'paradigm shift in its expectations' and therefore the impact of the initiative should not be underestimated in terms of its regulatory intentions – and consequences for firms.

The duty includes requirements for firms to:

- End rip-off charges and fees.
- Make it as easy to switch or cancel products as it was to take them out in the first place.
- Provide helpful and accessible customer support, not making people wait so long for an answer that they give up.
- Provide timely and clear information that people can understand about products and services so consumers can make good financial decisions, rather than burying key information in lengthy terms and conditions that few have the time to read.
- Provide products and services that are right for their customers.
- Focus on the real and diverse needs of their customers, including those in vulnerable circumstances, at every stage and in each interaction.

Problems

Some stakeholders have flagged concerns that the Consumer Duty can lead to unintended consequences, such as the withdrawal of products or services for certain customer segments, e.g. higher risk consumers. The FCA has emphasised that it does not want to see firms reducing access to appropriate products and services that offer fair value to their target markets. This would not support the FCA's objectives or their wider business priorities.

Benefits

While describing the proposals as a 'paradigm shift' in its expectations of firms in retail markets, the FCA stresses that the new Consumer Duty would not:

- Remove consumers' responsibility for decision-making or, in itself, prevent consumers from making decisions that are not in their interests.
- Require that all consumers of a product or service obtain the same terms.
- Impose an open-ended duty that goes beyond the scope of the firm's role and its ability to determine or influence consumer outcomes or protect consumers from all potential harms.
- Specify exactly how firms should act: rather firms will need to regularly monitor customer behaviour and product performance to satisfy themselves that they are achieving the outcomes required by the new duty.

The Consumer Duty is a significant step forward in enhancing consumer protection and aligns with the FCA's transformation into a more assertive and data-driven regulator. Firms must embed these principles into their practices to ensure compliance and deliver on the Duty's objectives.

For more information, visit the FCA's official Consumer Duty page: www.fca.org.uk/firms/consumer-duty

Appendix 4

ESG and insurance

An introduction to Environmental, Social, and Governance (ESG)

Environmental, Social, and Governance (ESG) is a framework for evaluating and assessing the practices of businesses and organisations in terms of their sustainability and ethical impact. While actions at a governmental level started well before, in the year 2000 the UN's Global Compact in which corporate and agency stakeholders participated, established principles on human rights, labour, the environment and anti-corruption.

In 2011, the UN Guiding Principles on Business and Human Rights (UNGPs) came into being. The UNGPs are a framework guiding responsible business conduct and addressing human rights abuses in business operations and global supply chains. While the UNGPs are soft law (meaning principles, declarations and agreements that are not legally binding), a change to law and regulation has taken place since their implementation. Today there is a wide range of ESG regulation and more is expected for the future.

Environmental

- **Climate impact:** this involves assessing a company's carbon footprint, energy usage, and overall impact on the environment. It also examines the measures taken to reduce or offset these impacts.
- **Resource management:** this includes the responsible sourcing of raw materials, efficient use of resources, waste management, and recycling initiatives.

Social

- **Employee relations:** this relates to how a company treats its employees, covering aspects such as working conditions, health and safety, fair compensation, and opportunities for growth and development.
- **Diversity and inclusion:** evaluating a company's efforts towards promoting a diverse workplace, and its stance against discrimination based on race, gender, age, religion, or other factors.
- **Community engagement:** understanding a company's impact on the communities in which it operates, its corporate social responsibility (CSR) initiatives, and any philanthropic efforts.

Governance

- **Corporate ethics:** this concerns the ethical conduct of a company, including transparency in its operations, anti-corruption measures, and overall integrity in its dealings.
- **Leadership structure:** the organisation and effectiveness of a company's leadership, including board composition, roles, and responsibilities.
- **Accountability:** ensuring there are systems in place to hold the company accountable to its stakeholders, including employees, customers, and the broader community.

Overall

In essence, ESG serves as a comprehensive metric for understanding the holistic impact of an organisation. Businesses that adhere to strong ESG principles are not only seen as responsible entities but also as organisations that are forward-thinking, resilient, and more adaptable to the changing dynamics of society, the environment, and regulatory landscapes.

ESG in the context of the insurance industry

In the context of the insurance industry, ESG provides a framework for evaluating and managing the emerging and long-term risks and opportunities associated with environmental, social, and governance issues. Here's a breakdown of how each of the ESG components is relevant to insurance:

Environmental

Climate change and catastrophic events: insurers face substantial risks related to climate change, including an increase in the frequency and severity of catastrophic events such

as hurricanes, floods, wildfires, and droughts. Understanding these risks can influence underwriting decisions and pricing.

Green insurance products: as companies increasingly invest in green technologies and sustainable practices, there's a growing demand for related insurance products. For instance, insurers offer specialised coverage for renewable energy projects. Another example is the issuance of so-called 'green catastrophe bonds'. On June 25 2021, Generali issued a €200m Catastrophe Bond which was the first ever green cat bond sponsored by an insurance company – in simple terms, the green aspects mostly related to the fact that the collateral was invested in assets with a positive environmental impact.

Liability risks: companies causing environmental damage might face lawsuits, particularly as regulatory frameworks around environmental accountability tighten globally. Insurers need to consider these potential liabilities when underwriting policies.

Social

Customer relations and fair practices: fair treatment of customers, especially in claims handling and underwriting, can influence the reputation and trustworthiness of insurance companies. We have seen how the FCA's consumer duty has increased the focus on this area.

Inclusive products: the social component also emphasises the importance of providing inclusive insurance products that cater to a broader segment of society, ensuring that traditionally underserved or marginalised groups have adequate access to insurance.

Employee well-being and diversity: internally, insurers are intensifying efforts to foster diversity, equity, and inclusion (DE&I). Many firms are enhancing mental health support and workplace flexibility to create inclusive environments and attract top talent.

Governance

Ethical business practices: this encompasses issues like business ethics, transparent accounting, executive compensation, and any potential conflicts of interest. For insurers, it may also relate to how they handle claims and how transparent they are in their policy guidelines. ESG calls for responsible organisational actions and behaviours, including transparency, and well-understood and clearly-communicated business ethics.

Regulatory compliance: insurers operate in heavily regulated environments due, inter alia, to the fact that they have to be able to pay claims when they arise. Effective governance ensures that insurers comply with all regulatory requirements, thereby reducing the risk of legal penalties and reputational damage.

Data security: given the vast amount of personal data insurers process, robust governance around data protection and privacy is essential.

Overall, insurers rate themselves highly in the governance dimension, due to the heavily regulated nature of the industry.

Investment: in the context of insurance, ESG considerations also influence investment decisions. Insurance companies, as significant institutional investors, often consider ESG factors when making investment decisions to ensure long-term sustainability (such as supporting renewable energy and green infrastructure projects) and risk-adjusted returns (considering ESG factors to reduce exposure to environmental, social, and governance risks). However, a couple of insurers have recently increased investments in fossil fuels – which is clearly not aligned with ESG investing principles.

The impact of ESG on the insurance industry

Insurers and reinsurers around the world are displaying a deep interest in ESG factors. For example, in December 2020, Lloyd's published its first ESG report, in which it announced that for the first time they would be setting targets for responsible underwriting and investment, in particular by asking managing agents, from 1 January 2022, to stop accepting new business on certain coal and oil activities and to phase out existing coverage by 1 January 2030. ESG risks have resulted in increasing numbers and value of insured claims, and therefore losses to carriers, and are also linked to other legal and, crucially, reputational concerns. Swiss Re has published a separate corporate social responsibility (CSR) report since 2007. Today, many insurers in Europe and in Asia publish ESG or SCR reports.

The number and type of ESG risks are growing. Perhaps the most obvious manifestations of these are the risks posed by climate change to (re)insurers. In 2020, S&P Global Ratings'

research estimated that 60% of S&P 500 companies own assets at a 'high risk' from the physical impact of climate change.

In AM Best's 2020 survey of 97 (re)insurers on ESG factors, corporate governance and product liability including cyber security were cited as the most relevant ESG issues for the insurance industry, alongside climate risk.

Risks related to, and the approach generally to, ESG issues can also impact a company's reputation. With the advent of viral social media, customers can easily express displeasure, with wide exposure, at how companies, particularly those that are public facing, have handled ESG issues.

Current ESG legal frameworks affecting the insurance industry

ESG legal frameworks are currently focused on diligence, disclosure and reporting obligations so as to allow investors and interested parties to bring pressure to bear on those who do not meet expected or mandated targets. Here we provide an overview of current legislation in the UK:

Environmental

The Companies Act: the Companies Act 2006 (Strategic Report and Directors' Reports) Regulations 2013 requires certain companies, including insurers, to report on environmental matters within their annual strategic reports. These provisions compel insurers to be more transparent about their environmental risks and mitigations.

Climate-related disclosures: the Bank of England and the Prudential Regulation Authority (PRA) have been proactive in urging insurance companies to improve disclosure of climate-related risks. They have issued supervisory statements, notably SS3/19 (issued April 2019) outlining expectations for managing financial risks from climate change, which includes enhanced disclosure. Additionally, they established the Climate Financial Risk Forum (CFRF) in March 2019 in collaboration with the Financial Conduct Authority (FCA) to advance sector responses to climate risks and promote improved disclosure practices. Such regulatory pushes demand that insurers re-evaluate their exposure to environmental liabilities.

Due to their specific characteristics, insurers are involved in two ways: first, through their risk-taking policies they can influence the activities of companies that are considered to be polluting; and, second, as major institutional investors insurers can choose carefully which environmentally conscious companies they prefer to invest in, while excluding the less sensitive companies from their investment portfolio.

Social

- **Equality Act 2010:** this act combats discrimination in various spheres, including the provision of services. It has influenced insurers to rethink their underwriting processes, ensuring they don't inadvertently discriminate against protected groups.
- **Consumer Rights Act 2015:** this legislation further cements the duty insurers have to treat consumers fairly, aligning with the broader 'social' focus of ESG.

Governance

- **Corporate Governance Code:** while the UK Corporate Governance Code (introduced in 2010) was primarily designed for listed companies, its principles surrounding transparency, accountability, and ethics are influencing insurance companies – particularly those with public listings.
- **Data Protection Act 2018:** given the vast amount of data insurers handle, this law, incorporating the EU's GDPR within the context of England and Wales, has considerable implications on how insurers process and store personal data.

Future ESG legal frameworks affecting the insurance industry

Given the growing cultural trends around the world, we can expect some developments in ESG legal frameworks in coming years, although the actual legislation is hard to predict. In particular, it is likely that the UK will remain committed to the development of ESG disclosure regulation despite its exit from the EU.

Expected developments in the UK

Evolution of climate-related disclosures: following global trends, the UK may see the introduction of stricter regulations requiring insurers to provide even more detailed climate-related risk disclosures. In fact, the UK Government has announced that it will be creating a mechanism for formal UK endorsement and adoption of two international standards:

IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information; and IFRS S2 Climate-related Disclosures. Once available for use in the UK, the Financial Conduct Authority (FCA) has also stated it intends to update the climate-related disclosure rules to reference the ISSB standards.

Expansion in liability coverage: the legal framework might expand the scope of liability insurance, especially concerning environmental damages or social liabilities, to be in line with emerging ESG concerns.

Increased regulatory oversight: the Financial Conduct Authority (FCA) and the PRA are expected to enhance their focus on ESG considerations, with more rigorous enforcement actions against insurers not aligning with ESG principles.

Tighter consumer protection provisions: with the rising importance of ESG factors, there might be reinforced regulations ensuring that insurers do not misrepresent their ESG standings or capitalise on the trend without genuine backing.

Governance and ethics requirements: future amendments in corporate governance-related laws might necessitate insurers to adopt more stringent ethical practices, ensuring they meet the evolving expectations of stakeholders.

In addition to developments in law, with the increased emphasis on ESG factors, insurers may face new legal challenges related to ESG disclosures, risk assessments, and coverage disputes. Courts and insurance law will be called upon to clarify liability in ESG-related cases. In fact, ESG litigation has already started in the USA. With the enactment of the new climate disclosure bill in California, more litigation can be expected.

Expected developments in the EU

In January 2023, the European Union adopted the Corporate Sustainability Reporting Directive (CSRD), which requires EU and non-EU companies with activities in the EU to file annual sustainability reports alongside their financial statements. This legislation comes as a successor to the EU Non-Financial Reporting Directive (NFRD) which has been in place since 2016 and under which EU companies of a certain size have to disclose non-financial and diversity information. In addition, there is the EU Corporate Sustainability Due Diligence Directive (CSDDD), which is expected to be adopted in 2025 and which not only covers sustainable and responsible corporate behaviour, human rights and environmental considerations in companies' own operations and corporate governance, but also in their value chains inside and outside Europe. All this legislation is part of the EU's European Green Deal initiative.

Conclusion

Employees, business partners, agents and end customers – not just regulators, standards-setters and investors – are vocally expressing concern about ESG-related issues. While these stakeholders' perspectives and areas of influence vary, they share one thing: increasing expectations. Moreover, regulatory and legal developments are forcing insurers to meet expectations with actions.

Forward-thinking insurers are working on ESG strategies to embed into every facet of their respective organisations. Adding to the pressure are the growing expectations of insurance customers, investors, boards, employees, and other ecosystem stakeholders for a strong position on how meaningful action will be taken, measured, and reported.

Leading insurers see ESG as an opportunity to further reinforce their position and drive positive change. They increasingly recognise their role in advancing the ESG agenda, not only through products and investments, but also within their own organisations, across their customer base and throughout the broader ecosystem.

Appendix 5

Artificial intelligence (AI) and insurance law

Artificial intelligence (AI) has significantly improved in recent years and is bringing about significant developments within the insurance industry. In fact, together with technologies such as telematics, the internet of things (IoT), smart home technologies, aerial imagery and drone technologies (which provide insurers with new ways to access data), progress in AI, machine learning and natural language processing are enabling insurers to process, analyse and gain insights from large data sources. For example, AI algorithms can assess risks more accurately by analysing vast datasets, resulting in more precise premium calculations, and policy language can be adjusted dynamically reflecting real-time changes in risk factors.

These developments are reshaping various aspects of insurance, including underwriting, claims processing, risk assessment, and regulatory compliance. For example, in 2020 we saw the first algorithmically driven Lloyd's syndicate, Ki, which began writing business in January 2021. This is a trend that we expect to continue in the coming years, not least as a reflection of the drives to reduce costs and improve efficiency.

AI has the potential to increase business efficiency and improve interaction with customers, but the true value of AI lies not in the technology alone but in the intelligent integration of AI models with human processes. It's also crucial for businesses to transparently communicate to their stakeholders how they leverage AI to foster trust in the digital landscape.

What is artificial intelligence?

Artificial intelligence (AI) can be traced back to the late 1950s, but significant growth in computing power and availability of data accelerated developments only relatively recently. While AI has captured the public's imagination for decades, it wasn't until the launch in late 2022 of ChatGPT – a generative AI application – that AI became more widely and publicly accessible. This sparked renewed interest in AI from the public, businesses – including financial institutions – and both national and global authorities.

There is currently no globally accepted definition of 'AI' but there is alignment towards the OECD definition. This states that: 'An AI system is a machine-based system that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments. Different AI systems vary in their levels of autonomy and adaptiveness after deployment'.

While this provides a brief overview of AI, a more comprehensive definition highlights its full scope and complexity:

- **Machine learning:** this can be defined as the use of data and algorithms to enable AI to imitate the way that humans learn, gradually improving its accuracy. Common uses include speech recognition for translating human speech to text, or in chatbots and virtual agents. In a business context, one use is to help identify suspicious financial transactions.
- **Deep learning:** within 'machine learning', a more advanced subset known as 'deep learning' leverages 'virtual neurons' modelled after the structure of the human brain to process large volumes of data. Deep Learning powers technologies like virtual assistants (e.g., Siri and Alexa) to interpret commands and enables photo apps to recognise

faces. In the business world, it is widely used for tasks such as risk assessment and fraud detection.

- **Visual recognition:** in the context of AI, visual recognition refers to the ability of a system to analyse and interpret visual data, such as images or videos, to identify objects, faces, scenes, or patterns.
- **Speech recognition:** refers to the ability of a system to process and convert spoken language into text, enabling it to understand and respond to human speech.
- **Natural language processing (NLP):** this helps machines understand and generate human language by combining elements of linguistics and computer science, allowing for more effective communication. Applications include chatbot communication, translation tools such as Google Translate, and analysing sentiment in social media posts. In businesses, NLP plays a role in optimising and automating operations and workflows.
- **Large language models (LLMs):** these are trained on large amounts of data so they can understand and generate natural-sounding text. They work by predicting the next word in a sentence based on the preceding word, producing coherent responses to different prompts. They have multiple uses, for example helping with language translation or code generation, and drive tools such as ChatGPT.
- **Generative AI (GenAI):** this uses deep learning to create content from scratch – original music, artworks and stories. It's used in tools such as ChatGPT and is quickly becoming mainstream in personal and business contexts, particularly for repetitive 'paperwork'-type tasks, however, there are some challenges to be aware of – including for example, inaccurate results, intellectual property issues, lack of cultural context, and inability to resolve ethical dilemmas. GenAI is able to interpret and answer requests by drawing on the data it's provided with - its models are trained on vast amounts of data and learn patterns, structures, and relationships within that data.

AI software uses technology and algorithms to automatically extract concepts and relationships from data and learn independently from data patterns.

Current use of AI in insurance

AI is currently being used in the following areas (albeit on a limited scale so far):

Automated underwriting: AI algorithms are being used for automated underwriting processes. Insurers can assess risks more accurately and efficiently using AI-driven data analysis. For example, in August 2024, Hiscox launched its AI-enhanced lead underwriting model for sabotage and terrorism business. The insurer collaborated with Google Cloud to create the model. Hiscox stated that it can now provide lead quotes for sabotage and terrorism risks within minutes. Eligible risks are evaluated using Google Cloud's large language model, which generates an email for the broker with pricing and other data already completed, ready for the underwriter to review.

Claims handling: AI-powered chatbots and virtual assistants are streamlining claims handling. AI enables insurers to quickly assess claims and put them on the right path – such as directing a claim to the appropriate claims team or automatically instructing a loss adjuster. A fast and more efficient response is particularly important for large complex commercial claims – particularly those with the potential for significant business interruption – where the best outcome for both parties comes from early intervention. These technologies can also communicate with policyholders, and even process payments. However, they also raise questions about how insurance law should accommodate automated claims processing and ensure that policyholders are treated fairly.

Property damage assessment: by analysing photos submitted through a user-friendly web app by policyholders, AI evaluates the extent of damage to buildings caused by such things as wind, hail and hurricanes. The AI, trained on extensive claims data, quickly identifies, classifies, and measures the damage, facilitating automated estimates. This can reduce the time to settle a property claim from months to as little as one day. The technology streamlines claims processing and enhances customer satisfaction. For example, MS&AD is using a tool called 'AI Property' from Tractable to help homeowners in Japan recover faster after natural disasters.

Customer service: chatbots and virtual assistants powered by natural language processing are improving customer interactions. Generative AI enables intuitive chatbot tools to address customer queries 24/7, speed up processes and response times, and generally improve

communication. Some insurers use AI-driven chatbots to assist customers with policy inquiries and claims filing.

Risk assessment: AI helps insurers better understand risks. Machine learning models analyse vast datasets to identify patterns and assess risks. This could lead to more personalised insurance policies, but it also raises concerns about the potential for discrimination based on the data used and model biases.

Loss prevention: AI enables insurers to explore what might happen next, and suggest potential actions. Such capabilities will present new opportunities to use claims insights to pro-actively prevent and mitigate losses, as well as enable more innovative services. For example, Zurich is using AI to identify insured properties most at risk of fire and water damage claims, enabling claims, underwriting and risk engineering to work with customers to prevent losses. In the UK, Zurich deployed AI to gain a deeper understanding of the risk of fire based on various indicators such as proximity to a fire hydrant, response time from the fire brigade and other relevant data points.

Identification of reinsurance claims: for example, in 2023 Zurich piloted Catastrophe Intelligent Agent (CATIA), an in-house AI-powered tool to streamline the claims tagging process. In just minutes, it identifies catastrophe claims based on the cause of loss and claim descriptions, targeting more accurate reinsurance recoveries.

Fraud detection: AI is increasingly used to detect insurance fraud. Machine learning models can flag unusual patterns or behaviour that may indicate fraudulent claims.

Regulatory compliance: AI is aiding insurers in managing complex compliance requirements by automatically monitoring regulatory updates and ensuring that policies and practices are aligned with current laws.

Future use of AI in insurance

In the future, AI has the potential to fundamentally change:

Intermediaries:

- AI broker – trained on all historic contracts and historic pricing with that specific insurer.
- Production of sales and marketing materials.
- Analysis of client feedback.

Insurers:

- Analysis of proposal forms.
- Compliance checks.
- Analysis of different potential coverages and price levels/profitability margins.
- Automated response to potential policyholder queries regarding coverage and prices – AI-powered chatbots can answer policy-related queries, helping policyholders quickly find information about their coverage, deductibles, and claims processes. Chatbots provide 24/7 support, enhancing customer service and satisfaction.
- Automation of policy endorsements – AI can analyse and extract relevant data from policy documents, endorsements, or customer requests. For example, when a customer submits a request to add a driver to a car insurance policy, natural language processing tools can identify and process the required information. In addition, optical character recognition (OCR) technology enables insurers to digitise and interpret information from physical documents or scanned images, facilitating the automation of policy updates. AI algorithms analyse the impact of changes (e.g., adding a new driver or increasing coverage limits) on risk factors and adjust premiums accordingly.
- Claims process automation – AI-driven claims processing can accelerate the settlement process by analysing claims data and policy language to determine coverage eligibility. This reduces claims handling time, reduces claims leakage, and enhances the overall claims experience.
- Generation of policy documents – AI systems could generate insurance policies based on standardised templates and policyholders' inputs, streamlining the policy issuance process. This reduces manual paperwork and ensures that policies are consistent and error-free.

- Dynamic policy updates – AI can enable policies to adapt in real time to changes in a policyholder's circumstances. For example, coverage can be adjusted automatically when a vehicle's usage pattern changes.
- Assistance in generation of top-quality reinsurance submissions. Providing, for example, a comparison of the potential economic benefits of different reinsurance structures based on the specific latest portfolio of the insurer. As well as reasons why the insurer's portfolio, underwriting philosophy, and underwriting expertise should be considered to be top quality.

The application of AI to risk management functions, such as pricing and underwriting, may hold the greatest potential for transformation in the insurance industry. AI tools promise the ability to create more customised products and provide coverage that better aligns with customer needs, ultimately enhancing profitability. These improvements are likely to yield a strong return on the investment in AI technologies. Similarly, the claims function stands out as another area where the deployment of AI can deliver significant benefits, offering insurers opportunities to streamline processes and improve outcomes.

However, AI is a reminder of the fundamental importance of good quality data for claims handling, as well for underwriting and risk engineering. Not only do insurers need accurate information, but they also need to accurately record it. Incorrect or incomplete data is as good as no data at all, while analytics and AI can bring little value without accurate data.

Use in the context of insurance law

The freedom of insurers to use certain features in risk selection and pricing is typically governed by a combination of anti-discrimination legislation, privacy/data protection legislation and insurance law.

- Anti-discrimination laws prohibit the unfair treatment of people based on sensitive attributes in many jurisdictions, e.g. in the UK the Equality Act 2010 prohibits discrimination based on protected characteristics, including age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, and sexual orientation. Similarly, in the U.S., federal laws prohibit discrimination based on race, colour, religion, nationality, sex, marital status, age and pregnancy in many circumstances. In the EU, the Gender Directive prohibits unequal treatment based on gender.
- Privacy law imposes restrictions or prohibits the processing of certain types of sensitive information, for example relating to genetic data.
- Insurance law may allow the use of sensitive attributes if actuarially justified. For example, in some countries (including the U.S.), gender is an admitted underwriting factor. Insurance law may also impose restrictions on certain uses of personal information (e.g. prohibition to use personal data for price optimisation in some jurisdictions).

Potential issues

The increasing adoption of AI presents challenges for both buyers and sellers of insurance, as well as for intermediaries.

For insurance companies, the extensive amount of sensitive personal data required to fully leverage the benefits of AI and make informed decisions necessitates meticulous handling. Failure to adequately protect this information or obtain proper consent for its use can result in substantial financial penalties. More importantly, mishandling or abuse of this data can severely damage the insurer's reputation and market position.

Equally significant is the need to manage the machine learning aspects of underwriting and claims processing to prevent discrimination based on factors like race, gender, or location. This issue is intricate, as discrimination isn't always overt; for example, using a policyholder's address as a basis for premium adjustment can indirectly reflect ethnic discrimination.

A recent focus paper from the EU's Fundamental Rights Agency (FRA) underscores the potential for algorithmic decision-making to breach the principle of non-discrimination as outlined in Article 21 of the EU's Charter of Fundamental Rights. The FRA recommends various measures, including recognising potential biases and abuses stemming from algorithms, verifying the data's quality, and ensuring that the algorithm's construction is transparent and explainable.

The policyholders: although AI promises policyholders faster and more tailored insurance coverage, it does carry certain drawbacks. Notably, the use of AI makes it considerably

easier for insurers to pinpoint subpar risks, raising the risk of adverse selection which could make it more challenging for policyholders with unique or specific characteristics to secure insurance. Additionally, many policyholders may feel uneasy about granting insurers access to their personal lives through the use of IoT monitoring or usage-based insurance (UBI) devices.

The intermediaries: one perceived advantage of AI is its potential to establish direct communication between policyholders and insurers, enabling insurers to expand their offerings and respond more precisely to policyholders' requirements. Furthermore, existing distribution channels may be bypassed to eliminate unnecessary frictional costs from the insurance procurement process. Disruptive insurers, for instance, rely on smartphone applications to reach their customers and even offer apps that facilitate third-party sales of their insurance products. This shift implies that, like insurers, intermediaries will face challenges to their traditional business models. While this may primarily affect the mass market in the short term, it is inevitable that it will also impact commercial insurance placements.

Emerging liability challenges

The utilisation of AI gives rise to a range of legal concerns regarding data management and the mitigation of bias or risk indicators in AI underwriting processes. However, the broader integration of AI in society is also altering the landscape of established risks and liabilities.

To effectively underwrite the policies they issue and handle claims while assessing their own exposure, insurers must not only determine liability for damages caused by malfunctioning AI belonging to an insured party but also establish responsibility for damages arising from decisions made by AI.

When AI malfunctions due to errors by its developer or manufacturer, liability issues may initially seem straightforward. Nevertheless, as AI decisions become increasingly distant from direct programming and rely more on machine learning principles, pinpointing the precise cause of a specific AI decision or the source of resulting damages could become challenging.

An AI system that learns from external data can operate independently and in ways its creators may not have anticipated or understood. In cases where AI actions are inexplicable or cannot be traced back to human error, who should be held liable?

The European Union has begun addressing this matter with the European Parliament's resolution and recommendations outlined in the Civil Law Rules of Robotics, passed in February 2017. This document urges the Commission to consider two liability approaches: strict liability or risk-based liability. The latter would centre on 'the person who is able to minimise risks and deal with negative impacts.' It also explores the possibility of a mandatory insurance scheme that encompasses 'all potential responsibilities in the chain of causation.' These recommendations are presently under review by the European Commission.

Meanwhile, in the United Kingdom, the Automated & Electric Vehicles Act of 2018 mandates that insurers must pay on a strict liability basis if an insured autonomous vehicle causes injury while operating autonomously. Subsequently, insurers would pursue any subrogated claims against entities responsible for the loss. In this context, the Law Commissions of England and Wales and Scotland have published their proposals regarding legal liability in relation to the use of self-driving cars. In essence, their recommendation is that the vehicle manufacturer should bear liability for any accidents or offences directly arising from the vehicle's autonomous driving functions.

Insurance policies will need to adapt to AI-related issues. Policy language may need to specify how AI-driven decisions are made and address disputes arising from AI outcomes. Clear disclosure requirements for AI use should be included so that the policyholder has transparency and can fight against discrimination.

Coverage for AI risks

As artificial intelligence becomes an integral part of business operations across various industries, it brings unique risks that traditional insurance policies may not fully address. To mitigate these emerging risks, insurers have developed specialised products and endorsements tailored to the challenges posed by AI.

For example, Munich Re offers a product named aiSure, which allows commercial providers of AI solutions to insure the performance of their offerings. AI start-ups can use the protection to build clients' trust in their technology. If the algorithm underperforms, the

insurance kicks in. More recently Munich Re started to offer aiSelf, which provides coverage to users who implement self-developed AI solutions in their own companies.

In addition, AI quality assurance platform Armilla AI (backed by capacity from Swiss Re, Greenlight Re and Chaucer) has, since October 2023, begun offering a product warranty to help companies evaluate the AI-powered products that they are buying and selling but also guarantee that these products will perform. Microsoft has pledged to take legal responsibility and pay the amount of any adverse judgments or settlements for copyright infringement as a result of AI-generated material created through its software.

'Silent AI' coverage

Some insurers are starting to analyse their exposures to AI risks, questioning whether 'silent AI' could be the new 'silent cyber'.

Silent AI coverage refers to potential exposures from artificial intelligence not explicitly addressed in insurance policies similar to silent cyber risk. It arises when AI-related risks, such as algorithmic errors or unintended consequences of AI systems, trigger claims under traditional insurance products without explicit AI-related exclusions or endorsements/coverage. Like silent cyber risk, it creates uncertainty for insurers regarding coverage, pricing, and risk management.

Insurers are increasingly adding clarity to policies by introducing AI-explicit exclusions or endorsements/coverage, aligning with the approach taken for cyber risks to better address the growing complexity and potential liabilities associated with AI technologies.

As AI use grows across the economy, large AI-related losses are likely not far behind.

Regulation of AI

The regulatory position in a nutshell in EU/UK/USA is that the EU has passed its AI Act, considered the toughest regime on the use of AI in the world, whereas the US and UK have decided to test the safety of AI rather than regulating AI – so they have a different approach.

UK

On 22 April 2024, the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA) and the Bank of England published their strategic approaches to regulating AI in response to the UK government's July 2022 AI Regulation Policy Paper. In summary, the releases made clear that there is a need for 'pro-innovation' and 'pro-safety'-focused approaches to any relevant regulations. Although it is unlikely that we will see prescriptive AI rules within the financial services sector anytime soon, the regulators acknowledged the need to keep up with the fast development and complexity of AI. Accordingly, we are likely to hear significantly more from UK regulators on AI in the coming months and years.

EU

The EU AI Act, proposed on April 21, 2021, is the first comprehensive framework to regulate artificial intelligence. It categorises AI systems into four risk levels: prohibited (e.g., social scoring), high-risk (e.g., healthcare), limited-risk (e.g., chatbots), and minimal-risk. High-risk systems face strict requirements for transparency, accuracy, and accountability. The different risk levels will mean more or less regulation. The Act introduces significant fines for non-compliance, up to €30m or 6% of global turnover.

The majority of obligations fall on providers (developers) of high-risk AI systems e.g. those that intend to place on the market or put into service high-risk AI systems in the EU, regardless of whether they are based in the EU or a third country. Adopted in March 2024, the Act entered into force on August 1, 2024, but its prohibitions will be phased in overtime. The first set of regulations, which take effect in February 2025, ban certain 'unacceptable risk' AI systems (e.g., those that involve social scoring and biometric categorisation). This is followed by a wave of obligations over the next two to three years, with full compliance for high-risk AI systems expected by 2027. The Act aims to ensure safe, transparent, and innovative AI deployment across the EU.

In summary, the EU AI Act establishes a comprehensive and enforceable framework for regulating AI, emphasising safety and accountability through a risk-based model. In contrast, the UK's approach is more flexible, focusing on fostering innovation while maintaining safety standards. While the EU's prescriptive rules are set to take effect by February 2025, the UK's regulatory strategy continues to evolve, promising further developments in the coming years. Both approaches reflect a growing recognition of AI's transformative impact and the need for governance that balances innovation with risk mitigation.

For businesses in the insurance industry, grasping the fundamental principles of AI regulations, even if such rules don't yet apply to them, can build trust among customers and regulators, potentially offering a competitive advantage. It also allows companies to prepare for future governance and compliance needs related to AI, enhancing their agility. To stay ahead of the rapidly changing AI regulatory landscape, companies can take several proactive steps. They can familiarise themselves with applicable AI regulations in their operating markets and align internal policies with those rules and supervisory standards. Additionally, businesses can establish strong governance frameworks, risk management protocols, and accountability mechanisms to better manage AI technologies.

Conclusion

AI will inevitably drive tremendous change within the insurance industry. It will fuel improvements in data processing, drive up the efficiency of analysis, and enhance predictive power.

As such, AI stands to bring about a profound transformation across all facets of the insurance industry, encompassing everything from underwriting and claims processing to resolving disputes and distribution. This transformation is already in progress, yet the full extent of its impact remains somewhat unpredictable. Traditional insurance models are facing fundamental challenges, but there are early signs that they are starting to recognise and respond to these challenges.

One hurdle hindering the full realisation of AI's potential is the uncertainty surrounding its legal and regulatory framework. Although governments have taken initial steps to address these issues, it remains unclear how this regulatory journey will ultimately unfold.

Striking a balance between innovation and consumer protection is a key challenge for policymakers and regulators in this rapidly changing landscape.

Insurance law aspects

Insurance law faces several challenges in trying to keep up with the rapid advancements in artificial intelligence. The integration of AI in various facets of the insurance industry has raised complex legal and regulatory questions. Here are some key considerations regarding insurance law and AI:

Complexity of AI applications: AI systems can be highly complex, making it challenging for existing insurance laws to address all the nuances and potential legal issues associated with AI technology.

Data privacy and security: AI relies on vast amounts of data, and the handling of this data must comply with data protection regulations, such as Data Protection Act 2018.

Transparency: AI algorithms can be considered black boxes due to their complexity. They can sometimes make decisions that are difficult to explain or understand. There is also an inherent difficulty in explaining causation and the role of each variable used and, therefore, in checking whether algorithms are fair and unbiased. Insurance laws may need to require transparency in AI-driven processes to ensure that policyholders and regulators can comprehend how decisions are made.

Appendix 6

Operational Resilience Regulation

Introduction to operational resilience

In today's digital age, financial institutions, including insurance companies, are increasingly reliant on interconnected systems, advanced technologies, and third-party service providers. This dependence exposes them to heightened risks such as cyberattacks, system failures, and operational disruptions. Such disruptions can have cascading effects, threatening not only the stability of individual institutions but also broader financial markets and consumer trust.

To address these challenges, the ability of financial institutions to withstand, adapt to, and recover from disruptions has become essential. Operational resilience has evolved as a critical concept, surpassing traditional risk management by emphasising the continuity of essential business services during even the most severe disruptions. As reliance on digital infrastructure and third-party providers grows, regulators have prioritised operational resilience to safeguard financial stability, protect consumers, and maintain confidence in the financial system.

In the European Union, the Digital Operational Resilience Act 2023 (DORA) provides a comprehensive framework for managing ICT (information and communication technology) disruptions (explained below) and cyber threats in financial entities, including insurers. It establishes requirements for ICT risk management, incident reporting, resilience testing, and third-party oversight to ensure the continuity of financial services. Similarly, in the United Kingdom, the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) have developed their own operational resilience regime. These frameworks require firms to identify important business services, set impact tolerances, and prepare for disruptions through testing and remediation. Other countries have introduced similar regulations in recent years, for example, the Australian regulator – the Australian Prudential Regulation Authority (APRA) – introduced Prudential Standard CPS 230, titled 'Operational Risk Management,' on July 17, 2023.

This section explores the principles of operational resilience as they apply to insurance companies, comparing the EU's DORA framework and the UK's regulatory approach. By examining these regimes, we will analyse their legal implications, practical challenges, and the broader role of operational resilience in maintaining trust and stability within the insurance sector.

Operational resilience regulatory requirements in the EU: DORA

DORA stands for the Digital Operational Resilience Act, a regulation introduced by the European Union to ensure that financial institutions and their third-party service providers can withstand, respond to, and recover from ICT-related disruptions (explained below) and cyber threats.

Financial institutions are entities that provide financial services to individuals and businesses. Insurance companies are explicitly covered by DORA.

ICT refers to the technologies and systems used to share, store, process, and access information (e.g. financial records, or personal data) and enable communication (talking on a phone, sending an email, or video chatting), including hardware, software, networks, and services (computers, the internet, mobile devices, telecommunications, and data storage systems).

So, ICT facilitates data storage, processing, and exchange and underpins modern financial services now. ICT brings many efficiencies and benefits to businesses and consumers but there is a risk inherent in ICT in that problems can be systemic, and it could impact

potentially the whole EU financial sector. So, back in 2020, the commission issued a digital transformation strategy which included building resilience in ICT.

DORA has 2 main objectives:

- to comprehensively address ICT risk management in the EU financial sector; and
- to harmonise the risk management regulations that already exist in individual EU member states.

Although DORA entered into force on January 17, 2023, its requirements became applicable and enforceable from January 17, 2025. DORA is an EU regulation, meaning it is a binding legal act directly applicable in all member states without requiring national implementation.

Accompanying DORA is an EU Directive (meaning it is binding on EU member states regarding objectives, but leaves the choice of form and methods to national governments) which amends existing Financial Services Directives, including Solvency II, to bring them into line with the requirements of DORA.

Who does DORA apply to (article 2 of DORA):

A broad range of EU-regulated financial entities, including:

- Insurance and reinsurance companies.
- Larger insurance intermediaries, reinsurance intermediaries, and ancillary insurance intermediaries.
- Certain (lower risk) financial entities are excluded from its scope.
- Critical ICT third party service providers – not directly, but they must comply with an oversight framework.

What is digital operational resilience? Generally – according to the European Banking Authority (EBA) – operational resilience is defined as 'the ability of an institution to deliver critical operations through disruption.'

In DORA, digital operational resilience is defined as:

'the ability of a financial entity to build, assure and review its operational integrity and reliability by ensuring, either directly or indirectly through the use of services provided by ICT third-party service providers, the full range of ICT-related capabilities needed to address the security of the network and information systems which a financial entity uses, and which support the continued provision of financial services and their quality, including throughout disruptions.'

In other words, the ability of an organisation to withstand impacts on its ICT and be able to continue to provide its services effectively.

Structure of DORA:

- ICT risk management (articles 5–16).
- ICT-related incident management, classification, and reporting (articles 17–23).
- Digital operational resilience testing (articles 24–27).
- Managing of ICT third-party risk (articles 28–44).
- Information-sharing arrangements (article 45).

Key requirements of DORA

DORA is like a long checklist, broken down into different pillars:

ICT risk management: implementation of a sound, comprehensive and well-documented ICT risk management framework.

Reporting ICT incidents: financial entities must establish processes to identify, manage, and report ICT-related incidents, including significant disruptions or breaches that impact their operations. These incidents must be classified and reported to the relevant competent authorities in a timely manner. Note: there is a requirement to report 'major' incidents to the competent authority, and to notify clients if there is a financial consequence for clients (this element is similar to the EU's General Data Protection Regulation).

Digital operational resilience testing: these provisions in DORA require financial entities to regularly test their ICT systems and processes to ensure they can withstand disruptions and cyber threats. Testing includes vulnerability assessments, penetration testing, and

scenario-based stress testing. Critical financial institutions must conduct advanced threat-led penetration testing (TLPT) **every three years**. These tests evaluate operational resilience under realistic conditions and ensure compliance with regulatory standards.

Managing of ICT third-party risk: these provisions in DORA require financial entities to monitor and manage risks arising from their use of ICT third-party service providers. Financial institutions must ensure **contracts** with these providers include clear terms on security, performance, and data protection. Critical providers are subject to oversight by EU regulators, ensuring compliance with resilience requirements. Entities must assess risks, perform due diligence, and have contingency plans to address potential disruptions.

Information-sharing arrangements: DORA encourages but does not mandate the sharing of cyber threat intelligence and information between Financial Services entities. This should enhance the collective knowledge of these entities and improve their collective resilience.

Note: DORA's requirements are subject to a proportionality principle, stated in article 4 – entities should tailor their compliance efforts based on factors such as their size, overall risk profile, and the nature, scale, and complexity of their services, activities, and operations. In other words, financial entities are not expected to implement a one-size-fits-all approach to compliance. Instead, their efforts to meet DORA's requirements should be tailored to their specific circumstances. This approach prevents excessive regulatory burden on smaller entities while ensuring that larger or higher-risk institutions implement robust measures to protect the financial system.

Operational resilience regulatory requirements in the UK

In the United Kingdom, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) have established comprehensive operational resilience requirements for financial institutions. These rules, effective from March 31, 2022, mandate that firms identify their important business services, set impact tolerances for disruptions, and ensure they can continue operations within these tolerances during severe but plausible scenarios.

Firms which are in scope of the UK's operational resilience regime are expected to have fully embedded these requirements by March 31, 2025. The regulators have provided insights and observations to assist firms in reviewing and enhancing their operational resilience frameworks to meet the upcoming deadline.

Additionally, the PRA and FCA have proposed new reporting requirements for operational incidents and the use of material third parties, aiming to standardise information received from firms and identify systemic issues related to incident and third-party risk management.

If we compare the regulatory regime regarding operational resilience in the UK to the EU's DORA we can see that the UK covers a wider range of operational risks, not limited to ICT dependencies.

With respect to UK regulators' rules/requirements for so-called critical third-party service providers (CTPs) that provide essential services to the financial sector, these came into effect in the UK from 1 January 2025. However, critical third parties will have twelve months to achieve compliance following their designation by His Majesty's Treasury. These regulators' rules/requirements were introduced following:

- The Financial Services and Markets Act 2023 (FSMA 2023) which granted the PRA and FCA the legal authority to regulate CTPs.
- The Prudential Regulation Authority (PRA), and Financial Conduct Authority (FCA) jointly publishing policy statement PS16/24 in November 2024, outlining the final rules and requirements for CTP under the authority of the FSMA 2023.

As of January 2024, His Majesty's Treasury (HMT) has not designated any critical third parties (CTPs) under the UK's financial regulatory framework.

The UK regime is not as prescriptive as DORA – strategies must be in place but the UK regulation does not set out in detail how you achieve resilience. The UK regime is more outcomes-focused. Especially following an operational incident, firms in the UK would need to justify the decisions that they took and the measures that they have in place to protect themselves, their clients and the wider UK financial system.

Furthermore, DORA is applicable to a wide range of financial service firms, whereas the UK regime is bit more narrowly focused – it applies to UK-authorised financial institutions (including banks, insurance companies, Lloyd's, and managing agents), but not smaller

intermediaries. It covers all of their activities, wherever they are located. It does not apply to branches authorised in the UK.

Key areas:

Important business services: firms must identify services whose disruption could cause intolerable harm to consumers or market integrity. This identification should be evidence-based and documented in the self-assessment.

Impact tolerances: for each important business service, firms are required to set clear impact tolerances, specifying the maximum acceptable disruption duration before causing significant harm. These tolerances should be regularly reviewed and justified within the self-assessment.

Transitional arrangements: by March 31, 2022, firms should have initiated mapping and testing to identify important business services and set impact tolerances. The transition period extends to March 31, 2025, by which time firms must ensure they can operate within their set impact tolerances.

Mapping and scenario testing: firms are expected to map resources and processes supporting important business services to identify vulnerabilities. Scenario testing should assess the firm's ability to remain within impact tolerances during severe but plausible disruptions.

Vulnerabilities and remediation: through mapping and testing, firms should identify vulnerabilities that could lead to breaches of impact tolerances. Remediation plans must be approved, funded, and governed to ensure vulnerabilities are addressed promptly.

Communication and self-assessment: firms must document their operational resilience journey in a self-assessment, detailing methodologies, identified vulnerabilities, and remediation plans. This document should be regularly reviewed and approved by the governing body. A communication plan should be created to communicate internally and externally bearing in mind that normal communication methods may themselves be disrupted.

Horizon scanning: firms are encouraged to regularly review and update their understanding of emerging risks and severe but plausible scenarios, including how the firm itself can change over time. Horizon scanning is essential to maintain and enhance operational resilience over time.

Reporting of operational incidents to the regulator

The FCA is planning to send out a consultation paper to discuss its expectations on how firms will report operational incidents.

However, under the FCA's Principle 11 and the PRA's Fundamental Rule 7, financial institutions already have obligations to notify regulators of significant matters, including operational incidents that could impact their operations, customers, or the financial system. These principles emphasise the duty of firms to maintain open and cooperative relationships with their regulators.

Principle 11 (FCA):

Firms must 'deal with its regulators in an open and cooperative way and must disclose to the appropriate regulator anything relating to the firm of which that regulator would reasonably expect notice.'

This principle obliges firms to notify the FCA of significant operational disruptions, such as ICT incidents, that could impair their ability to deliver important business services or affect consumers.

Fundamental Rule 7 (PRA):

Firms must 'deal with the PRA in an open and cooperative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.'

This requires firms to report incidents, including those affecting operational resilience, that could threaten financial stability or the safety and soundness of the firm.

Operational incidents, such as major ICT failures, data breaches, or cyberattacks, typically fall under the scope of these notification obligations.

Legal implications

The legal implications of operational resilience regulatory requirements for insurance companies are significant, as they reshape the obligations and responsibilities insurers must meet to comply with emerging frameworks. These implications can be framed as follows:

Enhanced regulatory obligations

Operational resilience requirements, such as those in DORA (EU) and the UK's FCA/PRA regime, impose specific duties on insurance companies to:

- Identify important business services and assess the impact of disruptions.
- Establish and document impact tolerances to ensure critical functions can continue during severe disruptions.
- Conduct regular scenario testing to demonstrate resilience. Failure to comply with these obligations can result in regulatory sanctions, fines, or reputational damage.

Governance and accountability

These frameworks emphasise strong internal governance, requiring boards and senior management to:

- Oversee the implementation of operational resilience measures.
- Approve self-assessments and remediation plans.
- Ensure compliance with ongoing monitoring and reporting requirements. This raises legal accountability for directors and officers, increasing their exposure to potential liability for non-compliance.

Contractual obligations with third parties

Operational resilience rules necessitate robust oversight of third-party service providers (e.g. cloud providers or ICT vendors). Insurance companies must:

- Include specific contractual terms addressing operational resilience, security, and incident reporting.
- Ensure third parties comply with regulatory requirements. Non-compliance or failures by critical third parties could lead to legal disputes or breach of regulatory obligations.

Increased reporting and disclosure requirements

Both the EU and UK frameworks require insurance companies to report ICT-related incidents to regulators. This creates legal implications regarding timely and accurate reporting to avoid penalties.

Sources

The updater has used their own knowledge where possible. Please see further information on DORA here:

<https://eur-lex.europa.eu/homepage.html>

<https://www.bankofengland.co.uk/prudential-regulation>

<https://www.fca.org.uk/>

Chapter 1 self-test answers

- 1 Public law concerns the relationship between the State and its individual members.
Private law concerns the relationship between the individuals themselves.
- 2 Law of contract, law of torts, law of trusts, law of property, family law, law of succession.
- 3 *Ratio decidendi* is the exact reason for a decision; *obiter dictum* is a statement made by a judge which is of persuasive authority only.
- 4 Any three from the following:
 - law of trusts generally;
 - promissory estoppel;
 - subrogation;
 - contribution;
 - special performance;
 - injunction.
- 5 Orders in council; statutory instruments (regulations and orders made by ministers); bye-laws.
- 6 The three rules of statutory interpretation are the:
 - literal rule;
 - golden rule;
 - mischief rule.
- 7 The three tracks are:
 - The small claims track – this is normally used for disputes up to £10,000, except for personal injury cases and housing disrepair cases, where the limits are usually £1,500 and £1,000, respectively.
 - The fast track – this is used for straightforward disputes where the financial value is not more than £25,000.
 - The multi-track – this is used for disputes which are neither small claims nor have been allocated to the fast track. It includes cases with a financial value exceeding £25,000, and cases of a lower value if the court considers the trial likely to last longer than one day or if any oral expert evidence given at the trial will not be limited to one expert per party in up to two expert fields.
- 8 It has always been possible for a person involved in litigation to make the other party an offer in the hope of settling the case before it comes to trial, and/or to make a payment into court. The rules governing these offers and payments are now contained in Part 36 of the Civil Procedure Rules, hence the terms 'Part 36 offer' and 'Part 36 payment'.

A Part 36 offer or payment is essentially an attempt to force the other party into a compromise. If an offer or payment into court is accepted by the other party then the case ends. However, if the offer or payment is not accepted within the time allowed for doing so the person refusing it may end up paying extra costs, even if they win the case. This puts pressure on the other party and may persuade them to settle for a lower amount rather than risk heavy legal costs. The aim of Part 36 is to encourage the acceptance of reasonable offers, and avoid the need for unnecessary court hearings.
- 9 Natural persons and juristic persons (or corporations).
- 10 A corporation sole is a legal person representing an official position which will be occupied by a series of different people. A corporation aggregate is an artificial legal person consisting of a number of people – for example, a limited company.

Chapter 2

self-test answers

- 1 A tort is a breach of a civil duty imposed on everybody by the general law, damages are always unliquidated and liability is usually based on fault.
A breach of contract is the breach of a duty imposed by agreement, damages may be liquidated or unliquidated and liability is usually strict.
- 2 A defence is a legal excuse for what would otherwise be a wrong. If successful, it removes all liability. Contributory negligence is a plea in mitigation which reduces liability (and damages payable) but does not remove it.
- 3 The act of the defendant must be direct. It must be intentional (or possibly only negligent). The tort is, in every case, actionable per se.
- 4 The defendant owed a duty of care to them, that duty of care was breached and they suffered loss or damage as a result of the breach.
- 5 The 'neighbour test' is a principle for establishing when a duty of care is owed in negligence. It was proposed by Lord Atkin in *Donoghue v. Stevenson* (1932) and is based on 'reasonable foreseeability'.
- 6 The two forms private nuisance may take are:
 - Wrongfully allowing the escape of noxious things from one's property so as to interfere with the claimant's land.
 - Wrongful interference with servitudes (rights attaching to land).
- 7 Vicarious liability is liability which one person assumes for the wrongful act of another. The main example in the law of torts is the vicarious liability of the employer for torts committed by their employees in the course of their employment.
- 8 Truth, honest opinion, publication on a matter of public interest, innocent defamation, privilege.
- 9 One year where the claim is for libel or slander, three years for personal injury and six years for most other tort actions (mainly property damage claims).
- 10 Ordinary visitors to an owner's property have protection under the Occupiers' Liability Act 1957, which states that the occupier has 'a duty to take such care as in all the circumstances of the case is reasonable to see that the visitor will be reasonably safe in using the premises for the purposes for which he is invited or permitted by the occupier to be there.'

The position for trespassers, as set out in the Occupiers' Liability Act 1984, is slightly different. A duty is owed only if the occupier knows or has reasonable grounds to believe that the danger exists and the trespasser is/may come into its vicinity. The risk must also be one against which the occupier may reasonably be expected to offer a trespasser some protection. The only protected forms of damage are death and personal injury, with no duty in relation to property.

Chapter 3

self-test answers

- 1 Agreement (generally shown by offer and acceptance), intention to create legal relations, consideration (for simple contracts), form, capacity to contract. The contract must not be illegal or against public policy.
- 2 At the cash desk. Taking the goods to the cashier is probably the offer to buy, taking money in payment is probably the acceptance.
- 3 An invitation to treat is a statement made when negotiations are still in progress, and not an offer. It is, effectively, an invitation to make an offer.
- 4 An acceptance generally can be in any form, e.g. in writing, orally or by conduct. However, if the offeror states that acceptance must take a particular form, the method stipulated must generally be used.
- 5 A transfer of title to land; a transfer of a British ship or shares in a British ship.
- 6 Necessaries are the basic products and services of everyday life.
- 7 A warranty is a term which affects only a minor aspect of the agreement. If it is broken, the injured party has a right to claim damages but not, in general, to terminate the contract. A condition is a term which relates to an important aspect of the agreement: it 'goes to the root' and if it is broken the victim has a right not only to claim damages but also to terminate the agreement.
- 8 If, after the contract is concluded, it becomes illegal, futile or impossible to perform.
- 9 Performance, breach, agreement, frustration.
- 10 An insurance contract may be illegal and void because the insured lacks the insurable interest required by statute (e.g. under the Life Assurance Act 1774), the purpose of the contract may be illegal or against public policy, the insured property may be used unlawfully or there may be a close connection between the loss for which the insured seeks compensation and a crime.
- 11 In the case of the assignment of the benefit of a contract, the entire contract is not assigned but merely the benefit of it. There is no change in the subject matter of the contract (such as the property which the policy covers), or in any other aspect of the risk; the insurance money is payable on exactly the same event or events. The assignor is simply saying that the proceeds of any valid claim they may have should go to the assignee in question.
- 12 An equitable assignment of a life policy has always been possible: this may be done, for instance, simply by handing the policy to another – provided the intention to assign is clear. If there is only an equitable assignment the assignee cannot enforce the policy in their own name – they have to join the assignor in the action, either as co-claimant or co-defendant.
- 13 Motor insurances in England are 'personal' contracts. The insurer's willingness to provide cover will depend not only on the vehicle to be insured but also on the age, occupation, experience and driving record of the insured and of the other people whom the insured may allow to drive.

Chapter 4 self-test answers

- 1 The three relationships are:
 - Principal and agent.
 - Principal and third party.
 - Agent and third party.
- 2 Actual authority (which may be expressed or implied) or apparent (or ostensible) authority.
- 3 By agreement (or consent), by ratification, by necessity.
- 4
 - The person doing the act must do it as agent and not for themselves.
 - The principal must have been in the agent's mind at the time.
 - The principal must have full knowledge at the time of ratification.
 - The principal must have been in existence at the time of the unauthorised act.
 - The whole contract must be ratified, and in a reasonable time.
 - Void or illegal acts cannot be ratified.
- 5 Agency by necessity arises when a person is entrusted with the goods of another and an emergency makes it necessary to do something to save them.
- 6 Under the law of agency, any knowledge which an agent possesses is imputed to the principal: in other words, the law assumes that the principal is aware of information which has been given to the agent: what is known by an agent is deemed to be known to the principal also. This is of particular importance in relation to the duty of disclosure. This rule is subject to sections 4 and 5 of the IA 2015.
 - Where expressly authorised by the principal.
 - Where the right to delegate is implied (i.e. routine administration).
 - Where delegation is in accordance with trade custom.
 - In cases of necessity.
- 7 The duties of an agent are:
 - Obedience.
 - Care and skill.
 - Personal performance.
 - Good faith.
 - Accounting for money.
- 8 Against either the agent or the principal.
- 9 By agreement, by performance, by lapse of time, by withdrawal of authority, by renunciation, by death, bankruptcy, insanity or by frustration.

Chapter 5

self-test answers

- 1 The parties must have reached agreement on the nature of the risk and the subject matter of insurance (what is to be insured and what perils are to be covered); the duration of the contract and the amount of the premium (or the method by which the premium is to be calculated).
- 2 The only type of insurance contract which must be in writing (and only for making a claim against the insurer, not for the binding nature of the contract) is a marine insurance policy (Marine Insurance Act 1906, s.22). The policy need only give the name of the insured or their agent, be signed by or on behalf of the insurer and specify the subject matter of the insurance with reasonable certainty.
- 3 The legal right to insure arising out of a financial relationship recognised at law between the insured and the subject matter of insurance.
- 4 A subject matter of insurance, an economic or financial interest in the subject matter of insurance, a current interest (not merely an 'expectancy'), a legal interest (in English law).
- 5 To reduce moral hazard and to discourage gaming.
- 6 At the time when the contract is made – but not necessarily when a claim is made on death or maturity.
- 7 Insurances on goods.
- 8 The contract is void. Policies governed by the Life Assurance Act 1774 are illegal and void.
- 9 Three of:
 - outright owners of property;
 - part or joint owners;
 - mortgagees and mortgagors;
 - executors and trustees;
 - landlord and tenant;
 - bailees;
 - people living together;
 - finders.

Chapter 6

self-test answers

- 1 A duty not to misrepresent any material fact.
A duty to disclose all material facts.
- 2 If the statement is false but there is no intention to mislead the other party, there is an innocent misrepresentation.
Where a person makes a false statement with the deliberate intention of misleading another and putting them at a disadvantage, this may be regarded as a fraudulent misrepresentation (but fraud has to be proved by the insurer).
- 3 It is the duty imposed on the parties to an insurance contract to act honestly and in fair dealing throughout their contractual relationship.
- 4 The standard definition is that provided by s.7(3) of the Insurance Act 2015:
A circumstance or representation is material if it would influence the judgment of a prudent insurer in determining whether to take the risk and, if so, on what terms.
- 5 No. They need only establish that the non-disclosure was material to the risk generally.
- 6 The first case is where there is an agreed change in the contract during the period of insurance. Here the insured has a duty to notify material facts which relate to the change.
The second case is where a continuing duty is imposed on the insured contractually through a 'change in risk' or 'increase in risk' clause incorporated in the policy wording.
- 7 Yes.
The right to avoid is unrestricted subject to the breach being a qualifying breach and either deliberate or reckless. Alternatively, the breach may be neither deliberate nor reckless, but the insurer would not have entered into the contract on any terms without the breach.
- 8 Yes.
The Insurance Act 2015 introduces the proportionate remedy that if the breach of the duty of fair presentation of the risk is neither deliberate nor reckless, and if the insurer would have entered into the contract on different terms had there been no breach of the duty, the contract is presumed to have been made on those terms.
If the insurer would have charged a higher premium, then the Act provides a proportionate reduction from the insured amount instead of avoiding the contract as a whole. The insurer may nevertheless avoid the contract, although the breach is neither deliberate nor reckless, if the insurer proves that in the absence of the qualifying breach, the insurer would not have entered into the contract on any terms.
- 9 If the breach is either deliberate or reckless, the insurer may avoid the contract and need not return any premium. If the breach is neither deliberate nor reckless, and if the insurer avoids the contract, the insurer must return the premium paid.
- 10 The insurer may avoid the contract if a qualifying misrepresentation was either deliberate or reckless. If the qualifying misrepresentation is careless, the insurer's remedies are based on what it would have done if the consumer had exercised reasonable care not to make a misrepresentation. If the insurer would not have entered into the consumer insurance contract on any terms, the insurer may avoid the contract and refuse all claims.

Chapter 7

self-test answers

- 1 A breach of the duty of fair presentation of the risk normally arises from a failure to supply full and accurate information in the negotiations which lead up to the formation of the contract – before the contract has come into existence. A breach of condition or warranty arises from a failure to comply with a term of the contract itself, so that the breach occurs after the contract has been made.
- 2 The *ejusdem generis* rule provides that general words which follow specific words are taken as referring to things of the same kind as the specific words.
- 3 Where the term is ambiguous, the courts will construe the term against the party that proposed it. In consumer insurance contracts, the insurer will usually set the terms.
- 4 A warranty in an insurance contract is a promise made by the insured relating to facts or to something which it agrees to do. Breach of a warranty suspends the insurance cover until the breach is remedied. A warranty in a non-insurance contract is a minor term which, if broken, allows an action for damages only.
- 5 A continuing warranty is one in which the insured promises that a state of affairs will continue to exist or they will continue to do something. It may be applied by insurers to ensure that some aspect of good housekeeping or good management is observed or to ensure that certain high risk practices are not introduced without the insurer's knowledge.
- 6 In marine insurance, warranties can arise expressly or impliedly. In non-marine insurance, warranties are express only.
- 7 A condition precedent to the contract is one which states that the contract will not come into existence unless the condition precedent is satisfied.

If a condition precedent to liability (or recovery) is not observed, the insurers will be discharged from liability automatically for the loss which is tainted by the breach. The contract will not be terminated. There may be future claims if the insured complies with the condition precedent regarding those claims.

- 8 These are conditions which are not part of the main agreement to insure but are concerned only with a side issue such as the adjustment of the premium. Mere conditions in insurance are interpreted the same way as innominate terms in contract. In other words, the breach constitutes sufficient grounds to terminate the contract and claim damages only if it is so serious that it goes to the root of the contract.
- 9 Yes. The Insurance Act 2015 repealed any rule of law which provides that the cover is terminated automatically upon breach of an insurance warranty.
- 10 Under the IA 2015, the cover does not terminate automatically upon breach of a warranty, but is suspended during the period of time when the insured breached the warranty to when they remedied it. Hence, the IA 2015 permits the insured to remedy the breach. Section 11 may operate together with s.10 of the IA 2015 so that if the breach has no relevance to the loss, as described under s.11, the insurer may not rely on the breach to deny liability. However, this is only if the term in question does not define the risk as a whole and it aims to reduce the risk of loss of a particular kind, at a particular place and at a particular time.
- 11 Under English law, the distinction between joint and composite insurance hinges on the interests of the insured persons. If the insured persons share a common interest in the subject matter, for example where they are joint owners of property, the policy is likely to be joint. On the other hand, where the interests are different, as in the case of lessor and lessee, or mortgagor and mortgagee, the policy is likely to be composite.
- 12 A joint policy is 'indivisible', so that a breach or default by one insured (such as a breach of the duty of fair presentation of the risk by a non-consumer, breach of warranty or act of wilful misconduct by one insured) may cause the whole policy to fail. By contrast, a breach or default by one insured under a composite policy may invalidate their own cover without affecting the right of other insured persons to claim, provided the latter are innocent of the breach or default.

Chapter 8 self-test answers

- 1 That the loss was caused by the operation of an insured peril, and the amount of the loss.
- 2 Proof 'on the balance of probabilities'.
- 3 Generally, yes. Even if there is a 'reasonable precautions' clause the insurers will usually be liable unless the loss was caused deliberately or through reckless conduct.
- 4 An 'uninsured' peril is a peril which is neither specifically insured nor specifically excluded by an insurance policy covering named perils only (e.g. the risk of theft in the case of a fire policy).
- 5 A cause which plays only a small part in bringing about the loss.
- 6 The decision of the Supreme Court has made it harder for insurers to use the 'fraudulent device' defence, where the insured has given a false representation to improve the prospects of a genuine claim. The claim will no longer be automatically forfeited as a result and the insurer will need to show that the lie is relevant to the existence or the amount of the insured's entitlement.
- 7 Under s.12(1) of IA 2015, the insurer can refuse to pay the fraudulent claim, recover any sums already paid with regards to the claim that was affected by the fraud, and can treat the contract as having been terminated with effect from the time of the fraudulent act. It can therefore refuse to pay any genuine claims that arise after the fraudulent act, but cannot refuse any claims that arose before this and were not affected by the fraud. In addition, the insurer does not have to return any premiums paid.

Chapter 9

self-test answers

- 1 Because it is difficult to put a value on human life and because life policies are not always intended to cover financial loss – the main purpose may be to provide a means of saving.
- 2 Betterment can take two forms. First, when a building (or other property) is repaired, certain parts of the structure will often have to be renewed so that when the work is complete it is in a better condition than it was before the loss.

Betterment can also arise if the quality of the building is improved in the course of carrying out repairs. For example, an extra storey may be added to a building or a sprinkler system installed.
- 3
 - Inadequate sum insured or limit of indemnity.
 - Operation of another policy limit.
 - Operation of an average clause.
- 4
 - Yes, in the case of marine insurance.
 - Possibly, in the case of commercial property insurance.
 - Probably not, in the case of household insurance(!).
- 5 An excess clause, or deductible, is a clause which provides that the insured must bear the first amount of any loss, expressed as a sum of money (say £250).

A franchise is similar to an excess in that there is no liability for any loss which is less than the franchise figure. However, once the franchise has been exceeded, the loss is payable in full.
- 6 In the case of a valued policy the parties agree that, in the event of a loss, a particular sum, fixed at the outset of the insurance, will be paid, regardless of the actual value of the property at the time.
- 7 The Act applies to fire insurance of buildings only in England, Wales and some other countries where it has been adopted (but not to Scotland or Ireland) and to policies written by insurance companies but not Lloyd's policies.
- 8 The action of giving up anything which remains of the insured property to an insurer who has paid a total loss is referred to as abandonment. The right of the insurer to take over the subject matter is known as salvage.
- 9 Where there is a constructive total loss under a marine policy, the insured must serve a notice of abandonment on the insurers if the insured wishes to be paid for a total loss. This is a formal notice indicating that the insured is willing to give up the subject matter to the insurers. It should not be confused with the action of abandonment itself. If no notice is served the insured is deemed to have suffered a partial loss and may claim only for this. However, there are some exceptions under the Marine Insurance Act 1906 in which the insured may claim for a constructive total loss although no notice of abandonment has been served.
- 10 Cover will usually terminate unless the insured replaces the property and the insurers agree to continue cover.

Chapter 10 self-test answers

- 1 The right of one person, having indemnified another under a legal obligation to do so, to stand in the place of that other and avail themselves of all the rights and remedies of that other, whether already enforced or not.
- 2 To prevent the double indemnity of the insured and to ultimately claim the loss from the person who is responsible for its occurrence.
- 3 Where the person who gives the money intends it to be for the sole benefit of the insured, it cannot be claimed by way of subrogation.
- 4 Subrogation may arise in tort, in contract or under statute.
- 5 Contribution will arise where:
 - two or more policies of indemnity exist;
 - each insures the subject matter of the loss;
 - each insures the peril which brings about the loss;
 - each insures the same interest in the subject matter;
 - each policy is liable for the loss.
- 6 An 'escape clause' is a form of non-contribution clause, which prevents the insured from having other insurance on the same risk. The policy is avoided if the insured takes out further insurance or already has other insurance when the policy is opened.
- 7 Under a 'more specific insurance' clause, the policy will pay only when the cover provided by another more specific insurance has been exhausted, if such a policy exists. In other words, the policy operates like an excess of loss insurance where there is another policy which is more specific (i.e. it identifies the insured property more precisely).
- 8 The maximum liability method and the independent liability method.
- 9 The independent liability method.

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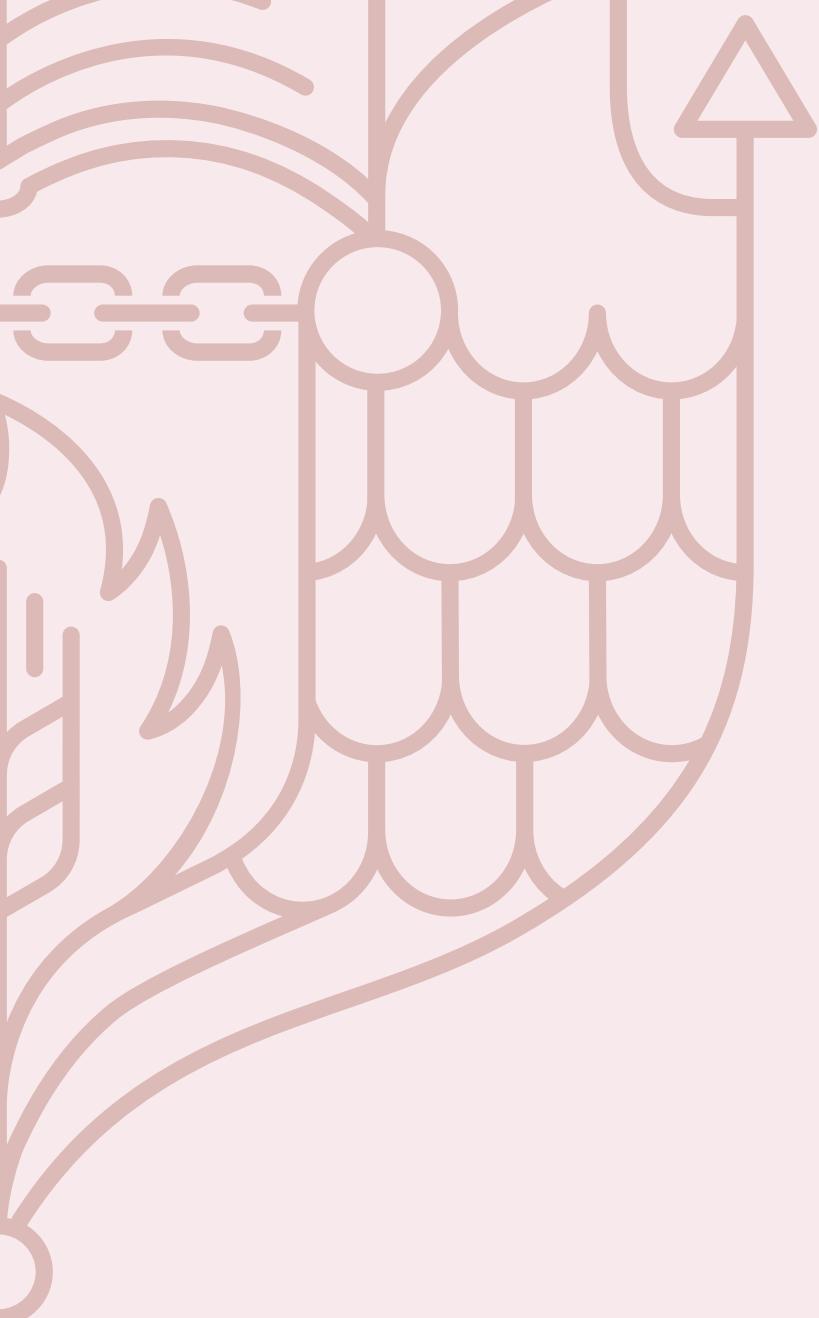
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