



Scottish Law Commission

promoting law reform

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ISSUED ON BEHALF OF THE SCOTTISH LAW COMMISSION

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Reforming the duty of disclosure in business insurance, and bringing warranty law up to date

In a consultation opening today, the Law Commission and Scottish Law Commission are proposing a new law to make clear what businesses must tell insurers when they buy insurance.

The current law states that before taking out insurance businesses must disclose every material circumstance they know or ought to know. But what exactly counts as an organisation's knowledge? Can a vast and complex international organisation reasonably be expected to know everything that is known to every employee? And how can it work out what an insurer would think was material?

As well as being unclear, the law is harsh. If a business breaches the duty of disclosure, an insurer can "avoid" the contract. That means it can act as if the contract does not exist and refuse to pay any claims. The consequences for the business and its employees may be catastrophic.

The Law Commissions believe that the law should support the commercial aspirations of the insurer and the policyholder. The policyholder should make a fair presentation of the risk, but they can expect the insurer to be both knowledgeable and competent.

The Commissions propose that there should be clearer principles for determining what corporate knowledge is and how to assemble it. The Commissions also suggest that if policyholders deliberately conceal information then insurers can avoid the claim. In all other circumstances, the outcome will depend on what the insurer would have done had it known the full facts.

David Hertzell, the Law Commissioner leading on the project for England and Wales, says: "We need to ensure that the law supports our world-leading insurance industry. Rules designed in the nineteenth century need to be updated. Many of the definitions and principles we are proposing are already found in the current case law. Embedding them in the statute would make the law clearer and fairer for insurers and their clients."

Professor Hector MacQueen, Scottish Law Commissioner, says: "The law in this area is based on the Marine Insurance Act of 1906 and has fallen out of date. Large, complex, international corporations struggle to cope with its requirements as much as their smaller counterparts because the present rules and remedies are weighted against them all. We are offering the industry and its business policyholders an opportunity to come together to develop definitions, principles and protocols that make for clearer, fairer law".

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Warranties

The two Commissions are also consulting on the law of warranties in insurance contracts. The current law is also based on the 1906 Marine Insurance Act and has attracted much criticism.

A warranty is a term of an insurance contract which carries harsh consequences. If the policyholder does not comply exactly, the insurer can refuse a claim. It makes no difference if the breach is trivial or irrelevant to the risk, or if the policyholder remedies the breach before the loss occurs.

In their consultation, the Commissions are provisionally proposing that:

- Breach of a warranty should suspend, rather than discharge, the insurer's liability. A remedy of the breach should restore the insurer's liability.
- Where a term is designed to reduce a particular type of risk, liability should be suspended only in relation to that risk.

For example, if a business fails to check its sprinkler systems, this would suspend liability for fire damage but not for flooding. Once the sprinkler system has been checked and found to be working, the insurer should pay for any subsequent fire.

These proposals would be mandatory for consumers. In business insurance, the parties would be able to contract out of these provisions, provided they did so in clear, unambiguous terms and the term was brought to the attention of the other party.

David Hertzell, Law Commissioner leading on this project for England and Wales says: "The current law of warranties has been called archaic, blunt and unfair. It is out of date and risks bringing the law of the UK into disrepute in the international marketplace. We are suggesting reforms that would bring the law up to date and clarify the responsibilities of insurer and insured."

Notes for Editors

1. The Scottish Law Commission and the Law Commission are non-political independent bodies, set up by Parliament in 1965 to keep all the law of Scotland and of England and Wales under review, and to recommend reform where it is needed.
2. For more details on this project, visit the Insurance Contract Law project pages on <http://www.scotlawcom.gov.uk> or <http://www.lawcom.gov.uk>
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