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INSURANCE CONTRACTS

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LAW REFORM COMMISSION'S ROLE

The Law Reform Commission is an independent statutory body established by the *Law Reform Commission Act 1975.* The Commission's principal role is to keep the law under review and to make proposals for reform, in particular by recommending the enactment of legislation to clarify and modernise the law. Since it was established, the Commission has published over 160 documents (Consultation Papers and Reports) containing proposals for law reform and these are all available at www.lawreform.ie. Most of these proposals have led to reforming legislation.

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Full responsibility for this publication lies, however, with the Commission.

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INTRODUCTION

A Background: Insurance Contract Law

1. This Consultation Paper forms part of the Commission's *Third Programme of Law Reform 2008-14*[1] and involves an examination of insurance contract law. In the Consultation Paper, the Commission examines the following principles and rules concerning insurance contracts: the concept of "insurable interest," the duty of disclosure placed on the insured; the nature and scope of pre-contractual misrepresentation by the insured; the nature and effect of "warranties" in insurance contracts, and their connection with "basis of contract" clauses; the relationship between exclusions in insurance contracts and the general law on unfair contract terms; formalities (including specific terms that need to be drawn to the insured's attention); the duty of utmost good faith (*uberrimae fidei*) in insurance contract law; the rights of third parties; and remedies available for breach of the contract (including the scope of repudiation of the contract and monetary compensation). The Consultation Paper examines whether these principles and rules would benefit from statutory consolidation.

B Insurance Contract Law: Some Key Common Law Principles

2. Insurance contract law in Ireland has not, until now, been the subject of any systematic review since the foundation of the State in 1922. As the discussion in this Consultation Paper makes clear, some of the key features of insurance contract law (in common with those of contract law in general) derive from long-established principles and rules of common law (judge-made law). This includes the important principle (which the courts in Ireland continue to affirm) that, at the pre-contractual formation of the insurance contract, there is a duty on the person taking out the policy of insurance (the proposer) to disclose material information that is relevant to the risk that the insurer is being asked to take on. The Irish judiciary have also been careful to point out that the common law imposes more obligations on the insurer than is commonly believed to be the case. Indeed, at the heart of any discussion on insurance contract law is the nature and extent of the obligation on both parties to act with utmost good faith, the concept of *uberrimae fidei.*

C Insurance Contract Law: pre-1922 Legislation

3. In addition to important common law rules of insurance contract law, in 1922 the State carried over a large body of pre-1922 insurance legislation, beginning with the *Life Assurance Act 1774.* The antiquity of the 1774 Act has created difficult issues of interpretation,[2] and even relatively modern legislation such as the *Marine Insurance Act 1906* has been criticised as producing a legal context "so wholly inappropriate, in part at least, to the purpose of the transaction being effected."[3] Nonetheless, Irish courts have, in general,[4] agreed with the view that the *Marine Insurance Act 1906* is, in general, a codification of the common law rules on insurance that apply "across the board". As the 1906 Act remains in force it has, by default, coloured the way in which even consumer insurance transactions are to be tested. As the Commission argues throughout the Consultation Paper, this approach requires reappraisal in the context of reform of insurance contract law, in particular bearing in mind the increased level of regulatory supervision that was enacted in the 20th Century and has accelerated in the 21st Century, including the influence of EU law.

1 *Report on Third Programme of Law Reform 2008-2014* (LRC 86-2007), Project 34.

2 See *Church and General Insurance Co v Connolly,* High Court, 7 May 1981.

3 Finlay CJ in *Brady v Irish National Insurance Co Ltd* [1986] ILRM 669, at 679.

4 In *Brady v Irish National Insurance Co Ltd* [1986] IRLM 669, at 679 the Supreme Court assumed "without deciding" that the 1906 Act applied to a policy relating to pleasure craft used exclusively on inland waters.

D Regulation and Supervision of Insurance: pre-1922 Legislation

4. Ellis and Wiltshire[5] observe that "Government supervision of insurance companies in Ireland dates from the *Life Assurance Companies Act 1870*." The 1870 Act required the deposit of £20,000 with the Accountant General of the Court of Chancery, a requirement to keep life funds separate from other business transacted by companies engaging in life assurance, as well as the preparation and filing of annual accounts of life and other assurance business. The *Assurance Companies Act 1909* repealed the 1870 Act and extended the regulatory structure in relation to life assurance into fire insurance, accident insurance, employer's liability and bond investment business, insofar as that business was not already the subject of a friendly society or trade union registration. The 1909 Act did not address industrial life assurance, that is, the activities of friendly societies and life assurance entities that granted life assurance via a mechanism for collecting premiums through collectors at periodical intervals of less than two months. The legislation in this area was consolidated in the *Friendly Societies Act 1896*[6] and the *Collecting Societies and Industrial Assurance Companies Act 1896.*[7] This was the key legislation in force in 1922 when the State was established.

E Regulation and Supervision of Insurance during the 20th Century

5. The Oireachtas first made provision in respect of motor insurance in the *Road Traffic Act 1933*, but it was the *Insurance Act 1936* that ushered in general licensing and deposit-making requirements for Irish companies wishing to transact business in ordinary and industrial life assurance, fire, bond, employer's liability, motor insurance, public liability, engineering, glass, guarantee and burglary insurance. Ellis and Wiltshire comment that, following the enactment of the 1936 Act, "it became almost impossible for foreign companies to enter the Irish market."[8] Although a "reciprocity provision" was contained in the *Insurance Act 1953* so as to facilitate limited entry to the Irish market by foreign companies, it was only through the market liberalisation provision of the EU regulatory regime (introduced from the 1970s onwards) that Irish insurance regulation lost its protectionist character. In addition to the 1936 Act, the other main legislative measures have been the *Insurance Act 1989*, the *Investment Intermediaries Act 1995,* and the *Insurance Act 2000.*

F Regulation and Supervision of Insurance: the EU influence

6. These Acts have been supplemented by a significant number of *Life Insurance Regulations* and *Non-Life Insurance Regulations* made under the *European Communities Act 1972* that have sought to implement requirements under various EU Insurance Directives. Together with the Acts already mentioned, these have enhanced the rules by which insurers are supervised, improving transparency requirements relating to insurers and intermediaries, as well as bringing intermediaries into a more rigorous regulatory environment.

7. The regulatory significance of EU law in this area is also illustrated by its impact in the health insurance area. The monopoly afforded by the *Voluntary Health Insurance Act 1957* to the State-owned Voluntary Health Insurance Board (VHI) was modified by subsequent legislation and thus facilitated the entry into the Irish market of private sector competitors. The European Court of Justice has ruled, however, in *European Commisison v Ireland*,[9] that the State has failed to comply with the provisions in

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[5] Ellis and Wiltshire, *Regulation of Insurance in the UK, Ireland and the EU* (Thomson Reuters Looseleaf) C.1-01.

[6] 59 & 60 Vict. c.25. The *Friendly Societies Act 1896*, as amended, remains in force in Ireland.

[7] 59 & 60 Vict. c.26.

[8] Ellis and Wiltshire, *Regulation of Insurance in the UK, Ireland and the EU* (Thomson Reuters Looseleaf) C.1-01.

[9] Case C-82/10, Judgment of the Court (Fourth Chamber), 29 September 2011. Legislation modifying the 1957 Act was enacted in 1996, 1998, 2001 and 2008. The Court in particular did not accept that the enactment of the *Voluntary Health Insurance Act 2008* (which has not been brought into force, as required, by a ministerial

various EU Non-Life Insurance Directives by not legislating to require VHI to comply with certain prudential conditions, specifically the establishment of a guarantee fund and compliance with a required solvency margin. This has had the significant effect of ending the associated derogation afforded to Ireland by Article 4 of the First Non-Life Insurance Directive, Directive 73/239/EEC.

G Statutory Regulation of Insurance Contracts

8. In addition to these significant regulatory legislative developments, the *Insurance Acts* have also affected individual insurance contract law, improving the protections and rights of proposers at the pre-contractual stage, as well as the protections and rights of insured persons after a contract of insurance has been agreed, the post-contractual stage. In so doing, the Acts have, in a number of respects, adjusted some of the common law rules of insurance contract law that have evolved through litigation. For example, the agency provisions in respect of tied brokers were adjusted in favour of the proposer by section 51 of the *Insurance Act 1989.* At a more general level, however, although section 61 of the *Insurance Act 1989* grants sweeping powers to the Minister for Finance[10] to prescribe codes of conduct for insurance undertakings in respect of the duty of disclosure and warranties, this power has never been used. To some extent, these powers have been superceded by other regulatory developments, to which the Commisison now turns.

H Regulation and Oversight by the Financial Regulator and the Financial Services Ombudsman (FSO)

9. The legislative developments outlined briefly above have been supplemented in important respects through the establishment of the Office of the Financial Regulator[11] and of the Financial Services Ombudsman (FSO).[12] These statutory agencies were intended to improve the regulatory oversight of financial services (including insurance) and to provide for an inexpensive dispute resolution mechanism for consumers and small businesses.[13] A significant regulatory tool developed by the Financial Regulator

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Commencement Order) or the economic crisis currently facing the State could justify the failure to implement the relevant EU Directives.

[10] When the *Insurance Act 1989* was enacted, the regulation of insurance undertakings generally had been the responsibility of the Minister for Industry and Commerce (now known as the Minister for Jobs, Enterprise and Innovation). The functions under the 1989 Act have since been transferred to the Minister for Finance, who also has responsibility at Government level for the regulation of other financial services undertakings.

[11] Under the *Central Bank and Financial Services Authority of Ireland Act 2003.* The *Central Bank Reform Act 2010* replaces the Central Bank and Financial Services Authority of Ireland and the Financial Regulator with a single unitary authority, the Central Bank of Ireland, which is structured around directorates and divisions. The Deputy Governor Financial Regulation oversees six divisions, two of which are Insurance Supervision and Consumer Protection.

[12] Under the *Central Bank and Financial Services Authority of Ireland Act 2004*, which inserted a new Part VIIB into the *Central Bank Act 1942.* The FSO was not affected by the changes made by the *Central Bank Act 2010*.

[13] The Commission acknowledges that the "principles only" ("light touch") approach to supervision by the Financial Regulator between 2004 and 2008 has, since 2008, been subject to extensive criticism in the wider context of the debate on the impact this may have had on the virtual collapse of the banking system in Ireland in 2008. The Commisson does not propose to discuss this wider debate in this Consultation Paper, since it ranges well beyond the insurance contract area. Nonetheless, the Commission notes that the Financial Regulator has, since 2009, adopted a more robust "principles and rules" approach to regulation. Similarly, the reorganisation of the general regulatory system, evidenced by the enactment of the *Central Bank Reform Act 2010* (and further planned legislation), suggests that this more robust approach will contuinue for the foreseeable future. Indeed on the 16 Dec 2011 the Central Bank issued its largest fine to date against the Combined Insurance Company of Europe for "the gavest and most persistent" breaches of the regulatory requirements contained in the 2006 Consumer Protection Code. See, "Insurance Firm fined €3.35 m for 28 breaches of regulations", *Irish Times,* 20 Dec 2011

has been the *Consumer Protection Code 2012*,[14] which sets out enforceable standards for financial services contracts, including insurance contracts, and which in many respects amount to a statutory statement of key contractual obligations. Along with these statutory innovations, voluntary Codes of Practice have also been developed by representative bodies suich as the Irish Insurance Federation (IIF), and the Commission considers that these have further potential.

10. The establishment, in parallel, of the FSO has had equally signficant effects, because the FSO has considerable decision-making powers to resolve consumer disputes as well as those involving small and medium sized undertakings (SMEs). The establishment of the FSO indicated the need for a decision-making process to resolve disputes that would be less expensive than litigation. The FSO has the additional advantage that the Office can engage in mediation of disputes and, even when engaged in decision-making, can make determinations that depart from the precise requirements of the principles and rules of individual insurance contact law. This statutory discretion appears to reflect the view that these principles and rules may not reflect an appropriate calibration between the respective obligations and rights of the insured and the insurer. The Commission notes, nonetheless, that the published decisions of the FSO indicate that, in many instances, the existing principles and rules have played a significant part in these processes.

I The development of Principles of European Insurance Contract Law (PEICL)

11. Another significant influence, certainly in terms of individual insurance contract law, has been the publication of the Principles of European Insurance Contract Law (PEICL), the outcome of a collaborative project between leading European experts in this area. The publication of PEICL mirrors comparable projects in other jurisdictions to set out key principles of the law, such as the Restatements of Law published by the American Law Institute (ALI). It remains to be seen whether the PEICL will have anything like the same influence on the development of law in EU member states as the ALI Restatements have had in the United States. In any event, from the Commission's perspective, the publication of PEICL provides another reference point for this current review of insurance contract law.

J The Commission's General Approach in this Consultation Paper

12. The Commission considers that a review of insurance contract law in the early 21st century should have regard to all these developments. This allows the Commission to consider afresh long-established principles and rules in this area, in particular those based on principles of private autonomy and which were developed before the advent of statutory regulation. The regulatory landscape, evidenced by the *Consumer Protection Code 2012*, has a much more interventionist character in relation to contractual practices than was previously the case, or perhaps is even generally appreciated. Furthermore, the advent of the FSO has produced a body of norms and standards that indicate the need for a fundamental reappraisal of Irish insurance contract law.

13. In approaching this Consultation Paper, therefore, the Commission considers that while existing common law principles and rules may be in some need of recalibrtation, a number of underlying key elements remain valid. The Commission is conscious that the existing law in this area includes long-established common law principles whose origins coincide with the still-extant *Life Assurance Act 1774*. It is equally conscious that the more recent case law in this area, and the recent legislation that established the Financial Regulator and the FSO, provide an important contemporary background against which propsoals for reform need to be considered. The Commission is also conscious that any proposals

[14] The *Consumer Protection Code 2012* (which was published in October 2011 after a significant public consultation process and is in force from 1 January 2012) is more detailed than the previous *Consumer Protection Code* published in 2006. This reflects the more robust "principles and rules" approach to regulation mentioned in the previous footnote. The Code was issued under the following statutory powers: (a) section 117 of the *Central Bank Act 1989*; (b) sections 23 and 37 of the *Investment Intermediaries Act 1995*; (c) section 8H of the *Consumer Credit Act 1995*; and (d) section 61 of the *Insurance Act 1989*. The *Consumer Protection Code 2012* is available at http://www.centralbank.ie/regulation/processes/consumer-protection-code/Documents/Consumer%20Protection%20Code%202012.pdf.

should take account of the EU setting, including proposals for the future development of insurance contract law at European level such as those indicated by the publication of the Principles of European Insurance Contract Law (PEICL).

14. In addition, as with its other law reform projects, the Commisison has also had the advantage of reviewing comparable developments in insurance contract law in a number of other jurisdictions, including proposals for reform and enacted reforms in Australia, Canada and the United Kingdom. In this respect, the Commission is also fully conscious of the importance of insurance as a financial service in Ireland, that it does not operate in isolation, and that it is closely connected with leading centres of insurance (such as London) as well as the increasingly globalised market for financial services.

15. The Commission now turns to outline the contents of the Consultation Paper.

A Outline of Consultation Paper

16. **In Chapter 1 (Regulatory Context)**, the Commission examines some detailed aspects of the current regulatory regime. The Commission acknowledges that the activities of existing non-statutory and statutory bodies have already had a significant impact on insurance contractual practice. The decisions of the FSO have also produced a body of principles, often informed by custom and practice within the industry as well as court decisions, that have led to more balanced outcomes in individual disputes. These developments are reflected in both the IIF voluntary Codes of Practice and the Financial Regulator's statutory *Consumer Protection Code 2012*, which the Commission notes applies, at least in part, not just to insurance taken out by consumers but also by commercial undertakings.

17. It is clear to the Commission that Codes of Practice can play a valuable role in resolving individual disputes. The Commission therefore concludes that regulatory bodies (in particular the Financial Regulator and the National Consumer Agency) should continue to liaise with each other in order to develop comprehensive statutory Codes of Practice setting out standards of best practice, building on the best practice standards developed by the Irish Insurance Federation and on the statutory model of the Financial Regulator's *Consumer Protection Code 2012*.

18. The Commission also provisionally recommends that legislation should provide that in any litigation or other dispute resolution process such statutory Codes of Practice setting out standards of best practice should be admissible in evidence; and that, if any provision of such Code is relevant to a question arising in the litigation or other dispute resolution process, the provision may be taken into account in determining that question, but that this would be without prejudice to the substantive rights between the parties. In addition, the legislative framework being proposed in this Consultation Paper should, in general, apply to consumers as defined for the purposes of the jurisdiction of the Financial Services Ombudsman (FSO), namely natural persons and businesses with an annual turnover not exceeding €3 million.

19. **In Chapter 2 (Insurable Interest)**, the Commission notes that although Irish common law did not require an insurable interest to be present for a contract of insurance to be enforceable, subsequent statutory developments aimed at counteracting fraud, gambling and criminal destruction of lives and property did. Pre-1922 legislation was largely ineffective or unclear on the insurable interest question but it is clear that in relation to life policies Irish law retains an insurable interest requirement by way of the *Life Assurance Act 1774*. However, in relation to non indemnity insurance, there is significant judicial authority for the view that the 1774 Act does not apply to property insurance. The Commission sees no case for the introduction of an insurable interest requirement where no such requirement currently exists. In cases of indemnity insurance the need for an insured to show a loss, and the indemnity principle, achieve the same net result as the insurable interest requirement.

20. In terms of reform, the Commission provisionally recommends that legislation should provide that an otherwise valid insurance claim cannot be rejected by the insurer solely because the insured lacks an insurable interest as it has been traditionally defined, that is, a legal or equitable relationship between the insured and the subject matter of the insurance contract. The Commission provisionally recommends that, instead, insurable interest should, in the interests of certainty, be defined in legislation (to reflect current Irish case law) as an interest that subsists when a person may benefit from the continued existence or safekeeping of the subject matter of the insurance or may be prejudiced by its loss; and that

this definition would apply both to non-life insurance (in particular property and liability insurance) and to life insurance. In connection with life policies, the Commission also recommends reform of the "natural love and affection" category of insurable interest insurable interest requirement to include civil partnership, cohabition and other familial relationships. This adjustment would also result in the repeal of the *Life Assurance Act 1774.* Finally, although the insurable interest requirement is not an essential element in defining insurance for regulatory purposes, the Commission considers it an important benchmark in assisting regulation of financial services, gaming and wagering. The Commission recommends that further regulatory steps be taken to distinguish insurance contracts from other financial or investment activities associated with risk.

21. **In Chapter 3 (Duty of Disclosure)**, the Commission notes that the duty of disclosure is mandated by both the common law and the *Marine Insurance Act 1906* as being applicable to all insurance contracts. The duty is rooted in "special knowledge" of a risk as being likely to be solely in the possession of the proposer. Whether this remains the case is open to some doubt in the light of telecommunications and other advances. The duty has always been balanced by reference to the insurer's duty to disclose and investigate circumstances within the insurer's competence and expertise. In some jurisdictions the duty of disclosure has been offset or indeed removed altogether by an insurer's obligation to ask specific questions.

22. The Commission provisionally recommends that the pre-contractual duty of disclosure in insurance contract law should be retained, but that it should (in accordance with authoritative case law in Ireland) be restricted to facts or circumstances of which the person applying for insurance cover – the proposer – has actual knowledge; and that the duty of disclosure would not, therefore, extend to every fact or circumstance which ought to be known by him or her (constructive knowledge). The Commission provisionally recommends that this modified pre-contractual duty of disclosure should apply to all insurance, other than Marine, Aviation and Transport (MAT) insurance, which would continue to be regulated in this respect by the *Marine Insurance Act 1906*.

23. The Commission also recommends that legislation should continue to provide that, because the proposer possesses more relevant information than the insurer, the pre-contactual duty of disclosure should continue to be the basis on which a contract of insurance is a contract of utmost good faith (*uberrimae fidei*). The Commission also provisionally recommends that the insurer should be under a statutory duty to explain to a proposer both the nature of the duty of disclosure and the consequences of non-disclosure.

24. **In Chapter 4 (Pre-contractual Misrepresentation and Insurance Contracts)**, the Commission discusses the duty in section 20 of the *Marine Insurance Act 1906* to give "true" answers, and provisionally concludes that this should be replaced by a duty to answer specific questions honestly and carefully. This would apply to consumer insurance and mass market insurance products (including mass market insurance products to all businesses, not limited to the jurisdictional limit of the Financial Services Ombudsman). The Commission also considers that the insurer must ensure that any question posed in writing to the proposer is drafted in plain, intelligible language; that any such question should be specific as to the information being sought by the insurer; and that where there is doubt about the meaning of a question, it should be interpreted by reference to a standard of what is fair and reasonable.

25. The Commisison also suggests that the misrepresentation provisions in the *Sale of Goods and Supply of Services Act 1980* could be modified so as to reflect the needs of the insurance contract. The Commission also provisionally recommends that rescission of a contract of insurance for non fraudulent misrepresentation should no longer be the primary remedy. This reflects in practice what Irish courts and the FSO have been doing in recent years.

26. The Commission accepts that questions asked by an insurer should be answered, but that the failure of an insurer to follow up on an obviously incomplete answer should be regarded as a waiver of the duty of disclosure in appropriate cases. This would involve the adoption of section 27 of the Australian *Insurance Contracts Act 1984*.

27. **In Chapter 5 (Warranties)**, the Commission acknowledges that contractual warranties may, in a passive sense, be unobjectionable because the warranty may help to identify or define the risk being underwritten. Warranties may also, however, act as "traps for the unwary", giving insurers wide-ranging

grounds for avoiding a policy. The Commission recommends a number of measures to deal with abusive provisions of this kind. The Commission provisionally recommends that the entitlement of an insurer to avoid a policy or a claim for breach of warranty should depend on whether the insured was provided at the pre-contractual stage, or contemporaneously with the conclusion of the contract, with the information required by the duty of disclosure (as already defined in this Consultation Paper).

28. The Commission also provisionally recommends that, in respect of promissory or continuing warranties that arise after the contract has been agreed, the insurer must provide the proposer with a clear statement prior to the formation of the contract about the scope of the continuing obligations imposed upon the proposer when he or she becomes insured. The Commission also concludes that statements of fact or opinion shall not be converted into a contractual warranty by anything stated in the contract. This means that "basis of contract" clauses will cease to be effective through the law of contract, the insurer's remedies being available in tort or under specific legislation. This recommendation is in line with best practice standards in the industry.

29. The Commission also provisionally recommends that, if the insured can show that there was no causal link between the failure to observe a promissory warranty and the loss, the insured should be able to recover on the claim. The New Zealand approach to this difficult issue provides a significant improvement to existing Irish law and the Commission provisionally recommends the adoption of the approach that has been in place there since 1977.

30. In Chapter 6 (Exclusions and Unfair Terms), the Commission notes that existing judicial approaches to unusual terms, in both consumer and commercial contracts, require the party who drafted such terms to draw attention to them. Legislation such as the *Consumer Protection Act 2007* also gives additional protection to consumers, but Irish law does not have specific protection for businesses contracting on another's standard terms. The Commission accordingly recommends that there should be a general statutory duty on an insurer to draw attention to unusual terms. The Commission also provisionally recommends that a good faith provision, based on section 14 of the Australian *Insurance Contracts Act 1984*, should be enacted. The Australian provision is an updated version of section 17 of the *Marine Insurance Act 1906*, with the specific focus being drawn to instances of unfairness at the time of conclusion of the contract. This reform would provide greater transparency and accountability in contractual negotiations.

31. The Commission also provisionally recommends that Regulation 4 of the *Unfair Terms in Consumer Contracts Regulations 1995* (which deals with specific circumstances in which a contract term shall not of itself be considered to be unfair) should be clarified in the context of insurance contracts so that it is provided, to avoid any doubt, that: (a) a term in an insurance contract shall not in itself be regarded as unfair where the subject matter of the term has actually been considered by the insurer in the calculation of the premium (price); (b) that this has been drawn to the attention of the proposer; and (c) that this clarification to Regulation 4 should apply to consumers as defined for the purposes of the jurisdiction of the Financial Services Ombudsman, namely natural persons and businesses with an annual turnover not exceeding €3 million. This reform would be in line with the suggestions in Article 2:304 of the Principles of European Insurance Contract Law (PEICL) and, in turn, reflects insurance legislation in a number of other EU states (including Germany).

32. In Chapter 7 (Formalities), the Commission examines contractual formalities, but is conscious in this respect that the regulatory bodies have issued specific requirements to insurance companies, often on foot of EU or other statutory compliance provisions. The Commission's recommendations should be seen in this context.

33. On the general question of the need for an insurance contract to be in writing, the Commission provisionally recommends that this should not be a necessary pre-condition to the validity of an insurance contract. The Commission is also aware that many insurance contracts are the subject of extensive requirements of notice and form under EU law. The Commission concludes that these requirements should be consolidated and set out in primary legislation, using the requirements in the *European Communities (Distance Marketing of Consumer Financial Services) Regulations 2004* as a model.

34. The Commission also provisionally recommends that legislation should include a statutory duty on insurers to provide a proposer with the prescribed requirements of notices, notification and forms. The

Commission provisionally recommends that, subject to a cooling-off period (if any), the insurer should transmit the insurance policy document to the insured within 15 working days of the contract being agreed.

35. In Chapter 8 (The Duty of Utmost Good Faith: Post-Contractual Aspects), having reviewed the case law concerning a suggested post-contractual duty of utmost good faith, the Commission concludes that there is very little support for the existence of any expansive duty of this kind. The Commission provisionally recommends, therefore, that legislation should set out the mutual duties on the insured and the insurer in respect of claims handling, so that the principle of good faith would then remain relevant only to pre-contractual formation of the contract, as discussed in Chapter 3, above.

36. The Commission also provisionally recommends that the law should continue to provide that an insured should be prohibited from recovering on a claim by submitting a fraudulent claim or fraudulent evidence to support a claim; but that it should also provide that an innocent co-insured or beneficiary may recover on a proportionate basis; provided that the fraudulent insured cannot benefit from the policy.

37. In Chapter 9 (Third Party Rights), the Commission concludes that in the context of third party rights in insurance contracts, it would, in general, be sufficient to protect such rights if the Oireachtas enacted legislation based on the draft *Contract Law (Privity of Contract and Third Party Rights) Bill* in the Commission's 2008 *Report on Privity of Contract and Third Party Rights*. In addition, the Commission invites submissions as to whether additional specific provisions should be enacted in the context of the operation of insurance contracts in specific settings, for example, in insolvency, on the death of an insured person and during the completion of a contract for the conveyance of land.

38. The Commission also provisionally recommends that section 62 of the *Civil Liability Act 1961* should be extended to allow a third party to proceed against the insurer where the insured cannot be located; this would reflect the approach in section 51 of the Australian *Insurance Contracts Act 1984*.

39. **In Chapter 10 (Remedies)**, the Commission considers that, under current law, there is an excessive emphasis on repudiation of liability under an insurance policy as a remedy for the insurer. The Commission has, accordingly, provisionally concluded that repudiation should no longer be the main remedy, and that in cases of non-disclosure and misrepresentation the principal remedy should be one of damages in proportion to the failure by the insured.

40. The Commission also provisionally recommends that any damages awarded to an insured arising from the insurer's failure to comply with the proposed post-contractual duties of the insurer (set out in Chapter 8) should reflect: (a) general principles of damages in contract law, namely whether the loss is a reasonably foreseeable consequence of the breach of contract (and in particular, damages that are reasonably foreseeable from a refusal in bad faith to meet a valid claim); and (b) emerging principles of restitution.

41. The Commission also provisionally recommends that legislation should provide that subrogation rights should be limited in two situations: (a) claims between family members and (b) the employer-employee relationship. The Commission invites submissions as to the precise form these restrictions should take.

42. Chapter 11 contains a summary of the provisional recommendations made in this Consultation Paper.

43. This Consultation Paper is intended to form the basis of discussion and therefore all the recommendations are provisional in nature. The Commission will make its final recommendations on the subject of insurance contract law following further consideration of the issues and consultation. Submissions on the provisional recommendations included in this Consultation Paper are welcome. To enable the Commission to proceed with the preparation of the Report, which will contain the Commission's final recommendations in this area, those who wish to do so are requested to make their submissions in writing to the Commission or by email to info@lawreform.ie by **31 March 2012.**

CHAPTER 1 REGULATORY CONTEXT

A Introduction

1.01 In this Chapter the Commission examines some detailed aspects of the current regulatory regime, with a focus on four matters in particular. In Part B, the Commission dsicusses overlapping regulation of Irish insurance contract law and commercial practices. In Part C the Commission examines European Union initiatives on insurance regulation and the related development of the Principles of European Insurance Contract Law (PEICL). In Part D, the Commission discusses new legal norms and forms of Dispute Resolution, in partyocular those arising from the role of the Financial Services Ombudsman (FSO). In Part E, the Commission discusses the need for insurance contract law reform. Agaisnt this background, in Part F the Commission sets out its conclusions and provisional recommendations for reform, acknowledging that the activities of existing non-statutory and statutory bodies have already had a significant impact on insurance contractual practice. The decisions of the FSO have also produced a body of principles, often informed by custom and practice within the industry as well as court decisions, that have led to more balanced outcomes in individual disputes. These developments are reflected in both the IIF voluntary Codes of Practice and the Financial Regulator's statutory *Consumer Protection Code 2012*, which the Commission notes applies, at least in part, not just to insurance taken out by consumers but also by commercial undertakings.

B Overlapping regulation of Irish insurance contract law and commercial practices

(1) Regulatory overlaps – financial services legislation

1.02 The most important regulatory agency that has a significant impact upon the law relating to insurance contracts is the Financial Services Ombudsman (FSO) insofar as the FSO has a broad jurisdiction to investigate complaints about the conduct of a regulated financial service provider in relation to the provision of, or an offer to provide, or a failure to provide, a financial service.[1] The creation of a Financial Regulator was a core recommendation of the 1999 *Implementation Advisory Group on the Establishment of a Single Regulatory Authority for the Financial Services Sector,*[2] the McDowell Report. The McDowell Report also recommended the creation of a statutory Financial Services Ombudsman to replace the non-statutory Ombudsman schemes.

1.03 While the Statutory Financial Services Ombudsman model of alternative dispute resolution is the most obvious regulatory agency, there are other statutory bodies that have significant roles to play in the way in which the insurance industry conducts business in Ireland. Some of these agencies have the power to regulate information gathering practices and the way in which insurance contracts can be structured, so it is no longer possible to see the process of negotiating an Irish insurance policy as being predominantly governed by principles of private autonomy and freedom of contract.

(2) Regulatory Overlaps – Competition Law

1.04 Competition law principles and objectives such as the desire to regulate levels of market concentration, facilitation of the ability of new suppliers to enter into the Irish insurance market (and thus avoid anti-competitive levels of market power in both the insurance and intermediary markets) have an important part to play in Irish economic life. Competition law may also ensure that insurance companies do not share or aggregate pricing data in ways that undermine consumers. The Competition Authority has undertaken a number of studies on the Irish insurance landscape, the most noteworthy being the

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1 Under Part VIIB of the *Central Bank Act 1942*, as inserted by the *Central Bank and Financial Services Authority of Ireland Act 2004.*

2 PN. 7271 (1999).

2005 Final Report and Recommendations, *Competition Issues in the Non-Life Insurance Market*. After investigating motor insurance, employer's liability insurance and public liability insurance, the Competition Authority made a number of recommendations aimed at improving competitiveness within each sector. Some recommendations involved providing proposers and insureds with contractual rights to a statement on claims history, timely and detailed renewal notices so as to facilitate switching to competitors; other recommendations such as a requirement that intermediary fees should be disclosed to insureds have been subsequently diluted so as to avoid "consumer information overload." The Competition Authority, in its 2009 *Annual Report*, noted that the Financial Regulator requires such disclosure of intermediary fees if the consumer makes a request for such information. The Competition Authority clearly has an important role to play in improving the rights of Irish consumers by promoting competition and making recommendations to the Financial Regulator. Other State agencies are also expected to respond to the views expressed by the Competition Authority.[3]

(3) Regulatory Overlaps - Equality Legislation

1.05 The provisions of the the *Employment Equality Acts 1998 and 2004* and the *Equal Status Acts 2000 and 2004* clearly have an impact upon the Insurance Industry. Both pieces of legislation prohibit discrimination based upon

- gender
- marital status
- family status
- sexual orientation
- religion
- age
- disability
- race
- membership of the traveller community status.

1.06 While most of the complaints made to the Equality Authority relate to discrimination in the provision of public sector services, and in particular discrimination based on race, gender and traveller status, there are pertinent examples involving insurance.

1.07 For example, Brother Anthony White[4] was able to use the services of the Equality Authority to challenge a practice of loading a surcharge onto the cost of hiring a motor vehicle because the driver was aged over 70, no account being taken of the individual circumstance of the driver. The service provider agreed to withdraw this automatic loading. The then chief executive of the Authority was quoted on the Authority's website as remarking:

> "the use of lower and upper age limits to govern access to insurance products and financial and other services is a widespread problem. Age limits exclude people without any consideration of their individual circumstances"

1.08 There are decisions of Equality Officers that also address disability issues. In *Mr A v A Life Assurance Company*[5] *the* Equality Officer found that a refusal to top up an income protection policy for an insured with diabetes was a *prima facie* case of disability discrimination. The insurer however was able to

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3 For example, the 2007 Report on Private Health Insurance contained recommendations that the Competition Authority said had been either fully implemented or written into draft legislation: *2009 Annual Report*, p.48.

4 www.equalitytribunal.ie. See also, "Pensioners in Search of Travel Insurance," *The Irish Times*, 2 May 2011.

5 Equality Decision DEC-S2011.008 (18 February 2011). See also, *O'Donoghue v Hibernian General Insurance* (2004) and *Ross v Royal Sun Alliance* (2003) cited in *Mr A v A Life Assurance Company*. See generally Smith, *Disability Discrimination Law* (Thomson Reuters, 2010).

come within the exemption provide by section 5(2)(d) of the *Equal Status Act 2000,* that is, the decision not to extend cover was reasonable having regard to underwriting and commercial factors.

1.09 In the more general context of discrimination, complaints brought against bodies that exist outside the public sector have been lodged. The press release accompanying the 2006 *Annual Report of the Equality Authority* stated that:

> "Access to education (57 casefiles), access to accommodation (41 casefiles), access to insurance (17 casefiles) and access to banking and financial services (15 casefiles) are the main issues raised under the Equal Status Acts after public sector services."

1.10 The database of decisions reached by the Equality Tribunal shows that a number of complaints have been made in relation to the charging of differential premiums, most decisions being arrived at on factual grounds such as whether the loading was based upon actuarial modelling or statistical data.[6] Complaints about discrimination in relation to preferential premiums and gender or marital status have also been upheld by the Equality Tribunal.

(4) Regulatory Overlaps - The Data Protection Commissioner

1.11 The constraints that data protection and privacy considerations place upon the proposer and the insurer also contribute to undermining the traditional view that "the proposer knows everything and the insurer nothing." Far from requiring the proposer to disclose anything that the proposer knows or is deemed to know concerning the risk, contemporary privacy principles and rules on data protection may impose obligations to withhold personal data about third parties who have not explicitly consented to disclosure. Similarly, the idea that an insurer may be free to either use or ignore information provided, for any particular purpose, may not accord with data privacy rules. This conflict between data protection principles, and pre-contractual and post-contractual data capture and use practices, has not been widely appreciated: it is nevertheless a cause of some uncertainty in relation to the approach to be adopted by proposers and insurers to information gathering.

1.12 The data protection principles consist of 8 guideline rules that must be followed by any data controller engaged in the collection and use of personal data, whether that data is recorded on paper or some other format, for example, electronically. The 8 rules require a data controller to

(1) obtain and process information fairly;
(2) keep information only for one or more specified, explicit and lawful purposes;
(3) use and disclose the information only in ways compatible with those purposes;
(4) keep the information safe and secure;
(5) keep the information accurate, complete and up-to-date;
(6) ensure the information is adequate, relevant and not excessive;
(7) retain the information for no longer than is necessary for those purposes;
(8) give the individual data subject a copy of their personal data, on request.

1.13 Within the specific context of the insurance sector there are a number of instances where Irish data protection law may inform pre-contractual information gathering practices. For example, there are specific rules in place when personal data is collected from a data subject following on from a medical examination. The *Data Protection (Access Modification) (Health) Regulations 1989* (SI No 82 of 1989) provide that, even if the data subject requests a copy of this personal data under rule 8 above, the relevant health professional investigating or treating the data subject is entitled to withhold the personal data in the event that such a professional forms the view that disclosure would be harmful to the data subject/patient. It may be that considerations of this kind were behind the decisions of the clinicians treating Ms Coleman in *Coleman v New Ireland Insurance Plc*.[7] While the decision reached by Clarke J

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6 *King v Voluntary Health Iinsurance*, DEC-S2008-116, and *Geoffrey O'Donoghue v Hibernian* (2004), at www.equalitytribunal.ie.

7 [2009] IEHC 273. Here a young woman was not advised by clinicians that her sight difficulties might be early indications that multiple sclerosis would develop in later life; this turned out to be the case. The High Court decided that there had been no non-disclosure or misrepresentation that would have justified repudiating an income protection policy.

in *Coleman* accords with data protection law, there are other situations where the ‘disconnects’ between privacy considerations and contract law are more evident.

1.14 Take the possible dilemma facing Mrs Lambert in the English case *Lambert v Co-operative Insurance*[8]. While on the facts of *Lambert* the issue of disclosure did not arise because Mrs Lambert did not consider it relevant, the point is this: should the disclosure be made, even if the personal data relates to a third party? Data protection law, especially rules 1 to 4, are probably relevant but, at an intuitive level, one could be excused for seeing the privacy consideration as being somewhat artificial. Nevertheless, it is possible to envisage cases where a previous conviction would not be disclosed, on privacy grounds, the effect being that the insurance policy might be avoided. While a *Spent Convcitions Act*[9] might answer this situation, the same may not be true of other sensitive personal data material such as health conditions or sexual history. The leading English decision on this is undoubtedly *Horne v Poland*,[10] in which an insurer was able to avoid payment on a burglary insurance policy on the basis that the proposer had failed to declare that he was born in Romania and had lived there until his teens, matters of importance to an underwriter assessing risk apparently.

1.15 The decisions of the Data Protection Commissioner also demonstrate how the data protection principles may cut across insurance contract law. Case Study 2 of 1999 for example[11] illustrates the fact that breach of any implied contractual duty of confidence in relation to personal data will also constitute a breach of the security principle (rule 4 above). Case Study 1 of 2001 also censored an insurer that collected irrelevant data on the marital status of a person seeking motor insurance,[12] and Case Study 8 of 2009 also drew attention to an insurer collating excessive information on penalty points imposed on drivers. There are also situations where the sharing of personal data with trade bodies or other insurers may be problematical. Such practices were held by the Data Protection Commissioner, in a decision relating to disclosure to the Insurance Industry Federation (IIF) of personal data on health insurance applicants, to be understandable from the insurer’s perspective, but the Commissioner felt that “explicit consent” to disclosure of medical data should be the necessary standard, albeit at the cost of having any proposal declined or the contract avoided, should the proposer fail to make the disclosure. [13]

1.16 These matters have led the Data Protection Commissioner, in consultation with the insurance industry, to formulate the *Code of Practice on Data Protection for the Insurance Sector*. Many of the requirements set by the code have a direct impact on data capture requirements and recalibrate the existing balance *vis-à-vis* the duty of disclosure, for example, further undermining the notion that the onus lies upon the proposer to volunteer information unprompted by the insurer.

1.17 The fair obtaining and processing principle (rule 1) is said to require the insurer, on an application form, to, *inter alia*, advise the “applicant” about the purpose of collecting the data, to whom it may be disclosed and any other relevant information necessary to ensure that all processing meets the requirements of fair processing. This obligation is reinforced by a requirement that insurers have a written privacy policy “setting out clearly for what purposes personal data is processed”, a privacy statement also being required for any insurer website. Rule 1 also has further implications should an insurance company as a matter of course seek personal data about an applicant from a third party, such

8 [1975] 2 Lloyd’s Rep. 485. In this case, the Court of Appeal “reluctantly” held in favour of the insurer in the context of an policy for “all risks,” because the proposer failed to reveal that her husband had been convicted of receiving stolen goods (McKenna J noting at p.191 that “[s]he is not an underwriter”).

9 See Law Reform Commission, *Report on Spent Convictions* (LRC 84-2007). The Government Legislaton Programme, Autumn Session 2011 (September 2011), available at www.taoiseach.ie, proposes to publish a *Spent Convictions Bill* in 2012. The issue is discussed further below.

10 [1922] KB 364.

11 Case studies are found in the Annual Reports of the Data Protection Commissioner and can be found also at www.dataprivacy.ie.

12 But see *Dunn v Ocean Accident and Guarantee Corporation* (1933) 45 Lloyd’s Rep 276 where concealment of marital status was deemed concealment of a material fact.

13 Case Study 13/2006.

as another insurance company or a database. The documentation provided to the customer must refer to this practice. Clearly, any such reference could convey to a proposer the impression that information held on any database will become known to the insurer and may therefore constitute information that the insurer knows or ought to have known, thus abridging the proposer's duty of disclosure. Rule 1 will also complicate the process of obtaining sensitive personal data – this includes moral hazard issues such as criminal convictions, as well as medical data – because explicit consent to capture and use is the required standard.

1.18 The use and disclosure principle (rule 3) similarly constrains an insurance company in relation to disclosure to other companies (as distinct from disclosure to the IIF): the Code states that disclosure may only be made to "other insurance companies, where this is clearly stated on the application or claim form or in other correspondence with a claimant". Similar situations also arise in the context of rule 6 which provides that an insurer who requests information about a proposer's family history may only use that information in order to underwrite the proposer's application. The information "will not be used in underwriting the application of any third party who is related to the applicant". Clearly one might envisage cases where this principle could cause difficulties where members of the same family seek medical insurance from the same company at different times, and one applicant, perhaps not unreasonably, believes that the insurer has been put on notice about the family medical history. The Code also contains specific provisions that prohibit genetic testing, the prohibition being, in furtherance of s.42(2) of the *Disability Act 2005*; in particular the code provides that should an insurer acquire a genetic test result, the result "must be ignored and not taken account of by the insurer in any way whatsoever. This applies both to positive and negative test results."

1.19 The Code of Practice has not resolved all of the contentious data collection and processing issues that arise in relation to private insurance. Press Reports in recent months[14] relate to a number of instances in which personal data held by the Department of Social Protection has been wrongfully disclosed by a staff member to a private investigator who then in turn sold the data on to insurance companies and other financial institutions. This seems to be a straightforward example of unfair data collection. More difficult issues of law are raised by an industry database, Insurance Link. This database holds data relating to individuals who seek quotations for insurance, even if no cover or claim is obtained. Concerns about the retention of this data and third party access are under investigation by the Office of the Data Protection Commissioner and some practices have been ruled illegal.[15]

(5) Regulatory Overlaps – Consumer Protection Agencies

1.20 National consumer protection agencies have had a role to play in intervening on behalf of consumers for many years. Insurers are of course bound by general principles of contract and tort law and the corpus of Irish consumer protection legislation will apply to service providers, for example Part V of the *Sale of Goods Act and Supply of Services Act 1980.*

1.21 In 2006, the last year in which the Office of the Director of Consumer Affairs was in existence, the Office received 43,142 queries or complaints, of which 1,500 involved the Financial/Insurance sectors.[16] The National Consumer Agency does not provide statistics in this way but the 2008 Annual Report indicated that multi-year insurance plan cover for goods constitutes a source of numerous consumer complaints[17] and that insurance issues in relation to home construction and multi-unit accommodation are very much "live" matters.

1.22 However, the provisions of the *Consumer Protection Act 2007*, which implemented the 2005 EU Unfair Commercial Practices Directive,[18] suggest that the National Consumer Agency (whose

[14] "Social welfare probe over breaches" *Irish Times* December 20, 2010; "Civil Servant investigated over sale of welfare data" *Irish Independent* April 6, 2011.

[15] 'Insurers breached data rules' *Irish Times*, April 27 2011. See Appendix 1, Insurance Link Investigation in the Data Protections Commissioner's *2010 Annual Report* at www.dataprivacy.ie.

[16] 2006 Annual Report, available at www.consumerconnect.ie.

[17] Available at www.consumerconnect.ie.

[18] Directive 2005/29/EC: OJL 149, 11.6.2005.

functions may in the future be merged into a new body incorporating the Competition Authority) will have a significant role to play in the resolution of consumer insurance complaints relating to general practices within the insurance industry. Recital 9 of the 2005 Directive provides that the directive is "without prejudice to Community and national rules on contract law... [f]inancial services and immovable property, by reason of their complexity and inherent serious risks, necessitate detailed requirements, including positive obligations on traders. For this reason, in the field of financial services and immovable property, this directive is without prejudice to the right of Member States to go beyond its provisions to protect the economic interests of consumers". Article 3(9) of the Directive allows Member States to impose requirements that are either more restrictive or prescriptive than those found in the directive. The financial services that were brought within the remit of the *Consumer Protection Act 2007* include services or facilities for insurance, and the 2007 Act goes on to prohibit unfair commercial practices, misleading commercial practices and aggressive commercial practices that are prejudicial to consumers.

(6) Financial Services and consumers

1.23 In introducing to the Oireachtas what became the *Consumer Protection Act 2007* the then Minister for Enterprise, Trade and Employment said that its provisions "add to all sectors of the economy and offer protection to consumers whether they are buying a loaf of bread or taking out a mortgage with the local bank".[19] As the Act went through the Oireachtas it was the subject of amendments to ensure that the jurisdiction to investigate complaints was vested in the Consumer Director of the Financial Services Authority, this being transferred to the Financial Services Ombudsman at a later date. Periodic reviews and investigations by the Financial Regulator into sectors of the insurance industry were seen as an important part of the role of the Financial Regulator as a consumer advocate. In June 2010 investigations into home insurance centred on a few failures to process claim cheques within 10 business days. The Financial Regulator also questioned an increasingly standard practice whereby home insurance providers resort to using an "approved builder" panel to effect home repairs. Both the Financial Regulator and the Consumers Association of Ireland questioned this practice *vis-à-vis* compliance with the Financial Regulator's 2006 *Consumer Protection Code* (since superceded by the *Consumer Protection Code 2012*), transparency requirements and competition law. Problems identified in relation to motor insurance included failures in relation to the statutory renewal timelines and inadequacy of renewal documentation.

1.24 The *Central Bank Reform Act 2010* has vested responsibility for banking and financial services regulation in the Central Bank of Ireland. The Central Bank thus replaces the three previous statutory agencies, the Central Bank, the Financial Services Authority of Ireland and the Financial Regulator. The directorate within the Central Bank of Ireland responsible for Financial Regulation has oversight over six divisions, two of them being insurance supervision and consumer protection. In 2011, the Consumer Protection Division released the findings of a Complaints Handling Inspection in Insurance Firms.[20] The inspection matched up the *Consumer Protection Code* and compliance levels attained within twelve insurance providers. Despite the prescriptive nature of the Code, high levels of non-compliance were found in regard to provision of initial point of contract data to the consumer, information on the Financial Services Ombudsman and rules requiring the acknowledgement of a complaint, in writing within five days of receipt of the complaint.

(7) The Jurisdiction of the Financial Services Ombudsman

1.25 The non-statutory Insurance Ombudsman of Ireland ADR Scheme, operative between 1992 and 2004, was confined to complaints in which the proposer/insured acted "in a private and personal capacity only". While the initial definition of "consumer" in the *Central Bank and Financial Services Authority of Ireland Act 2004* identified a consumer as a natural person not acting in the course of, or in connection with, carrying a business, the 2004 Act contained an enabling provision allowing the Financial Services Ombudsman Council to prescribe persons, or groups of persons to be designated as

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[19] *632 Dáil Debates* Col. 1272. Note Professor Craig Brown's observation that "in a sense all insurance law is about consumer protection", in Brown "Private Insurance and Public Policy: Reconciling Conflicting Principles" (2009) 47 CJBL 267 at 275

[20] Published on 19 April 2011.

consumers. The *Central Bank Act 1942 (Financial Services Ombudsman Council) Regulations 2005* (SI No. 190 of 2005) prescribe two classes of person:

> "(a) a person or group of persons, but not an incorporated body with an annual turnover in excess of 3 million euro. For the avoidance of doubt a group of persons includes partnerships and other unincorporated bodies such as clubs, charities and trusts, not consisting entirely of bodies corporate;
>
> (b) incorporated bodies having an annual turnover of 3 million euro or less in the financial year prior to the year in which the complaint is made to the Ombudsman (provided that such body shall not be a member of a group of companies having a combined turnover greater than the said 3 million euro)."

1.26 The 2005 Regulations also prescribe the maximum amount of compensation that the Financial Services Ombudsman may award: for insurance complaints this is set at €250,000.

1.27 The creation of a statutory agency marked the end of the system of the ADR model of adjudication that the Irish Insurance Federation (IIF) had promoted through their sponsorship of the Office of the Insurance Ombudsman of Ireland. The terms of reference of the Insurance Ombudsman of Ireland, fixed by IIF in 1992, gave the Insurance Ombudsman the right to act as, "counsellor, conciliator or adjudicator" in relation to "complaints, disputes and claims." The Insurance Ombudsman however did not have the right to entertain complaints other than those emanating from natural persons who took out insurance in a private and personal capacity only. The Insurance Ombudsman Scheme had a limitation on certain kinds of matter that could be entertained in a complaint such as a reference that "relates to the rating or underwriting of a risk." Furthermore, the Insurance Ombudsman was required, when adjudicating on the merits of a complaint to:

> "(a) exercise his discretion in a fair and reasonable manner;
>
> (b) have regard to the terms of the insurance contract, these Terms of Reference, all applicable rules of law and relevant judicial authority and general principles of good insurance practice."

1.28 These requirements stand in sharp contrast to the considerations that attend the adjudication powers of the Financial Services Ombudsman. The parameters set by the IIF in these terms of reference were distinctly legalistic, tempered as they were by the requirement to exercise the discretion in a fair and reasonable manner and act by reference to general principles of good insurance practice. Nevertheless, the decisions of the Insurance Ombudsman of Ireland reflect the fact that, in practice, the Insurance Ombudsman demonstrated a significant degree of independence. As the 1999 McDowell Report indicated, the Review Group was satisfied that the structure of the Insurance Ombudsman Scheme – a private company controlled by the Ombudsman Council interacting with the Department of Enterprise, Trade and Employment – was such as to guarantee the independence of the Scheme. Nevertheless, the Review Group opted for a "one-stop shop"[21] statutory financial services ombudsman model rather than retention of the voluntary scheme.

(8) Merger of the Industry ADR Scheme with the Statutory Model

1.29 Although the Insurance Industry lobbied for the Insurance Ombudsman of Ireland ADR model to be retained, the Oireachtas ultimately decided to provide for a statutory complaints procedure under which a new entity, the Financial Services Ombudsman, would mediate, investigate and adjudicate upon a complaint made by an eligible consumer. A degree of continuity was provided in that "the Financial Services Ombudsman shall have regard to the existing Terms of Reference of the Insurance Ombudsman of Ireland for complaints regarding insurance", save when they have been superseded by the 2004 Act.

1.30 Section 16 of the *Central Bank and Financial Services Authority of Ireland Act 2004* amends the *Central Bank Act 1942* by inserting a new Part VIIB into the 1942 Act. While these provisions contain

[21] *Report of the Implementation Advisory Group on the Establishment of a Single Regulatory Authority for the Financial Services Sector* (1999), para. 4.12.

restrictions on the ability of the Ombudsman to hear some complaints, the Ombudsman is directed "as far as possible, [to] try to resolve the complaint by mediation"[22] The Ombudsman must, following investigation of a complaint, make a finding in writing (save where the complaint has been settled or withdrawn) that the complaint is substantiated, in whole or in part, or is not substantiated. Section 57 CL(2) provides that:

> "(2) A complaint may be found to be substantiated or partly substantiated only on one or more of the following grounds:
>
> (a) the conduct complained of was contrary to law;
>
> (b) the conduct complained of was unreasonable, unjust, oppressive or improperly discriminatory in its application to the complainant;
>
> (c) although the conduct complained of was in accordance with a law or an established practice or regulatory standard, the law, practice or standard may be, unreasonable , unjust or oppressive or improperly discriminatory in its application to the complainant;
>
> (d) the conduct complained of was based wholly or partly on an improper motive, an irrelevant ground or an irrelevant consideration;
>
> (e) the conduct complained of was based wholly or partly on a mistake of law or fact;
>
> (f) an explanation for the conduct complained of was not given when it should have been given;
>
> (g) the conduct complained of was otherwise improper."

1.31 For present purposes the most noteworthy of these grounds is (c): the Financial Services Ombudsman may uphold a complaint, notwithstanding that the conduct was compliant with the law, established practice or a regulatory standard, because of the unreasonable, unjust, oppressive or improperly discriminatory impact that the law, practice or standard had on the individual complainant.

1.32 There are signs that even the FSO complaints mechanism is becoming increasingly caught up in litigation. Applications for judicial review[23] and declarations that the Ombudsman has acted *ultra vires* his legislative powers[24] have become a feature of the regulatory landscape, undermining what MacMenamin J, in *Hayes v Financial Services Ombudsman*,[25] described as a legislative model which is "an informal expeditious and independent mechanism for the resolution of complaints. The respondent seeks to resolve issues affecting consumers. He is not engaged in resolving a contract law dispute in the manner in which a court would engage with the issues." In contrast, Hogan J, in *Koczan v Financial Services Ombudsman*[26] seems to have viewed the task of the Financial Services Ombudsman as much more difficult than merely resolving contract disputes: the task "runs well beyond that of the resolution of contract disputes in the manner traditionally performed by the courts… the Ombudsman must, utilising his or her specialist skill and expertise, resolve such complaints according to wider conceptions of *et aegus*

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22 On the mediation requirement, see the discussion of *J & E Davy v Financial Services Ombudsman* [2008] IEHC 256, [2010] IESC 30 in the Commission's *Report on Alternative Dispute Resolution: Mediation and Conciliation* (LRC 98-2010).

23 *J & E Davy v Financial Services Ombudsman* [2008] IEHC 256, [2010] IESC 30; *Square Capital Ltd v Financial Services Ombudsman* [2009] IEHC 407. See "Serious errors in Ombudsman Ruling" *The Irish Times,* 19 November 2011.

24 *Quinn Direct v Financial Services Ombudsman* [2007] IEHC 323, *Caledonian Life v Financial Services Ombudsman* [2010] IEHC 384.

25 High Court, 3 November 2008.

26 [2010] IEHC 407. For a decision in which the High Court effectively ruled on the duty of disclosure in insurance contract law see *FBD Insurance plc v Financial Services Ombudsman* [2011] IEHC 315.

et bono which go beyond the traditional limitations of contract law." The Supreme Court decision in *Davy*[27] does little to resolve this paradox.

C European Union Initiatives on Insurance Regulation

(1) Single Market for Insurance

1.33 The creation of a single European Market for insurance has been on the agenda of the European Union for nearly 50 years. In 1961 the European Commission document, *General Programme on the abolition of restrictions on the freedom of establishment and the freedom to provide services*[28] set as objectives the creation of a single European insurable market by way of the coordination of rules relative to the supervision of insurance companies and insurance contract law rules. An ambitious deadline was set for the end of 1969 but no progress was made on either front. The European Commission however succeeded in pushing through a number of directives that have progressively addressed the supervision and licensing issues. A full consideration of EU insurance regulation lies outside the scope of this Consultation Paper.

1.34 The experience of the European Commission in setting out a harmonisation programme was not a happy one. While the General Programme in 1961 had argued that without harmonisation of insurance contract law a single market could not emerge, to the detriment of the insured and third party beneficiaries, the European Commission approached this topic in the late 1970s with a proposal for a directive in 1979.[29] The explanatory memorandum accompanying the proposal explained the objective of the directive in the following terms:

> "The harmonization of contract law in connection with freedom to provide services and freedom of choice of applicable law has a twofold objective. Firstly, to guarantee the policyholder that whatever the choice of applicable law, he will receive identical protection as regards the essential points of the contract. Secondly, to eliminate as competition factors for undertakings the fundamental differences between national laws."

1.35 The proposed 1970s draft insurance contracts directive did not seek to operate across insurance generally: life and health insurance were excluded, as was MAT insurance and some others. The reaction of the British insurance industry in particular to the proposed directive was generally hostile. Eventually, the proposal was withdrawn in 1993.[30]

1.36 Viewed at this juncture, the proposed directive was a rather curious text. Articles 3 and 4 set out provisions on the duty of disclosure with the insurer's right to terminate for non-disclosure being abridged by provisions in which the insured made a proposal to amend the cover; termination could follow if the policyholder "may be considered to have acted improperly." A duty to notify the insurer of changed circumstances was required, a provision that was difficult to operate in the British or Irish context where policies are concluded annually and where the duty of disclosure is normally spent when cover commences. Most controversially of all, the draft directive provided that if a claim arises before the amendment or termination of the contract, "the insurer shall be liable to provide any such cover as is in accordance with the ratio paid between the premium paid and the premium that the policyholder should have paid if he had declared the risk correctly." Other provisions in the proposal dealt with the return of unjustified payments, premium reductions in the event of risk reduction, contract termination and third party beneficiaries.

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[27] *J & E Davy v Financial Services Ombudsman* [2008] IEHC 256, [2010] IESC 30. The case is essentially a judicial review decision. The UK literature on the UK FOS also points to how the merger of Judicial Review provision with complex private and commercial law issues is "sub-optimal": Morris, "The Intersection of Commercial Powers and Complaints" [2009] LMCLQ 344 at 365.

[28] O.J. No. 2, 15.1.1962 pp.36-62.

[29] Proposal for a Council Directive on the coordination of laws, regulations and administrative provisions relating to insurance contracts. O.J. 1979 No.C 190/2 as amended by a later text at O.J. 1980, No. C355/30.

[30] O.J. 1993, No. C 228/4.

(2) Adverse comments on the proposed insurance contracts directive – the Law Commission for England and Wales

1.37 The English Law Commission subjected the draft insurance contracts directive to a devastating critique in its 1980 Report, *Insurance Law: Non Disclosure and Breach of Warranty.*[31] At the onset of the Report the Law Commission said that it saw the proposed directive as doing little or nothing to repair existing defects in English law in relation to the duty of disclosure and breach of warranty. The draft directive was said to involve the creation of "complex machinery" that would engender uncertainty and perhaps allow insurers to use their superior bargaining position in a manner adverse to the interests of the insured. The Law Commission also considered that if the draft directive was to be adopted English law would be frozen indefinitely in an unsatisfactory state.[32] More detailed criticisms related to the proportionality principle in Article 3 insofar as the Commission saw the principle affording no guidance on how calculations were to be made, and that the principle raised difficult issues of proof in relation to the notional premium.[33] The provisions in Articles 4 to 6 (which related to adjustment to the terms of the contract due to changes in circumstances) were also attacked on the basis that they were riddled with ambiguity, were unfamiliar to the common law tradition and "inappropriate to English law and practice."[34]

1.38 When viewed even at this distance the criticisms in the Law Commission Report retain some degree of force, particularly in relation to the details found in Articles 4 to 6 of the draft directive. While the draft directive did not address some of the issues that were of concern to those who saw English law as defective – for example breach of warranty and causation problems – the Law Commission can be itself criticised for overstating the chilling effect that adoption of the draft directive would have had on the wider task of securing insurance contract law reform in England and Wales. More significantly still, the attack on the proportionality principle[35] raised issues of definition and operational complexity without, it may be argued, the Law Commission dealing adequately with the arguments of some supporters of the directive who felt that the Commissioners were exaggerating those practical difficulties[36] and pointed out that the courts had experience of making similar decisions or adjustments in other situations. As discussed below, in the more recent studies and reports the English and Scottish Law Commissions have recommended the use of proportionality, sweeping aside the views of the Law Commission from 1980 on this point rather unceremoniously.

(3) Recent European Developments

1.39 A significant amount of academic literature on this subject[37] suggests that the European dimension to the insurance contact law reform debate should not be underestimated. Market conditions demonstrate that while insurance products in Member States are generally sold by multinationals, through branches or subsidiary companies established in each jurisdiction for those purposes, there is said to be a significant body of support by insurers and purchasers for cross border insurance services. Several of these enthusiasts for a more integrated European insurance market point to the increasing number of "euro-mobile citizens" who move to and live in Member States other than their country of birth and who cannot easily bring their insurance cover with them in many instances. On the supply side the jurisdiction-specific nature of insurance products means that there is no internal market, with anti

[31] Law Com No. 104.

[32] Para 1.21.

[33] Paras 4.2 to 4.31.

[34] Paras 5.1 to 5.18.

[35] The Law Commission, in the 1979 Working Paper had already voiced objections to the proportionality principle.

[36] See para 4.16 of Law Com No.104.

[37] Eg. Basedow "The Case for a European Contract Act" [2001] JBL 569; Basedow "Insurance Contract Law as Part of an Optional European Contract Act" [2003] LMCLQ; Rühl "Common Law, Civil Law, and the Single European Market for insurances" (2006) 55 ICLQ 879; Clarke & Heiss "Towards a European Contract Law? Recent Developments in Brussels" [2006] JBL 600.

competitive consequences and purchasers being denied new or innovative insurance products and services. The conventional wisdom is that the rules of private international law are incapable of providing a satisfactory solution to this situation.

1.40 The insurance directives themselves provide that the applicable law is the place where the consumer has his or her habitual residence.[38] This situation has recently been reaffirmed in Regulation EC No. 593/2008 on the law applicable to contractual obligations ("Rome I"), which provides specific rules on choice of law in insurance contracts, but in relation to most mass insurance contracts[39] the applicable law will generally be the law of the country where the policy holder has his or her habitual residence.[40] It is also to be expected that any litigation will take place in the courts situated in the place where the policyholder will be habitually resident because Council Regulation (EC) No. 44/2001 ("Brussels I") provides that an insurer may be sued by the policyholder, insured or beneficiary "in the courts or the place where the plaintiff is domiciled." These rules on choice of law and jurisdiction make it very difficult for an insurance product supplier to trade abroad other than through subsidiary companies or branch offices; those companies or offices may be expected to know and comply with national insurance contract rules, whereas a parent company cannot reasonably be familiar with such contract rules (most of which are mandatory) in a multiplicity of countries. Basedow and others[41] have pointed out that the solution does not lie in allowing the parties to select the law of the insurer's domicile as the applicable law. The Principles of European Insurance Contract Law (PEICL) explain why such an approach would be both undesirable in policy terms and ineffective from a competition law perspective:

> "the argument turns out to be mistaken. First of all, the approach would deprive the policyholder of protection by private international law which appears not to be acceptable as a matter of legal policy. Secondly, the shift mentioned in the rules of private international law would be followed by a switch in behaviour on the part of insurers and policyholders. Whereas under the current private international law regime it is chiefly the insurer who hesitates to provide cross-border services it would be the policyholder who would be reluctant to acquire foreign insurance products in the absence of private international legal protection. The internal market would remain incomplete."[42]

1.41 The European Commission's Action Plan[43] has singled out insurance contract law as a critical area in need of reform, arguing that in the absence of harmonised contract rules, mandatory laws formulated on a jurisdiction-specific basis means that "firms are unable to offer, or are deterred from offering, financial services across borders, because products are designed in accordance with local legal requirements,"[44] the Commission stressing that these problems are especially problematic in relation to insurance contracts.[45] The European Commission Action Plan was followed by the opinion of the European Economic and Social Committee (EESC) on the European Insurance contract.[46] In the EESC, after drawing attention to a wide body of opinion (including the European Federation of National Insurance Associations which opined that diversity of national insurance contract law "acts as a brake on the development of cross border transactions in the insurance sector") the EESC called for the full

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38 See Second Council Directive 88/357/EEC, article 7(a) (non life) and Directive 2002/83/EEC, articles 1(1)(g) and 32(1).

39 Article 7.

40 In the case of life assurance it is the law of the Member State of which the policyholder is a national.

41 See the introductory remarks to *Principles of European Insurance Contract Law* (Sellier) (2009) at paragraph 16.

42 Heiss, Introduction to *Principles of European Insurance Contract Law* (Sellier, 2009).

43 *A More Coherent European Contract Law – An Action Plan.* Com (2003) 68 final, p. 47.

44 Com (2003) final, p.47.

45 Com (2003) Final, p.48.

46 CESC 1626/2004, (Rapporteur Pegado Liz).

harmonisation of insurance contract law rules on a staged basis.[47] The first stage of this process, it was suggested, would address:

(a) pre-contractual duties, mainly information;

(b) formation of the contract;

(c) insurance policy, nature, effects and formal requirements;

(d) duration of the contract, renewal and termination;

(e) insurance intermediaries;

(f) aggravation of risk;

(g) insurance premium;

(h) insurance on account of third party.

1.42 The conclusions and recommendations reached by the EESC included a reference to unanimity of views by all interested parties and a need for gradual harmonisation, to take account of the Commission's 1979-80 proposed Directive.[48]

(4) The Restatement of European Insurance Contract Law – The Project Group

1.43 The task of formulating the rules that will seek to harmonise European insurance contract law has fallen to the Project Group entitled *Restatement of European Insurance Contract Law*. This group of academics, each with considerable expertise in insurance contract law, has been active since 1999 and, in 2005, the Project Group was included in the European Commission sponsored Network of Excellence on European Contract Law (CoPECL). As two of the leading lights in the Project Group have acknowledged,[49] the Project Group has followed the EESC suggestion that harmonisation of the General Part of Insurance Contract Law is to be a starting point, the focus being on mandatory rules for use in mass-risk insurances. However,[50] the Principles of European Insurance Contract Law (PEICL)[51] that have emerged are envisaged as a semi-mandatory code that may serve the parties to an insurance contract as an optional instrument, a 28th regime of insurance contract law in Europe. The Project Group however see the PEICL as mandatory in the sense that, once selected, the PEICL provides all the relevant contractual rules: the parties are not to be free to cherry-pick individual rules. The Project Group explain some of the advantages of an optional instrument thus:

> "An optional instrument would allow parties to conclude their contract on the basis of European law instead of national law. This option would offer advantages particularly to "multiple players", such as entrepreneurs doing business in the European internal market, who would not have to be concerned with the impact of diverging national contract law regimes on their transactions. The costs of legal research and adaptation of the contract to each national system of contract law would disappear. Moreover, an optional instrument would allow for efficient cross-border use of the Internet in order to sell standard policies. For euro-mobile policyholders an optional instrument would provide a stable contractual framework that is not subject to the changing national law of their domiciles."[52]

1.44 The Commission has found the work of the Project Group to be of considerable assistance in elaborating proposals in this Consultation Paper on how Irish law should be reformed. Some of the provisional recommendations are based on the PEICL but the Commission is conscious of the need to

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47 CESC 1626/2004, para. 6.3.1.

48 CESC 1626/2004, para 7.5.

49 Clarke & Heiss, "Towards a European Contract Law? Recent Developments in Brussels" [2006] JBL 600 at 602.

50 *Ibid.*

51 Sellier, 2009.

52 *Ibid,* para 135.

strike a balance between recommending a radical reform of insurance contract law and adjusting some outmoded or inappropriate contract rules that are unfair or do not reflect contemporary market practices.

1.45 The work of the Project Group is based on an appreciation that the way forward can best be chartered through comparative research into substantive law rules developed by national parliaments and national courts. In one recent comparative study of German and English law, Giesela Rühl argued that the "common law and civil law are in fact not as far apart from another as is commonly assumed." [53] Rühl suggests that while German law and English law have significantly different formal rules[54] on essential matters such as the duty of disclosure, the role of causation in relation to the insurer's ability to avoid the contract, as well as the effect of non-disclosure, in practice these differences do not lead to radically different results for the insured. Her argument turns upon the ability and or willingness of the English judiciary, and the adjudications of the Financial Ombudsman Service (often using good practice guidelines) to temper the more extreme results of the common law and the *Marine Insurance Act 1906*.

1.46 The difficulty with this approach is immediately apparent if one were required to apply English case law.[55] Decisions that favour the insured/proposer may just as easily be contrasted with decisions that go the other way.[56] While Rühl is not suggesting that formal or theoretical differences do not matter – on the contrary, she puts forward the view that English practical results, especially in consumer insurance cases make harmonisation of English rules in line with German law less problematical than is generally thought – her study serves to underline a number of points. Firstly, the contrast between German law and English formal rules is stark. Rühl in particular characterises English law as having (to a civil lawyer) "a perceived consumer – hostile attitude" that stands as "a major obstacle towards more unity in the law of insurance contracts".[57]

1.47 Secondly, on some of the differences that exist as between English law and German law, the Irish position is in some respects closer to German law – the deemed knowledge provisions that emerge from English case-law stand in sharp- contrast to recent Irish decisions and McCarthy J's observation in *Aro Road and Land Vehicle Ltd v Insurance Corporation of Ireland*[58] that good faith in the context of disclosure "requires candour and disclosure, not, I think accuracy in itself, but a genuine effort to achieve the same using all reasonably available resources."

1.48 Thirdly, Rühl's very insightful analysis points up the level of the difficulty facing any insurance contract law reformer. Is the task one in which efforts are to be made to minimise the differences between (formal) rules and (informal) custom and practice? Which set of norms is to be dispositive? Can covert methods such as judicial subversion of an inappropriate rule ever to be an acceptable substitute for legislative action to reform substantive law rules?

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53 Rühl, "Common Law, Civil Law, and the Single European Market for insurances" (2006) 55 ICLQ 879 at 910.

54 Specific examples given by Rühl include the duty of a proposer to disclose facts known to the proposer and facts deemed to be known (English law) whereas German law only requires disclosure of facts actually known. The same more benign approach to remedies is cited by Rühl, favouring the German view: this includes the freedom of the insurer to avoid the contract for non-disclosure regardless of degrees of fault (English law) whereas the availability of remedies may turn on the dishonesty, negligence or innocence of the proposer in German law.

55 Eg on promissory warranties Rühl cites *contra proferens* interpretation as a check on unfair promissory warranties, citing inter alia *Provincial Insurance Co v Morgan* [1933] AC 240. This view may overestimate the importance of *contra proferens* interpretation. Contrast *Dawsons Ltd v Bonnin* [1922] 2 AC 413 with the *Morgan* case and *Hales v Reliance Fire and Accident* [1960] 2 Lloyd's Rep 391.

56 The conclusion reached at (2006) 55 ICLQ 879 at 899-900 on non-disclosure, that in practice, differences between German law and English law "do not actually exist" is far too general.

57 Rühl, "Common Law, Civil Law, and the Single European Market for Insurances" (2006)55 ICLQ 879 at 880.

58 [1986] IR 403, citing Fletcher Moulton LJ in *Joel v Law Union & Crown Insurance* [1908] 2 KB 863 at 885. An earlier example can be found in Palles B's judgment in *Gorman v The Hand in Hand Insurance Company* (1877) 11 IRCL 224 articulating a rule of reasonable construction, difficult to reconcile with temporal restrictions on cover via warranties.

1.49 Before leaving the general issue of how European law and developments within the EU may impact on insurance law and practice in Ireland, it is useful to note that the ECJ may, from time to time, provide rulings that will constrain the freedom of "the Market" to set contractual terms. The highly controversial 2011 decision of the Court in *Association Belge des Consommateurs Test-Achats ASBL v Charles Basselier*[59] makes it clear that even if actuarial factors can justify using gender as a basis for fixing a premium, Community law may invalidate such practices. The narrow view of this case is that a limited derogation in Belgian legislation was incompatible with the principle of equality as between men and women on the basis that the derogation permitted in Directive 2004/113/EC was transitional whereas the Belgian legislation was unlimited in duration. The opinion of Advocate General Kokott addressed wider concerns, highlighting the fact that society will not permit differential premiums to be charged in relation to race, even if actuarial or statistical data would justify such distinctions from being drawn. As insurance involves a system whereby risks are pooled with the consequence that the unfit or unhealthy are subsidised in relation to health insurance by the rest of the population, public policy requires a general shift towards unisex premiums in certain categories of insurance. These issues were explored by the United States Supreme Court in their landmark 1978 decision in *City of Los Angeles Department of Water and Power v Manhart*[60] :this decision broadly corresponds with the same process of reasoning and outcome demonstrated by the ECJ in its 2011 *Charles Basselier* decision.

D New Legal Norms and forms of Dispute Resolution

(1) The adjudications of the Insurance Ombudsman 1992-1998

1.50 Between 1992 and 1998, the then Insurance Ombudsman of Ireland, Paulyn Marrinan Quinn, produced a number of adjudications and settlements that provide extremely valuable insights into how an effective system of alternative dispute resolution may be allowed to develop outside of the court system. In the collected decisions for the period in question, the Ombudsman (while noting that the method of dispute resolution adopted by her office was inquisitorial in nature) stressed that the results of the Insurance Ombudsman's adjudications are to be "fair and reasonable in the circumstances."[61] However, the Insurance Ombudsman also placed an emphasis on the need to ensure that:

> "like cases should be treated as alike and be determined on similar principles. Consistency is exercising judgment and discretion has been my stated aim, from the onset, and of course, this requires awareness of previous decisions as well as the development of the principles, practices and jurisprudence over time".[62]

1.51 It is clear that in developing this jurisprudence, the Insurance Ombudsman was in many situations being guided by the decisions of the High Court and Supreme Court, with decisions such as *Kelleher, Aro Road* and *Fagan* being cited and applied insofar as judicial statements could provide guidance to the Insurance Ombudsman. References to Principles of Good Insurance Practice also informed many of the adjudications (and settlements) made during this period. It appears to the Commission that the jurisprudence of the Insurance Ombudsman in this six year period strikes a very good balance between the traditional approach taken by the courts to issues of pre contractual disclosure and information gathering exercises, and the more nuanced requirements of consumer protection principles.

1.52 While the details of the more important adjudications of the Insurance Ombudsman will be considered more fully later in this Consultation Paper, the Commission would like to make the following observations on how the Insurance Ombudsman applied the relevant legal principles in the 1992-1998 period:

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[59] Case C-236/09, judgment of 1 March 2011.

[60] 435 US 702 (1998). The Supreme Court struck down contribution differentials in an employee pension plan requiring female workers to contribute more towards retirement on the basis that female employees enjoyed grater longevity and thus cost the pension fund more than in the case of male workers.

[61] Insurance Ombudsman of Ireland Digest of Cases 1992-1998 ("Digest").

[62] See Mission Statement at p.v of Digest.

- In relation to non-disclosure disputes where material facts were withheld or a pre-existing condition was not disclosed, the Insurance Ombudsman frequently upheld the insurer's right to repudiate the contract.[63] There were decisions however which reflect the view that if a proposal form does not ask a question about a medical condition *vis-á-vis* critical illness cover, the insurer may be deemed to have dispensed with the need of the proposer to volunteer other information.[64] Decisions on what is a material fact also incline towards the view that the test is what a reasonable insured would consider to be material, in situations where no proposal form is used.[65]
- Situations in which the duty to disclose was not explained to a proposer, contrary to the relevant code of practice, generally led to a finding against the insurer, especially if there was some additional factor present such as the policy being a poor match for the needs of the proposer.[66]
- In some non disclosure decisions the fact that the proposer failed to disclose a material fact, inadvertently or innocently, led to the claim being upheld,[67] or the application of proportionality,[68] or a recommendation that an *ex gratia* payment be made.[69]
- Where there were instances of non-disclosure, the fact that there was no causal link between the facts not disclosed and the risk that materialised did not prevent the insurer from having a right to avoid the policy.[70]
- The decisions of the Insurance Ombudsman on misrepresentation (as well as non disclosure of material facts) tended to follow the same patterns as in the non disclosure cases. In the case of an innocent misrepresentation as to the age of an insured, the insurer was held not to be entitled to repudiate the policy because a proportionality remedy was actually contained in the policy.[71] While the Insurance Ombudsman clearly distinguished cases of non disclosure from those of misrepresentation,[72] the insurer was often restricted to a proportionality remedy where the misrepresentation was not fraudulent.[73]
- In relation to promissory warranties, cases involving the failure to maintain security measures tended to lead to a finding that the warranty, if not strictly observed, would allow the insurer to refuse to meet the claim.[74]
- The Case Studies reveal also that the Insurance Ombudsman often found against the insurer on the basis that some contractual practices were unsatisfactory (eg exclusions were not communicated clearly)[75] and that rights to avoid had been waived.[76]

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63 Case studies 47, 49, 154, 155 and 159.

64 Case studies 15, 16 and 158.

65 Case Studies 157 and 158.

66 Case Studies 41, 42, 44 and 50.

67 Case study 76.

68 Case Studies 49 and 99.

69 Case Study 50.

70 Case Studies 48 and 49.

71 Case Study 81.

72 Case Studies 49, 80 and 157.

73 Case Study 56. See also Case Study 155.

74 Case Studies 88 and 89.

75 Eg Case Studies 65 and 87.

76 Case Studies 58 and 85.

(2) Decisions of the Financial Services Ombudsman

1.53 Since 2005, the Financial Services Ombudsman has exercised the statutory jurisdiction to adjudicate on complaints made to his Office. While the decisions handed down in this period reflect many of the same approaches to legal issues that are evident in the adjudications of the Insurance Ombudsman, the summaries provided by the Financial Services Ombudsman suggest a more *ad hoc* approach has been taken in resolving complaints. The Financial Services Ombudsman has stressed the duty of disclosure and the need for proposers to avoid making misrepresentations as "fundamental principles of insurance"[77] and has also found against proposers for a failure to carefully read documentation unless mitigating factors are present.[78] The insurer who finds that his agents do not ask for information from proposers that is sought in a proposal form may have an award made against the insurer while being able to avoid payment of the sum insured.[79] "Proportionality" awards may be given, although such an award sometimes looks more like an award of a "fair and reasonable" amount rather than proportionality in the strict sense of being an informed decision on what the premium should have been had the true facts been known or disclosed.[80] The decisions in *Aro Road* and *Kelleher* have been cited and have been extended into business to business insurance providing group cover to employees[81] but those two court decisions were distinguished on the facts and a waiver of rights was held not to have occurred. In this decision the Financial Services Ombudsman wrote that:

> "All complaints received by the Ombudsman are unique and each is considered on its own merits having regard to the particular facts of the complaint."

1.54 This view, which reflects the statutory basis of the Financial Services Ombudsman's jurisdiction, stands in contrast to the more 'judicial' approach of the first Insurance Ombudsman, Paulyn Marrinan Quinn, who stressed a need for consistency in decision making.

(3) The failure to legislate

1.55 The 1976 *Final Report of the Committee of Inquiry into the Insurance Industry*[82] provided the basis for legislative adjustments to insurance law in the form of the *Insurance Act 1989*. While the 1989 Act addressed many of the concerns raised by the Committee of Inquiry (eg the supervision of insurers, payment of commissions, the regulation of intermediaries) the failure of the 1989 Act to address all of the concerns of the Committee of Inquiry in relation to consumer protection is a matter of some regret. The Committee pointed to a need for legislation to provide for full disclosure to be made in relation to disclosure and warranties, but the Oireachtas was content to provide for a power to prescribe codes of conduct. Section 61 of the 1989 Act provides:

> "Where the Minister [for Finance][83] considers it necessary in the public interest and following consultation with the insurance industry and consumer representatives, he may by order prescribe codes of conduct to be observed by undertakings in their dealings with proposers of policies of insurance and policyholders renewing policies of insurance in respect of duty of disclosure and warranties."

1.56 Voluntary codes of conduct evolved through an understanding reached between the Government and the Industry and these codes have proved effective in dissuading various governments

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77 December 2009 Complaints, pages 24-25; July 2009 Complaints, pages 24-26.

78 See June 2007 Complaints, case 11.

79 November 2008 Complaints, pages 13-14.

80 December 2008 Complaints, pages 16-17.

81 July to December 2007 Complaints, No. 20.

82 Sometimes described as the O'Donoghue Report (Prl. 5530 published in March 1976).

83 When the *Insurance Act 1989* was enacted, the regulation of insurance undertakings generally had been the responsibility of the Minister for Industry and Commerce (now known as the Minister for Jobs, Enterprise and Innovation). The functions under the 1989 Act have since been transferred to the Minister for Finance, who also has responsibility at Government level for the regulation of other financial services undertakings.

from using the section 61 power. However, the precise status of these codes of practice remains uncertain and it has been pointed out by Buckley[84] that the Circuit Court decision in *CB Justice v St Paul Ireland*[85] undermined these codes in a fundamental way. Here the insurer was held to be able to rely on a proposer's breach of warranty even though the non fraudulent breach of warranty had no link with the loss; the code indicated that an insurer would not repudiate a policy in such circumstances. Buckley is scathing in his criticisms of the Oireachtas:

> "a Code of Conduct, or Statement of Self-Regulatory practice, is not a substitute for reform of the law. The need for reform is confirmed by the very existence of the Code and by the recent repudiation of it in open court by a major insurer. Why should a Code of Conduct or a Statement of Insurance Practice be a substitute for legislation rather than a supplement to it? If Insurers are prepared, under threat of legislation, to adopt a Code of Conduct that substantially replicates in unenforceable form the broad principles which might have been enacted, why are they so concerned with avoiding statutory legislation? Why should the Code be restricted to policies effected by persons in their private capacity only? Why should not the principle of utmost good faith and its associated duty of disclosure be abolished and allow legislation to place the onus on insurers to prove fraudulent misrepresentation or fraudulent non-disclosure in those cases they wish to repudiate?"[86]

E The need for contract law reform

(1) Sources of new rules

1.57 The Chapters that follow provide an overview of how Irish insurance contract law is currently structured, particular attention being paid to the duty of disclosure, insurable interest, misrepresentation, warranties and basis of contract clauses, as well as the duty of good faith and third party issues. The Commission's general conclusion is that the present rules, which have built up around the specialised area of marine insurance and have been extended horizontally by judicial pronouncements, are unsuitable to consumer insurance and most forms of mass market business to business insurance in the 21st Century. The Commission notes in particular that the Irish judiciary has been generally extremely critical of what may be described as less that rigorous business practices in dealings with proposers, and have adopted a pro-insured position *vis-à-vis* disclosure, misrepresentations and warranties. Indeed, many of the provisional recommendations made in this Consultation Paper have been prompted by the need for Irish statute law to more closely reflect judicial attitudes on these issues. In addition, the impact of the decisions of the regulatory agencies that have been discussed earlier in this Chapter require some adjustment of contract law if a diverse range of legitimate interests – from privacy and equality concerns, consumer protection and the need to ensure that the law meets the reasonable expectations of business proposers – are to be realised.

1.58 Particular emphasis will be placed on legislative developments and reform proposals in other countries, particularly, where the common law tradition has shaped insurance law. Wider European considerations and the work of the Project Group, in the form of the Principles of European Insurance Contract Law (PEICL), will also be highly relevant. The Commission also believes that the way in which general contract law has evolved provides considerable room for manoeuvring insurance contract rules into alignment with 'ordinary' contract law principles and remedies. At the same time, the Commission seeks to build upon values such as transparency and fairness, as encapsulated in the principle of

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84 Buckely *Insurance Law in Ireland* 2nd ed (Oak Tree Press 2002) at para 3-75 to 3-77.

85 Circuit Court Record No. 008024/2003, 25 November 2004.

86 Buckley, para 1-19. See also by the same author, Buckley, "Insurers' Self Regulation does not work" [2005] CLP 10. The Association of British Insurers (www.abi.org.uk) continues to produce Codes and Guidance Notes on General Insurance, Life and Savings, and Health and Protection Insurances. For businesses, a *Contract Certainty Code of Practice* (2007) is available but "the code is not compulsory, as that may breach competition law." There are some very helpful statements on certainty of terms and formalities requirements that could be built upon in any future legislative text although there is little assistance on non disclosure, warranties etc.

uberrima fidei, regulatory requirements under Irish financial services regulation, and best practice requirements as they have developed with the Irish Insurance industry.

(2) Reform Proposals in the United Kingdom – support for legislative changes

1.59 While the issue of insurance contract law reform has been under review in the United Kingdom since 1954, it is a remarkable fact that until 2011 no Bill had been presented to Parliament by any Government. The Law Reform Committee, following its appointment in 1954, expressed a general view that legislative intervention to improve the position of insureds constituted an interference with freedom of contract but the Committee still felt able to recommend that the duty of disclosure should be adjusted to replace the prudent insurer test of materiality with a reasonable insured test. The Committee also suggested that warranties of fact should not be allowed to be effective when a proposer was able to show that any misstatement made was true to the best of his knowledge and belief. When the Law Commission of England and Wales revisited these matters in 1980 the arguments by the insurance industry favouring self regulation via statements of practice were swept aside on the ground that the duty of disclosure was unfair and that statements of practice lack the force of law. “Basis of contract” clauses and warranties of fact set out in proposal forms were also the subject of recommendations that would have reduced the insurer’s rights to avoid policies. It is particularly interesting to note that in its 1980 Report the Law Commission specifically rejected the arguments that any reforms should be limited to consumer insurance.

1.60 In the period between January 2006 and December 2009, the Law Commissions of England and Wales, and of Scotland, have issued a number of documents, a scoping paper, Issues Papers, and a Consultation Paper with summaries of responses thereto, and, most recently, a final report and draft bill. These documents have ultimately led the Law Commissions to reformulate both their agenda and reform timetable and several of their initial legislative proposals. In particular, the Final Report sets out a rather modest number of measures that are confined to the consumer insurance duty of disclosure, remedies for misrepresentation and basis of contract clauses. Nevertheless, the Law Commissions have remained consistent in arguing for legislative reform of insurance contract law on the basis that:

- the law should be brought into line with both the Financial Ombudsman Service decisions and industry practice which requires an insurer to have asked clear questions before the insurer may avoid a policy for non-disclosure; indeed the Law Commissions go so far as to recommend the abolition of the residual duty of disclosure in consumer insurance;
- codification of best practice would simplify the law and improve consumer confidence in the insurance industry
- reform should also seek to align the position of small businesses with the reform proposals outlined in relation to consumer insurance;
- proposed reforms should include revision of the right of an insurer to avoid policies on the basis of misrepresentation and breach of warranty, with an insurer’s rights of avoidance being replaced in certain instances by financial remedies;
- in cases of fraud however, the position of an insurer should remain as it currently is.

1.61 In 2011, the UK Government introduced into the House of Lords the *Consumer Insurance (Disclosure and Representations) Bill 2011*. This Bill is to be processed by reference to the speedy procedures available in respect of non controversial Bills that involve implementation of Law Commission proposals. The Bill is the first legislative text to emerge from a detailed and schematic set of insurance contract law topics that have been the subject of issues papers and consultations. These include subjects relating in particular to sections 22 and 53 of the *Marine Insurance Act 1906* as well as general topics such as insurable interest, the insured’s post-contract duty of good faith, damages for late payment and warranties.[87] In this Consultation Paper the Commission seeks to provide a set of reform proposals that will cover many of the topics that have occupied the English and Scottish Law Commissions.

87 At the time of writing (November 2011), the Committee Stage in the House of Lords had been held on 19 October 2011, and the Report Stage in the House of Lords was scheduled for 20 December 2011.

(3) The Financial Regulator – consumer protection code

1.62 The Commission is of the view that the Financial Regulator, in the revised *Consumer Protection Code 2012*,[88]which takes effect from 1 January 2012, has provided the basis for a new set of principles that should inform the way in which Irish contract is reformed.[89]

1.63 It is important to stress that the Financial Regulator's *Consumer Protection Code 2012* applies to all regulated entities and that the content of Chapter 2 of the Code, entitled General Principles, operates horizontally across the financial services sector: specifically, Chapter 2 applies to all customers and not just consumers. The 12 General Principles include two principles that the Commission considers to be highly relevant in framing any recommendations for reform.

- Rule 2.5 provides a regulated entity "seeks from its customers information relevant to the product or service requested."
- Rule 2.6 requires that a regulated entity "makes full disclosure of all relevant material information, including all charges, in a way that seeks to inform the customer."

1.64 Furthermore, the *Consumer Protection Code 2012* contains detailed rules on disclosure, formalities, and claims processing.

F Conclusions and Provisional Recommendations

1.65 Bearing in mind these developments, the Commission has concluded that regulatory bodies (in particular the Financial Regulator and the National Consumer Agency) who currently have statutory responsibilities in connection with the insurance industry should continue to liaise with each other, and with representatives of the insurance industry, in order to develop comprehensive statutory Codes of Practice setting out standards of best practice, building on the best practice standards developed by the Irish Insurance Federation and on the statutory model of the Financial Regulator's *Consumer Protection Code 2012*. The Commission has also concluded that these statutory Codes of Practice should form the basis for the content of insurance contracts.

1.66 The Commission has also concluded, consistently with the approach in its *Interim Report on Personal Debt Management and Debt Enforcement*,[90] that legislation should provide that in any litigation or other dispute resolution process statutory Codes of Practice setting out standards of best practice should be admissible in evidence; and that, if any provision of such Code is relevant to a question arising in the litigation or other dispute resolution process, the provision may be taken into account in determining that question, but that this would be without prejudice to the substantive rights between the parties.

1.67 The Commission has also concluded that the legislative framework being proposed in this Consultation Paper should, in general, apply to consumers as defined for the purposes of the jurisdiction of the Financial Services Ombudsman, namely natural persons and businesses with an annual turnover not exceeding €3 million.

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[88] The *Consumer Protection Code 2012* (which was published in October 2011 after a significant public consultation process) is more detailed than the previous *Consumer Protection Code* published in 2006. This reflects the move from "principles only" ("light touch") to "principles and rules" regulation since 2008. The Code was issued under the following statutory powers: (a) section 117 of the *Central Bank Act 1989*; (b) sections 23 and 37 of the *Investment Intermediaries Act 1995*; (c) section 8H of the *Consumer Credit Act 1995*; and (d) section 61 of the *Insurance Act 1989*. The *Consumer Protection Code 2012* is available at http://www.centralbank.ie/regulation/processes/consumer-protection-code/Documents/Consumer%20Protection%20Code%202012.pdf.

[89] It is important to see the Code in a broader international context. The International Association of Insurance Supervisors (IAIS) (www.iaisweb.org) is the worldwide representative body for insurance regulators and supervisors. IAIS has a number of regulatory and standards based codes, perhaps the most pertinent being the 2003 *Principles for the Conduct of Insurance Business.* The Central Bank of Ireland is an IAIS Member.

[90] *Interim Report on Personal Debt Management and Debt Enforcement* (LRC 96-2010), paragraphs 2.48-2.57.

1.68 The Commission provisionally recommends that regulatory bodies (in particular the Financial Regulator and the National Consumer Agency) who currently have statutory responsibilities in connection with the insurance industry should continue to liaise with each other, and with representatives of the insurance industry, in order to develop comprehensive statutory Codes of Practice setting out standards of best practice, building on the best practice standards developed by the Irish Insurance Federation and on the statutory model of the Financial Regulator's Consumer Protection Code 2012. The Commission also provisionally recommends that these statutory Codes of Practice should form the basis for the content of insurance contracts.

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CHAPTER 2 INSURABLE INTEREST

A Introduction

2.01 In this Chapter, the Commission notes that although Irish common law did not require an insurable interest to be present for a contract of insurance to be enforceable, subsequent statutory developments aimed at counteracting fraud, gambling and criminal destruction of lives and property did. Thus, while the common law did not distinguish a contract of insurance from other kinds of transaction that revolved around contingent events, in particular wagers that concerned the question about how long an individual would live,[1] Parliament intervened in order to discourage gaming as a socially and morally destructive activity in the *Life Assurance Act 1774*,[2] which was applied to Ireland by the *Life Insurance (Ireland) Act 1866*.[3] However, the 1866 Act is ambiguous in terms of its scope of application and there is a clear line of authority in Ireland holding that the 1774 Act does not apply in relation to the sale of goods and that the Act does not apply to fire insurance – indeed, the 1774 Act is confined to life assurance.[4] If this is correct then the statutory rule that the contract of insurance requires the person on whose account the contract is made to have an interest[5] will not prevent such a contract from being enforceable. While legislation in the form of the 1774 Act, the *Gaming Act 1845* and section 36 of the *Gaming and Lotteries Act 1956* render wagering contracts void, it does not follow that a contract involving insurance, for which no insurable interest can be shown, is a gaming or wagering contract. Section 3 of the 1774 Act and the indemnity principle in indemnity insurance require the claimant in an insurance contract to prove a loss. The loss recoverable under the policy is correlated to that loss, although this is not so in the case of contingency insurance, as distinct from indemnity insurance.[6] This chapter is concerned with the nature of the insurable interest test, whether the test should be reformed and/or the requirement abolished altogether.

2.02 The purpose of property insurance is to shift the risk of loss from the insured to the insurer. It is, therefore, axiomatic that the insurer should only be liable to indemnify the insured for the loss suffered.[7] Superimposed on this principle of indemnity is the requirement of insurable interest. This produces the result that two apparently separate and distinct fundamental principles of insurance law are harnessed in order to serve one objective, namely, to determine the existence and scope of liability of the insurer for the loss suffered.

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1 *Earl of March v Pigot* (1771) 5 Burr. 2802; *British Commercial Insurance Company v Magee* (1834) Cooke & Alcock 182. On the history of gaming see Langford, *A Polite and Commercial People* (OUP, 1992); on life insurance see Clark, *Betting on Lives: the Culture of Life Insurance in England 1695-1775* (MUP, 1999).

2 14 Geo 3,, c.48. The *Statute Law Revision Act 2007* retained the 1774 Act in force.

3 29 & 30 Vict., c.42. The *Statute Law Revision Act 2007* retained the 1886 Act in force.

4 *Church and General Insurance Co v Connolly* High Court, 7 May 1981; *Motor Iinsurance Bureau of Ireland v PMPA Insurance Co* [1981] IR 142. See *MacGillivray* para. 1-044.

5 A legal or equitable interest as distinct from a mere expectation (for example, a legacy): see *Marine Insurance Act 1906*, section 5(2) .

6 *Medical Defence Union v Department of Trade* [1980] Ch 82, at p 89 (Megarry VC). See generally Templeman in Soyer, *Reforming Marine and Commercial Insurance Law,* (Informa Law 2008) Ch. 9.

7 A policy is not prevented from being an indemnity merely because it only covers part of the loss. Valued policies are not contracts of indemnity in the strict sense since the parties agree the measure of loss at the time that the contract is concluded rather than at the time of the loss. See Templeman (*op cit*) page 188, footnote 3.

2.03 In contrast, a non-indemnity "valued" policy pays a set or specified amount to the insured upon the materialisation of the event or risk specified in the insurance contract. Indemnity insurance, on the other hand, will only indemnify the claim up to and to the extent of the loss. This distinction is of critical importance as most life policies are contracts paying a fixed amount on the death of the assured. Life assurance policies were considered to be contacts of indemnity until the 1807 case of *Godsall v Boldero*[8] was held to have been wrongly decided by the Court of Exchequer Chamber in *Dalby v The India and London Life Assurance Company.*[9] Parke B said that:

> "The contract commonly called life-assurance, when properly considered, is a mere contract to pay a certain sum of money on the death of a person, in consideration of the due payment of a certain annuity for his life, - the amount of the annuity being calculated, in the first instance, according to the probable duration of the life: and when once fixed it is constant and invariable. The stipulated amount of annuity is to be uniformly paid on one side, and the sum to be paid in the event of death is always (except where bonuses have been given by prosperous offices) the same on the other. This species of insurance in no way resembles a contract of indemnity."[10]

2.04 Parke B specifically followed *The British Insurance Co v Magee* in holding that contracts against fire and marine risks were contracts of indemnity that were enforceable at common law to the extent of "the losses sustained by the assured in their buildings, ships and effects."[11]

2.05 In the mid-18th century there seems to have been some uncertainty as to whether an insurable interest was, indeed, required for an enforceable policy. Certainly the courts were enforcing not just contracts in which the insurer agreed to be liable, 'interest or no interest', but, more generally, wagering agreements.[12] However, anxieties about the perceived evils inherent in wagering together with "moral hazard", ie, the concern that allowing those who lack interest to insure might encourage them to bring about the loss, led to legislative intervention in England. While these Acts never applied to Ireland, the *Life Assurance Act 1774,* as applied to Ireland in 1866, and the *Marine Insurance Act 1906* carried the definition of insurable interest developed in this context into Irish insurance practices.

2.06 This process of creating an insurable interest requirement began in England with the *Marine Insurance Act 1745,*[13] which laid down as a prerequisite to the validity of certain insurance contracts that the insured possess an insurable interest in the subject matter of the policy.[14] This left the question open as to how insurable interest was to be defined.

2.07 The opening part of this chapter considers the competing tests for determining the requirement of insurable interest in the context of indemnity insurance. On the one hand, there is a broad conception, which has come to be known as the factual expectation test, whereby the determinative question is whether or not the insured in fact suffered some loss from damage to the subject matter, or stood to gain some advantage from its continued existence. On the other hand, there is a narrower conception, referred to as the legal interest test, whereby the insured is required to demonstrate not only that he has as a matter of fact suffered loss but that his indemnification arises from some legally enforceable right in the

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8 9 East 72.

9 (1854) 15 CB 365.

10 *Ibid*, at 387.

11 (1854) 15 CB 365, at 387. *Dalby v The India and London Life Assurance Co* was followed in *Keith v Protection Marine Insurance Co of Paris* (1882) 10 LR (Ir) 51.

12 Although wagers were held not to be enforceable in *Goddert v Garrett* (1692) 2 Vern 269, they were enforced in *Assevieda v Cambridge* (1710) 10 Mod 77; *Harman v Van Hatton* (1716) 2 Vern 717; *De Paiba v Ludlow* (1721) 1 Comyns 361; *Dean v Decker* (1746) 2 Str 1250. See also *Craufurd v Hunter* (1798) 8 TR 13. See generally, R Merkin, "Gambling by Insurance-A Study of the Life Assurance Act 1774" [1981] *Anglo-American LR* 331.

13 19 Geo 2, c 37.

14 Section 1 of the 1745 Act.

insured property, which justifies recovery. After some uncertainty, the legal interest test emerged in England as the orthodox approach. Yet, it is arguable that the policy concerns which serve to underpin the legal interest test no longer prevail. Indeed, it will be argued that insistence on this test can operate as a trap for the unwary, insofar as it renders an otherwise unobjectionable policy void thereby frustrating reasonable commercial expectations.[15]

2.08 Further, it is questionable whether modern insurance law should facilitate the evasion of obligations freely entered into by insurers with full knowledge and or the opportunity to establish what legal or equitable interest exists or existed at the relevant time.

B The emergence of the insurable interest requirement

2.09 In this Part, the Commission considers the emergence of the principle of insurable interest culminating in the decision of the House of Lords in *Macaura v Northern Assurance Co.*[16] The Commission then examines the rather different approach taken by judges in other common law jurisdictions. The Commission discusses how modern English courts have reassessed insurable interest in a series of subrogation cases and the recent discussion and proposals for reform undertaken by the English and Scottish Law Commissions. The Commission then moves on to consider what should be done within this jurisdiction to clarify the insurable intrest requirement. The Commission suggests in what follows that, if it is accepted both that the original policy reasons for insurable interest no longer apply and that the underlying purpose of insurance is to shift the risk of pecuniary loss, then the requirement for insurable interest can be dispensed with altogether because its functions are effectively discharged by the principle of indemnity.

2.10 Like many other 18th century statutes, the preamble to the *Marine Insurance Act 1745*, in which its purpose is set out, is somewhat obscure:

> "the making of assurances, interest or no interest, or without further proof of interest than the policy, hath been productive of many pernicious practices, whereby great numbers of ships, with their cargoes, have either been fraudulently lost and destroyed, or taken by the enemy in time of war; and such assurances have encouraged the exportation of wool, and the carrying on many other prohibited and clandestine trades, which by means of such assurances have been concealed, and the parties concerned secured from loss, as well to the diminution of the public revenue, as to the great detriment of fair traders: and by introducing a mischievous kind of gaming of wagering, under the pretence of assuring the risque on shipping, and fair trade, the institution and laudable design of making assurances, hath been perverted; and that which was intended for the encouragement of trade and navigation, has in many instances, become hurtful of, and destructive to the same."[17]

2.11 Section 1 of the 1745 Act states that all insurance contracts on British ships and their cargoes are declared "null and void" where made "interest or no interest, free of average, or without benefit of salvage to the assurer".[18] In a series of cases in which the scope of the 1745 Act was considered, Lord Mansfield

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15 Lord Mansfield, in *Carter v Boehm* (1766) 3 Burr 1905, expressed the view that insurers who take insurance premiums aware that the policy may be void should not be able to invoke non disclosure against an insured. See the discussion by Watterson in Mitchell and Mitchell, *Landmark Cases in the Law of Contract* (Hart, 2008), pp.110-116 especially by way of public policy. However, there is no case law suggesting that doctrines of waiver, estoppel or election operate in this way.

16 [1925] AC 619.

17 For a brief history see Templeman (*op cit*).

18 See *Kent v Bird* (1777) 2 Cowp 583. The provisions in the 1745 Act were repealed by the *Marine Insurance Act 1906* (s.92) and replaced by s.4 of the 1906 Act, under which a wager policy is void, but not illegal. Note also that section 1(1) of the *Marine Insurance (Gambling Policies) Act 1909* (which is to be cited with the 1906 Act as the *Marine Insurance Acts 1906 and 1909* and was also retained by the *Statute Law Revision Act 2007*) provides that, where any person effects a contract of marine insurance "without having any bona fide interest, direct or indirect, either in the safe arrival of the ship in relation to which the contract is made or in the

CJ expressed the view that it made "insurance a contract of indemnity".[19] For instance, in *Lowry v Bourdieu,*[20] the claimants, who had lent money to a ship's captain, took out an insurance policy which would compensate them if the ship failed to arrive. Lord Mansfield held the policy to be a wager and, therefore, void: "it was a hedge. But they had no interest; for, if the ship had been lost and the underwriters had paid, still the plaintiffs would have been entitled to recover the amount of the bond."[21] He went on to observe that:

> "There are two sorts of policies of insurance; mercantile and gaming policies. The first sort are contracts of indemnity, and of indemnity only... The second sort may be the same in form, but in them there is no contract of indemnity, because there is no interest upon which a loss can accrue. They are mere games of hazard; like the cast of a die."

2.12 Significantly, Lord Mansfield was not denying the enforceability of wagering contracts generally, but merely acknowledging that the 1745 Act made them unenforceable in relation to marine adventures by introducing the requirement that the insured demonstrate an insurable interest. [22]

2.13 A general definition of insurable interest proved elusive. In *Le Cras v Hughes,*[23] Lord Mansfield, perhaps unhelpfully, stated that an interest is necessary, but no particular kind of interest is required. He did go on to stress, however, that it was not necessary to possess a legal interest in the insured property. The issue in this case was whether the crews of a Royal Navy squadron had an insurable interest in two enemy ships they had seized. Lord Mansfield decided that they had for two reasons. The first was that the crews had rights vested in them by the *Prize Acts* which gave them a sufficient interest to support the insurance. This was uncontroversial, but he went on to justify the decision on the separate ground that there was a moral certainly that the crew would acquire rights over the seized vessels:

> "[w]herever a capture has been made, since the Revolution, by sea or land, the Crown has made a grant [of the prize ships]: there is no instance to the contrary."[24]

2.14 The late 18th century case law on insurance contracts not covered by the 1745 Act seems principally to have been driven by the concept that agreements should be enforced rather than be defeated by the anxiety over wagering.[25] The view was taken that insurance should be encouraged because it played a key role in commerce by enabling people with little capital to engage in business by reducing their exposure to risk and ruin. As Marshall observed in his textbook of 1802: 'insurances are made for the encouragement of trade'.[26] This emphasised the importance of focusing on the social and commercial benefits of insurance rather than on the restrictions imposed by legislation on wagering.

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safety or preservation of the subject-matter insured, or a bona fide expectation of acquiring such an interest," the contract is deemed to be a contract of gambling on loss by maritime perils, and the person effecting it is guilty of an offence, and must forfeit to the State any money he or she may receive under the contract.

19 *Le Cras v Hughes* (1782) 3 Doug 79, at 86. See also, *Moran, Galloway &* Co *v Uzielli* [1905] 2 KB 555 at 563, per Walton J.

20 (1780) 2 Doug 468. On Lord Mansfield's dislike of wagers and case-law that he was involved in see Swain, *Da Costa v Jones* in Mitchell and Mitchell, *Landmark Cases in the Law of Contract* (Hart, 2008).

21 *Ibid,* at 470. See also *Moran, Galloway &* Co *v Uzielli* [1905] 2 KB 555.

22 (1780) 2 Doug 468 at 470. It is worth noting here that this did not eradicate the practice of parties entering into what are known as PPI (Policy Proof of Interest) contracts: the insurers do not raise the issue of the insurable interest as a defence to a claim, although if the policy is the subject of litigation over another issue the court will refuse to enforce it. See further, *Gedge v Royal Exchange Assurance* Co [1900] 2 QB 214.

23 (1782) 3 Doug 81.

24 *Ibid* at 86. See also *Boehm v Bell* (1799) 8 TR 154.

25 This was in spite of the efforts of judges such as Buller J in *Atherfold v Beard* (1788) 2 TR 610 and *Good v Elliott* (1790) 3 TR 693.

26 S Marshall, *A Treatise on the Law of Insurance* (1802) pp 99-100.

Nevertheless, it was the policy against wagering underlying the 1745 Act that proved to be the decisive issue in the leading decision of *Lucena v Craufurd.*[27] Briefly, the facts were that commissioners had been given statutory authority to take charge of Dutch ships and cargoes in England. Acting under the orders of the Admiralty, a Royal Navy ship took several Dutch ships at sea. The commissioners then arranged to insure the ships while they were on their way to England. They were lost before arrival. While the provisions of the legislation meant that the commissioners would clearly have had an insurable interest in the ships if they reached these shores, the issue was whether such an interest existed before their arrival. The case was first argued before Lord Kenyon CJ and a special jury at the Guildhall in 1799; it was then appealed through the Court of King's Bench and the Exchequer Chamber, and finally reached the House of Lords in 1802.

2.15 The overwhelming majority of the judges in the lower courts referred to the second ground given by Lord Mansfield for his decision in *Le Cras* as support for their view that the commissioners possessed an insurable interest, that is, the Crown had previously and invariably obtained and granted prize rights to the crew. Seizure of the Navy gave the Crown an interest that could produce inchoate interests in others. Similarly, the majority of the judges called to give their advice to the House of Lords argued that `a vested interest is not necessary to give the right of insuring. The commissioners had a contingent interest; and supposing the intentions of the Crown to remain unaltered, nothing stood between them and the vesting of that contingent interest but the perils insured against'.[28] The judges summed up their approach:

> "The question always is, whether the policy be a gaming contract? If it be no artifice how can it elude the force of the statute? The case of *Le Cras v Hughes* was infinitely more likely to introduce an abuse of the statute than the present case. That has been decided above 20 years; yet what ill consequences have followed? The same may be said of valued policies. In the case of wagering policies, any number of persons may make insurances on the same ship. But that is not the case here. If the commissioners could not insure this property, the Dutch owners could not; and it would be a strange paradox to assert, that these are ships and cargoes subject to all the perils of the sea in their voyage, and yet none are competent to insure them.'[29]

2.16 There were two very strong dissenting voices in the House of Lords. Chambre J held that the statute appointing the Commissioners afforded no right over the property until arrival in the jurisdiction. While Lawrence J in his dissenting judgment similarly denied the existence of insurable interest, his reasoning differed. It is worth considering his opinion at some length because of its enduring influence. He began by defining the nature of an insurance contract in terms of the protection it afforded the insured partly not merely against loss resulting in deprivation of property but also against uncertain events which may lead to some other disadvantage, such as loss of anticipated profit. The risk of such loss, damage or other prejudice is thereby shifted to the insurer.

2.17 Having spoken generally about the nature of interest and insurance, Lawrence J went on to formulate what has become known as the factual expectation test:

> "To be interested in the preservation of a thing, is to be so circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction. The property of a thing and the interest devisable from it may be very different: of the first the price is generally the measure, but by interest in a thing every benefit and advantage arising out of or depending on such thing, may be considered as being as comprehended."[30]

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27 (1802) 3 Bos. & Pul. 75 (Exchequer Chamber) ; (1806) 2 Bos. & Pul. NR 269 (House of Lords).

28 Before the House of Lords, (1806) 2 Bos. & Pul. NR 269 Le Blanc J, Grose J and Sir James Mansfield CJ took the same view as the majority in the Exchequer Chamber (they were joined by judges that had already been of the majority in the lower court – Graham B, Rooke J and Heath J)

29 (1806) 2 Bos. & Pul. NR 269 at 297

30 *Ibid,* at 302-3.

2.18 In the House of Lords, Lord Eldon delivered the leading speech. Although he agreed with Lawrence J that here there was no insurable interest, Lord Eldon was keen to emphasise the very different policy consideration which led him to that conclusion. His main concern was with wagering. Curiously, Lord Eldon rejected the suggestion that before the 1745 Act insurance might have been effected without interest, but, in any event, he took the view that the Act was decisive and that the courts should follow its spirit: "lest that sort of wagering in policies should grow up, which has of late been extending itself considerably."[31] He rejected the alternative ground for the decision in *Le Cras,* namely, that expectation of a grant by the Crown was sufficient:

> "What expectation, though founded upon the highest probability, was not interest, and it was equally not interest, whatever might have been the chances in favour of the expectation"[32]

2.19 For Lord Eldon the appropriate test was to ask whether the insured possessed 'a right in property, or a right derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party?'[33] On this basis he said in the following paragraph, that the commissioners:

> "If they have a right so to insure, it seems to me that any person who is directed to take goods into his warehouse may insure; and that there is nothing to prevent the West India Dock Company from insuring all the ships and goods which come to their docks. If moral certainty be a ground of insurable interest, there are hundreds, perhaps thousands, who would be entitled to insure. First the dock company, then the dock-master, then the warehouse-keeper, then the porter, then every other person who to a moral certainty would have anything to do with the property, and of course get something by it."

2.20 Whichever of the two tests – Lawrence J's factual expectation test, or Lord Eldon's legal interest test – is applied, the final outcome in the majority of cases will be the same. The decision in *Lucena* itself illustrates the point.

2.21 In cases heard in the 19th century the judges, in so far as the definition of insurable interest was considered, expressed support for factual expectancy. For example, in *Lloyd v Fleming,*[34] Blackburn J said:

> "This subject-matter [of the insurance] need not be strictly a property, in either the ship, goods, or freight; for, as has been long said, if a man is so situated with respect to them that he will receive benefit from their arriving safely at the end of the adventure, or sustain loss in consequence of their not arriving "[35]

2.22 Notwithstanding the uncertain state of the case law, for marine insurance the issue appeared to be settled by Chalmers, who in drafting the *Marine Insurance Act 1906*, adopted Lord Eldon's test:

> "a person is interested in a marine adventure where he stands in any 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 damage thereto, or by the detention thereof, or may incur liability in respect thereof."[36]

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31 (1806) 2 Bos. & Pul. NR 269 at 323

32 *Ibid,* at p.323. See also *Routh v Thompson* (1809) 11 East 428 at 433, per Lord Ellenborough CJ.

33 (1806) 2 Bos. & Pul. NR 269 at 324

34 (1872) 7 LR QB 299. See also, Blackburn J's judgment in *Wilson v Jones* (1867) LR 2 Ex 139, at 150 and Brett MR in *Stock v Inglis* (1884) 12 QBD 564. See in particular *Moran, Galloway & Co v Uzielli* [1905] 2 KB 555.

35 (1872) 7 LR QB 299, at 302.

36 Section 5(2).

2.23 In the non-marine context, the issue was settled by the House of Lords in *Macaura v Northern Assurance Co Ltd*[37]. In this case, Macaura was the only substantial shareholder in a company to which he had sold timber on credit. He insured the timber in his own name and when it was destroyed by fire sought to claim against the policies. An initial allegation that Macaura's claim was fraudulent and dishonest was dismissed by an arbitrator and, apart from a brief statement to that effect, this was not mentioned in the House of Lords. The issue before the court was whether Macaura had an insurable interest in the timber owned by the company. Counsel for Macaura, drawing on Lawrence J, argued that Macaura's insurable interest derived from his being the only shareholder. It was also argued that a separate insurable interest arose from his being the only substantial creditor of the company whose only substantial asset from which the debts could be paid was the timber. On both grounds, it was claimed, Macaura was bound to benefit by the preservation of the timber and suffer by its destruction. All five of their Lordships rejected this argument[38] ruling that Macaura had no insurable interest. In giving the leading speech, Lord Buckmaster cited, with approval, Walton J's reasoning in *Moran, Galloway & Co v Uzielli,*[39] in which he had said: "in so far as the plaintiffs' claim depends upon the fact that they were ordinary unsecured creditors... I am satisfied it must fail."[40] Lord Buckmaster, therefore, dismissed the idea that a creditor had an insurable interest in the assets of a debtor. His principal objection to Macaura's contention, however, turned on his status and interest in the company as shareholder. If Macaura's argument was accepted, then, in Lord Buckmaster's view, each shareholder in every company would have an insurable interest in corporate assets and the extent of that interest `could only be measured by determining the extent to which his share in the ultimate distribution would be diminished by the loss of the asset — a calculation almost impossible to make.'[41] Lord Buckmaster then explicitly attacked Lawrence J's view in *Lucena v Craufurd* by saying, "I find ... difficulty in understanding how a moral certainty can be so defined as to render it an essential part of a definite legal proposition."[42]

C Modern development of insurance interest and factual expectation in other jurisdictions

2.24 In Canada, Australia, the USA and South Africa a pragmatic approach has been adopted in response to the perceived social and commercial benefits which widespread insurance offers. The reasoning in *Macaura* has been rejected principally on the basis that an overly technical determination of the insurable interest requirement has the potential to defeat the reasonable commercial expectations of the parties.[43] In its place the courts have substituted factual expectancy as the determinative test.

(1) Canada, Australia, the USA and South Africa

2.25 Thus, in *Constitution Insurance Company of Canada v Kosmopoulos,*[44] the facts of which closely resemble *Macaura,* the Supreme Court of Canada, which had previously followed the restrictive

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37 [1925] AC 619. Nicholl, in *Insurable Interest: As Intended* [2008] JBL 432 argues that *Lucena v Craufurd* is misunderstood, later courts failing to distinguish between the subject matter of the insurance contract with the asset that has been lost or damaged. This article contains an interesting analysis of *Wilson v Jones* (1866-7) LR 2 Ex 139, stressing the importance of construing the policy so as to identify the insured's interest.

38 Lords Buckmaster, Atkinson, Sumner, Wrenbury and Phillimore.

39 [1905] 2 KB 555.

40 *Ibid,* at 562.

41 [1925] AC 619 at 627.

42 [1925] AC 619 at 627.

43 See further, A J Campbell, 'Some Aspects of Insurable Interest' (1949) 27 *Can Bar Rev* 1; D Galbraith, 'An unmeritorious defence—The requirement of insurable interest in the law of marine insurance and related matters' [1993] *Insurance* 177; RA Hasson, 'Reform of the Law Relating to Insurable Interest in Property—Some Thoughts on *Chadwick v Gibraltar General Insurance'* (1983-84) 8 *Can Bus LJ* 114.

44 (1987) 34 DLR (4th) 208. Noted by L Stuesser (1987-8) 13 *Can Bus LJ* 227.

Lord Eldon formulation,[45] overruled this approach. Wilson J, for the majority, took the view that the definition of insurable interest was ripe for fundamental re-examination: "if the application of a rule leads to harsh justice, the proper course to follow is to examine the rule itself rather than affirm it and attempt to ameliorate its ill effects on a case-by-case basis."[46] She therefore refused to follow the expedient solution adopted by her colleague, McIntyre J, of distinguishing *Macaura* and piercing the corporate veil on the basis that this was a one-shareholder corporation.[47]

2.26 Reviewing Lord Eldon's reasoning, which had led Lord Eldon to reject the factual expectation test, Wilson J cited a passage from Brown and Menezes, *Insurance Law in Canada.*[48] Commenting on *Macaura,* the authors conclude:

> "After *Macaura,* it is no longer possible to claim merely that one would be adversely affected by the loss; the insured must assert that he owned an interest in the objects destroyed. This provides the illusion of great certainty. Property law is among the most technical and certain segments of the law. This certainty is totally illusory because the new formulation makes no concessions either to the reasons for which insurable interest is a component of insurance law or for commonplace business transactions .... Assuming that an insurable interest in `things' must mean property, among the simple questions raised are matters such as how does one own a direct interest in property which is not in existence at the time of the contract? Can next season's crops or fluctuating inventory be insured? Are warehousing and other bailee policies subject to the law as set out in *Macaura* so as to limit the right to insure to the bailee's liability to the bailor?"

2.27 With respect to Lord Eldon's anxiety that the adoption of the factual expectation test would lead to too much insurance, Wilson J concluded that that fear "may also be illusory." Insureds are under a duty to disclose all material circumstances so that insurers can assess the risk and if an insurer cannot estimate the likelihood of the loss occurring (because, for example, the information is in the hands of third parties) then it does not have to write the policy.[49]

2.28 Wilson J rejected the argument that a broadly conceived notion of insurable interest would lead to an increase in the willful destruction of insured property stating that the legal interest test provided no better deterrent against such moral hazard. She considered that insureds who have a legal or equitable interest would, in fact, have better access to the insured property and therefore more opportunity to destroy it than those with an interest in the broader sense: "If Lawrence J's definition of insurable interest... were adopted, this moral hazard would not be increased. Indeed, the moral hazard may well be decreased because the subject-matter of the insurance is not usually in [their] possession or control."[50]

2.29 Recognising that there might be an incentive to sole shareholders to destroy corporate assets, if insurance moneys were paid to them free of the company's creditors, Wilson J pointed to company law remedies and doctrines, including the constructive trust and directors' duties, by which the courts can make the proceeds of insurance policies held by a shareholder available to the company. By such means the share-holder is more effectively prevented from benefiting personally from a wrongful act.

2.30 Wilson J's analysis reflects a shift in emphasis from Lord Eldon's concerns, which led to a narrow definition of insurable interest, to a view that recognises the economic and social benefits of insurance and, therefore, a broader conception of insurable interest. In the modern commercial world property insurance is generally sought to secure indemnification, and, as Wilson J points out, it is more

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45 See, for example, *Guarantee* Co *of North America v Aqua-Land Exploration Ltd* (1965) 54 DLR (2d) 29. See also *Wandlyn Motels Ltd v Commerce General Insurance* Co (1970) 12 DLR (3d) 605.

46 (1987) 34 DLR (4th) 208, at 214.

47 *Ibid,* 210. Although not cited by McIntyre J, support for his approach can be found in *Durocher v* Gevry [1961] Que QB 283.

48 C Brown and J Menezes, *Insurance Law in Canada* (Scarborough, Ontario: Carswell, 1982), at 84.

49 (1987) 34 DLR 4^{th} 208, at 218.

50 *Ibid,* at 224.

socially beneficial to encourage widespread insurance than to restrict it. There seems, therefore, no convincing reason in this context for interfering with freedom of contract and, in particular, for not requiring insurers to meet liabilities under contracts which they have freely entered into and for which they have received premiums.

2.31 In Australia Lord Eldon's approach has also been discarded. The Australian Law Reform Commission (ALRC), in its Report *Insurance Contracts*[51] concluded that Lawrence J's formulation "would allow more flexibility to insurers and to the insuring public, without in any way promoting gaming and wagering in the form of insurance or adding to the risk of destruction of the property insured."[52] In its opinion, technical rules had prevented the insured in *Macaura* from recovering the loss actually suffered by him. The ALRC considered that the strict legal interest test gave rise to results that were socially undesirable. For example, a named beneficiary under the will of a living testator stands to lose much of his projected inheritance if the testator's property is destroyed by fire. Yet, if the beneficiary takes out a fire policy on the property, the legal interest test will prevent recovery notwithstanding actual loss. The ALRC also thought that the restrictive test produced commercially undesirable results. By way of example, it cited *Truran Earthmovers Pty Ltd v Norwich Union Fire Insurance Society Ltd*[53], in which a purchaser of a bulldozer was held to have no insurable interest in the vehicle even though he had lent the owner money which was to be deducted from the purchase price: 'Once again, technical rules prevented recovery of an actual loss.'[54] The ALRC therefore proposed legislative reform to provide that 'where an insured is economically disadvantaged by damage to or destruction of the insured property, the insurer should not be relieved of liability by reason only that the insured did not have a legal or equitable interest in the property.'[55] This was given statutory effect by the Insurance Contracts Act 1984, section 17.[56] Thus, an insurable interest is not required in Australia.

2.32 Although early US case law followed Lord Eldon's narrow formulation,[57] the view that most states have now adopted is that economic interest is the determinative test.[58]. Some 30 years before the decision in *Macaura,* the New York courts recognised that shareholders did have an insurable interest in corporate assets: *Riggs v Commercial Mutual Insurance* Co.[59] Statute law in the USA reflects this pattern. Two statutory examples will suffice. The California Insurance Code, s 281 provides that '[e]very

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51 Report No 20 (1982), ch 5. See also the ALRC Discussion Paper No 63, *Review of the Marine Insurance Act* 1909 (2000), ch 7.

52 ALRC Report No 20, at para 120.

53 (1976) 17 SASR 1.

54 Report No 20, at para 119.

55 In reaching its recommendation for the adoption of economic interest as the determining question, the ALRC noted that several American States had adopted this test, citing, by way of example, the New York Insurance Law s.158, which defines insurable interest as including 'any lawful and substantial economic interest in the safety or preservation of property from loss, destruction or pecuniary damage.'

56 See also s.7(1) of the New Zealand *Insurance Law Reform Act 1985*, which abolishes the requirement of insurable interest in the case of life insurance and all contracts of indemnity insurance.

57 See, for example, *Farmers' Mutual Insurance* Co *v New Holland Turnpike Road* 122 Pa 37 (1888).

58 See, for example, the decision of the Supreme Court of Massachusetts in *Hayes Milford Mutual Fire Ins* Co 49 NE 754 (1898). For Californian case law see *Smith v Royal Insurance Co.* 5 F.Supp. 436 (1933) (later reversed on other grounds); *Burns v California Fair Plan* 152 Cal App. (4th) 646 (2007). For New York case law see *Scarola v Insurance Corp of North America* 31 NY (2d) 411 (1972) and *Lane v Sec. Mut.Ins. Co.* 96 NY (2d) 1 (2001). On the related issue of ownership, Appleman, *Insurance Law and Practice* sect. 2122 states, "the excessive technical construction which sole and unconditional ownership policy [behind property insurance] has outlived its usefulness in the insurance field and therefore no more should be required in these times of modern industrial development and business expansion *than an insurable interest in the property"* (emphasis added). These comments first appeared in Appleman in 1949.

59 125 NY 7 (1890).

interest in respect of the property, or any interest in relation thereto, or liability in respect thereof, of such a nature that a contemplated peril might directly damnify the insured, is an insurable interest.' In the codified New York Insurance Law, Art 34 defines insurable interest in property insurance as including 'any lawful or substantial economic interest in the safety or preservation of property from loss, destruction or pecuniary damage.'

2.33 In South Africa, the 1774 Act was never enacted or adopted in any way and the South African judiciary adopted an economic interest test. In *Refrigerated Trucking (Pty) Ltd v Zive*[60] a Transvaal Court has provided a broad ecomonic interest test, following earlier South African authorities that appear to reject a legal or equitable interest approach, the judges upholding a contract even though the claimant has "neither a *jus in re* nor a *jus in rem* to the thing insured."[61] In *Zive* the Court held:

> "an insurable interest is an economic interest which relates to the risk which a person runs in respect of a thing which, if damaged or destroyed will cause him to suffer an economic loss or, in respect of an event, which if it happens will likewise cause him to suffer an economic loss. It does not matter whether he personally has rights in respect of that article, or whether the event happens to him personally, or whether the rights are those of someone to whom he stands in such a relationship that, despite the fact that he has no personal right in respect of the article, or that the event does not affect him personally, he will nevertheless be worse off if the object is damaged or destroyed or the event happens."

(2) The current British debate on Insurable interest

2.34 In the few cases where insurable interest is directly in issue,[62] it is not surprising that *Macaura* continues to represent the orthodox approach. For instance, in *Mitchell v Scottish Eagle Insurance* Co *Ltd,*[63] Mitchell had entered into partnership with his son but had insured the partnership's premises in his own name. In the Outer House, Lord Prosser, applying the *Macaura* principle, held that Mitchell lacked an insurable interest.[64] More directly, in *Cowan v Jeffrey Associates,*[65] the issue again arose as to the interest possessed by the director and sole shareholder of a company. Lord Hamilton felt obliged to follow *Macaura,* observing that, while it was an English authority and not, therefore, technically binding on him, nevertheless, it was highly persuasive. In his view the adoption of factual expectancy would require either legislative intervention or the House of Lords reversing itself. Although these recent Scottish decisions show the continued importance of the narrow legal interest test, the judiciary has displayed tentative signs of a willingness to sidestep the force of *Macaura.* For instance, in *Sharp v Sphere Drake Insurance Ltd, "The Moonacre",*[66] Colman J distinguished *Macaura* and held that the sole shareholder in a company possessed an insurable interest in a yacht purchased by the company because the yacht was intended for his use and a power of attorney had been granted to him in respect of it.

2.35 While the requirement of insurable interest has not been subjected to the sort of rigorous analysis that led other common law countries to adopt the factual expectation test, the English and

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60 1996 2 SA 361(T). The insurable insurable interest position in South African law is uncertain according to Havenga, "Liberalising the Requirement of an Insurable Interest in (Life) Insurance" (2006) 18 SA Merc LJ. 259, suggesting that South African judges see the central issue as whether the contract is a wager or not. On moral hazard see Van Niekerk (2009) 21 SA Merc LJ 126.

61 *Littlejohn v Norwich Union Fire Insurance Society* 1905 TH 374; See Reinecke and S Van der Merwe, (1984) 101 SALJ 608; Midgley, (1986) SALJ 18.

62 For the reasons why there have been so few cases, see, J Birds, 'Insurable Interests', in N Palmer and E McKendrick (eds), *Interests in Goods* (London: LLP, 1998). The following examination of recent English law draws heavily from *Lowry and Rawlings, Insurance Law – Doctrines and Principles* (2009).

63 1997 SLT 793.

64 Lord Prosser drew support for his position from the judgment of Lord Sutherland in *Arif v Excess Insurance Group Ltd* 1987 SLT 473.

65 1999 SLT 757.

66 [1992] 2 Lloyd's Rep 501.

Scottish courts have, nevertheless, taken cognisance of developments in those jurisdictions. The issue has emerged in the context of insurers' rights of subrogation. Simply put, on paying a claim in full the insurer takes on the rights of action which the insured would have had: in effect, the insurer steps into the shoes of the insured. This means that the insurer can, for instance, sue the tortfeasor responsible for the loss. However, the tortfeasor can use all the defences that would have been available against the plaintiff in an action brought by the insured, and the insurer will have no cause of action where the loss is caused by the insured.[67] This is of particular importance in insurance policies relating to construction contracts, in which the head contractor is commonly required by the contract to insure the project for their own benefit and that of the sub-contractors. The issue then comes down to whether the sub-contractor has an insurable interest which will grant immunity against the insurer's subrogation rights. Of course, if the position was taken that it is only the insurer who can plead the absence of an insurable interest these difficult problems could be avoided.

2.36 That the courts distinguish between joint and composite liability is illustrated by *Petrofina (UK) v Magnaload Ltd*,[68] in which it was held that the owners, the head contractors and each of the sub-contractors on a construction site, had an insurable interest in the entire works despite the fact that they were working only on limited parts of the site. Their interest arose not from any ownership or possession, but from the fact that, in the event of negligence, each sub-contractor could suffer loss should any part of the works be damaged or destroyed. So, although the sub-contractors lacked property interest in the work in progress, they had an insurable interest in its continued existence. In so finding, Lloyd J said the case was analogous with that of an insurable interest possessed by a bailee in goods. Accordingly, it was possible for a policy covering the entire works to be taken out on a coinsurance basis by the head contractor and all sub-contractors. Lloyd J reasoned that to hold to the contrary would result in commercial inconvenience as each sub contractor would need `to take out his own separate policy. This would mean, at the very least, extra paperwork; at worst it could lead to overlapping claims and cross claims in the event of an accident. Furthermore ... the cost of insuring his liability might in the case of a small sub-contractor, be uneconomic.'[69]

2.37 The approach taken by Lloyd J was endorsed in *National Oilwell Ltd v Davy Offshore (UK) Ltd.*[70] Colman J held that the suppliers of a subsea wellhead completion system for a floating oil production facility were coinsured's under the contractor's All Risks policy. Colman J dismissed the contention that there could not be an insurable interest based merely on potential liability arising from the existence of a contract between the insured and the owner of property. Instead, he held that an insurable interest could be found in the insured's proximate physical relationship to the property in question.[71]

2.38 In *Glengate-KG Properties Ltd v Norwich Union Fire Insurance Society Ltd*,[72] the English Court of Appeal considered the meaning of the phrase "the interest of the insured" in a policy covering the owner of a building against consequential loss following a fire or other insured peril. The issue was whether the insured could recover for the loss of architect's drawings, which were, at the time of the loss, owned by the architects, although the insured might eventually have acquired them. It was held that the insured had an insurable interest in the drawings despite the lack of a proprietary interest. Although the court saw the insurable interest as being in respect of consequential loss rather than in the actual

67 *Simpson v Thompson* (1877) 3 App Cas 279.

68 [1983] 2 Lloyd's Rep 91. Noted by J Birds [1983] *JBL* 497. *See also Tomlinson (Hauliers) Ltd v Hepburn* [1966] AC 451; *Waters & Steel v Monarch Fire and Life Assurance* Co (1856) 5 E B 87

69 [1983] 2 Lloyd's Ref 91 at 96-7. In a Canadian case that has been cited before the English courts, the issue has been reduced to one of construction of the particular terms of the insurance contract: G *A Baert Construction (1960) Ltd v Canada Insurance* Co [1966] ILR 1-170 (Man CA). Lloyd J followed *Commonwealth Construction Ltd v Imperial Oil Ltd* (1976) 69 DLR (3d) 558 in *Petrofina*.

70 [1973] 2 Lloyd's Rep 582; *Hopewell Project Management v Ewbank Preece Ltd* [1998] 1 Lloyd's Rep 448.

71 [1973] 2 Lloyd's Rep at 611. See also *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288, 301.

72 [1996] 1 Lloyd's Rep 614.

drawings themselves, Auld LJ and Sir Iain Glidewell both expressed the view that the drawings could have been insured on the basis of Lawrence J's 'factual expectation' test.

2.39 As Lowry and Rawlings argue, this line of authority can, therefore, be seen as amounting to some recognition of the broader conception of an interest as adopted in Canada and elsewhere. However, a limit was placed upon this trend by the Court of Appeal in *Deepak Fertilisers & Petrochemical Corporation v Davy McKee (London) Ltd and ICI Chemicals and Polymers Ltd.*[73] The Court did accept the broad conception of insurable interest. It agreed that a sub-contractor in a building contract possessed an insurable interest in the entire works during construction. This was because of the economic disadvantage which would be suffered if, in the event of the structure being damaged or destroyed, they lost the opportunity to complete the work and receive remuneration. However, once the work had been completed the court stressed that such an interest came to an end. *Deepak* itself has been criticised by a later Court of Appeal Decision in which that Court was anxious to carve out an even broader notion of insurable interest for sound commercial reasons.[74]

2.40 It is noteworthy that the broad conception of insurable interest has been utilised beyond the confines of construction insurance. In *Mark Rowlands Ltd v Berni Inns,*[75] the issue arose because of a tenancy agreement that required the lessor to insure premises against fire and to use any proceeds of insurance to rebuild. The tenant contributed to the premium and was relieved of the duty to repair in the event of fire damage. The Court of Appeal held that the insurers, who had paid out on the policy following a fire, could not recover against the tenant. The tenant was not mentioned in the policy, but it was clear from the terms of the lease that the insurance was effected on his behalf. The court took into account the fact that the tenant was required to contribute to the premium and that the lease excluded his liability for fire. Although the insurers were unaware of the arrangement in the lease, the court held that it must have been the intention of the lessor and lessee that in the event of a fire the lessor's loss would be recouped from the insurance policy. This meant there would be no other claim against the tenant by the lessor, or, therefore, by the lessor's insurer. In his judgment, Kerr LJ ignored Lord Eldon's definition and explicitly adopted what he termed the 'classic' definition of insurable interest given by Lawrence J.[76]

2.41 Clearly, where the lessor and the tenant jointly take out an insurance policy, the insurer cannot use the covenant to keep the house in good repair as a means to sue the tenant for damage to the house because the tenant would be entitled to claim against the policy; unless, of course, the tenant has deliberately damaged the property, in which case he or she could not claim against the policy. The tenant will not be able to claim immunity from a subrogated claim by the lessor's insurers in respect of damage to any parts of the building which are not covered by the lease, as, for instance, where the tenant negligently sets fire to his or his part of the premises and that fire also damages premises occupied by another tenant of the same lessor in the same building.[77]

(3) Conclusions on the Bitish debate

2.42 The anxieties over moral hazard and wagering that prompted Lord Eldon to reach his view of insurable interest seem less relevant in the context of modern commercial practice. Lord Eldon's test does not seem to achieve the objectives he believed it would. It does not necessarily provide any better deterrent against the moral hazard that the insured might destroy the property than the factual

73 [1999] 1 Lloyd's Rep. 387.

74 *Feasey v Sun Life Assurance Corp of Canada* [2003] 2 Lloyd's Rep IR 637: see Templeman in Soyer, *Reforming Marine and Commercial Insurance Law* (Informa Law 2008) p.207.

75 [1986] QB 211. *Berni Inns* was distinguished by Lord Bingham in *Co-operative Retail Services v Taylor Young Partnership* [2002] UKHL 17, (2002) 74 Con LR 12, at paragraph 4 of his judgment.

76 See above at para 2.20.

77 See *Barras v Hamilton* 1994 SLT 949.

expectation test, indeed, it can be argued that an owner is likely to have more opportunity to damage the property.[78]

2.43 With respect to Lord Eldon's other concern, the dangers of a wager being concealed under the guise of an insurance contract seem more remote now than they were in the early nineteenth century. Since that time the activities of insurance and wagering have become separated. Gaming has become a legitimate activity with sifnificant economic benefits to the ecomony. The Commission examines these issues later in this chapter. *Macaura* itself has been explained as a case where the insurers believed that the insured had acted fraudulently, but, because they could not prove the point, they used a lack of insurable interest as a technical defence.

2.44 Lord Eldon's other concern, that without an insurable interest requirement in relation to property, gaming would be concealed as insurance, has been dealt with through statutory regulation of financial services and the legitimisation of gaming and betting, where the UK Parliament has provided the appropriate framework for these activities. Indeed, the UK *Gambling Act* 2005 has effectively removed the insurable interest requirement for non marine indemnity insurance but, as Templeman argues, the effect of the 2005 Act is in many senses completely uncertain. In spite of the 1745 Act and its successors, Policy Proof of Interest (PPI) contracts, or honour policies, where the insurer agrees not to raise the issue of insurable interest, remain an important slice of the marine insurance industry.[79] While it would not make good business sense for the insurer to deny liability, even though such a policy is unenforceable, it seems curious that in formal terms insurance law is so out of line with commercial practice. A more fundamental point is that Lord Eldon prioritised the public interest advantages to be secured in the regulation of gaming through prohibition by the use of insurable interest and failed to give proper emphasis to *pacta sunt servanda*, the competing public interest in ensuring that contracting parties perform their promises. In the final analysis, it is this that underpins the whole of contract law and might, therefore, be considered as of greater importance in public policy terms.

2.45 Modern insurers can frame coverage on the basis of a proposal in which they can ask such questions about the relationship between the proposer and the property as they think relevant to their decision as to whether or not to accept the risk. Moreover, the duty of disclosure, which places the insurer in an advantageous position when compared with parties in noninsurance contracts, makes it difficult to justify a situation in which the insurer can freely enter into the contract on the basis of full disclosure and still deny liability because of a lack of insurable interest. The implications of the lack of litigation directly on insurable interest since *Macaura* might be that the insurers accept the logic of this argument, or that the commercial implications of refusing to pay out would, presumably, be the same as those facing the bookmaker who failed to pay a winning bet.

2.46 The absence of legal clarity must have adverse commercial results. This is certainly the view of Mark Templeman QC who comments that large offshore and construction projects are often situated according to the insurance arrangements that have been made for them. Advising clients (Templeman says) that such arrangements may be void because the law is unclear, and that it is likely that the insurable interest point may not be taken by either side in litigation thus saving the insurance arrangement, is an unstisfacotry position for English law to be in:

> "it is even more unsatisfactory for a client, having paid for such advice, to be required to order its affairs on the basis that a significant transaction may be fatally flawed, but that with any luck no one will complain. Clearly, the law is in need of reform."[80]

2.47 If the policy considerations that underpinned Lord Eldon's definition are no longer relevant, then one is left to wonder whether the requirement of insurable interest serves any useful purpose. It has the potential to allow the insurer to defeat the reasonable expectations of the parties and this encourages

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78 See SA Rea Jnr, 'The Economics of Insurance Law' (1993) 13 *Int Rev of Law & Economics* 145-62. See generally, Malcolm Clarke, *Policies and Perceptions of Insurance: An Introduction to Insurance Law* (Oxford, Clarendon Press, 1997) at 21-22.

79 See MacGillivray, Ch.1 and *Lowry and Rawlings, op cit* p.351.

80 In Soyer*, Reforming Marine and Commercial Insurance Law*, (Informa Law 2009) p.208.

the judges to complicate the law by devising exceptions to the requirement, as has been seen in the cases on subrogation. Where a party stands to suffer a pecuniary loss it seems illogical to argue that the desire to insure against such loss is tantamount to wagering. This has been a repeated theme of judicial comment, in many of the decided cases. The point was made by Mance J:

> "... the present policy is not on its face one which the parties made for other than ordinary business reasons; it does not bear the hallmarks of wagering or the like. If underwriters make a contract in deliberate terms which covers their assured in respect of a specific situation, a Court is likely to hesitate before accepting a defence of lack of insurable interest.[81]

2.48 Maintaining the insurable interest requirement ignores modern developments such as a number of statutes permitting third parties to sue insurers directly in certain circumstances, notwithstanding the absence of insurable interest. One is left to wonder what it adds to the principle of indemnity under which, in general, the claimant is compensated for the pecuniary loss suffered. It seems wrong to allow the requirement to be used as a technical defence in circumstances which bear no relation to its original policy objectives. Where fraud is alleged it should be proved. An insurer always has the option of refusing to underwrite a risk which is difficult to assess, such as where a shareholder seeks to insure the assets of a company.

2.49 The continuing insistence on requiring insurable interest—whatever definition is adopted—harks back to a time when policy issues *dicta*ted that this should be a precondition to the validity of the insurance contract. Once those policy arguments are removed, the justification for the requirement disappears.[82] Even if, as the Commission has shown, a process of assimilation of the factual expectation test is underway, the obvious question remains, is there a role for insurable interest?

2.50 The Law Commissions, in Issues Paper No. 4, *Insurable Interest* criticised the law relating to contingency insurance, primarily on the basis that the law was both uncertain and difficult to analyse and was capable of allowing contracts of insurance to be avoided on technical grounds while being capable of being side-stepped via assignments and other commercial dealings. The Law Commissions also suggested that moral hazard and gambling in the guise of insurance were not effectively counteracted by an insurable interest requirement, especially in the light of the *Gambling Act 2005* which has all but abolished the need for an insurable interest in non-marine indemnity insurance in the United Kingdom. In cases of contingency insurance the same problems of uncertainty of definition and scope of application arise and have to be addressed.

2.51 In relation to indemnity insurance, the Law Commission's main proposal was that there should be no requirement of insurable interest in such insurance. This has been described as a "plainly sensible" recommendation by one commentator who has subjected Issues Paper No.4 to a critical evaluation.[83] On the choice between abolition or the possible reform and retention of an insurable interest in relation to contingency insurance, the Law Commission favours this latter option on the basis that the insurable interest in contingency insurance often serves to define insurance *vis-à-vis* speculative financial transactions and indeed gambling. But Templeman argues that the insurable interest is ill suited for this purpose.[84] Similarly, a reluctance to allow persons to effect a life insurance policy in relation to persons with whom they have no legal or emotional tie

> "must stem from a concern that to do so will encourage wrongdoing. But there is really no evidence that this is so…the deterrents to wrongdoing are the sanctions of the criminal law and the refusal of the courts to allow a wrong-doer to recover or retain the proceeds of their crime.

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81 *Cepheus Shipping Corporation v Guardian Royal Exchange Assurance plc (The 'Capricorn')* [1995] 1 Lloyd's Rep 622 at 641, per Mance J.

82 On this see the comments of the Australian Law Reform Commission, Report No. 20, *Insurance Contracts,* above, and Discussion Paper 63, *Review of the Marine Insurance Act 1909* para 11.24.

83 Templeman in Soyer, *Reforming Marine and Commercial Insurance Law* (Informa Law 2008) Chapter 9. He is less enamoured of the timing of interest query (p.220 to 221 in *Soyer*).

84 Soyer, *Reforming Marine and Commercial Insurance Law* (Informa Law 2008) Chapter 9.

Further, the assignment of life policies and the existence of the [Traded Endowment Policies Market] themselves give rise to the same risk of wrongdoing."[85]

D The insurable interest test in Irish Law

2.52 There is no clear statement from the Irish courts on whether a strict legal interest test is to be applied or whether a factual expectation test, or some variant thereon, will be enough to satisfy an insurable interest requirement, when this arises. *Macaura* was considered in *Coen v Employers Liability Insurance Co*[86] but no opinion was expressed on the relevant test. The facts of *PJ Carrigan Ltd and Carrigan v Norwich Union Fire Society Ltd*[87] closely resemble those contained in *Macaura* itself, but Lynch J had no difficulty in finding that because the second plaintiff was the holder of a substantial if not a beneficial interest in a company that had purchased real property, the second plaintiff had in law an insurable interest. The factual expectation test is in accordance with recent Irish case law[88] that recognises legitimate expectation as being an alternative basis for recognising promises as enforceable, even absent some legal ground for holding the promise to be contractually enforceable.

2.53 There are of course difficulties in using legitimate expectation in this way – an insurance company is not a public body and it is engaged in commercial, not regulatory activities. But contract law alone can be adequate. If the contract of insurance was characterised as one in which the insurer has undertaken to extend cover to a proposer or insured, and the facts reveal that the proposer or insured has a (legitimate) or factual expectation that the policy will be honoured, it is difficult to see why or how an insurer should be permitted to resile from the contract. The legitimate or factual expectation should of course be anchored on some appropriate economic relationship between the proposer or insured and the subject matter of the insurance contract. Wagering contracts will not suffice; situations where the proposer or insured has suffered no loss because the property is essentially owned by others will be outside most insurance contracts, by virtue of the indemnity principle. If an insurer is to insist upon being able to avoid payment upon a policy because no insurable interest existed at the time of the contract, it might be appropriate to require the insurer to bargain for such a right in express terms and be under a duty to seek information from the proposer on the nature of the interest held as a *sine qua non* to such a right to resile from a contract. In the absence of such an exchange of information, an insurer should be regarded as not requiring the proposer to have anything other than a factual expectation in the transaciton or property in question and that the policy will be honoured by the insurer. As the reasoning of Wilson J in *Constitution Insurance Co of Canada v Kosmonpoulos* attests, the insurable interest requirement is a poor means of advancing the deterrence functions against wagering and moral hazard, while at the same time having the negative effect of frustrating the development of socially desirable insurance policies, especially in the areas of income protection, elderly and disability maintenance insurance, and life policies.

2.54 In *A Casebook of Irish Insurance Law*, Corrigan and Campbell observe:[89]

> "By and large, however, it is rare for insurers to raise the issue of insurable interest to avoid their contractual obligations. It is primarily a technical requirement and, in the absence of significant substantive reasons for relying on it as a defence, it is unlikely that an insurer would obtain a sympathetic hearing and so succeed in invoking it before an Irish court."

2.55 Buckley[90] citing Keaton, *Insurance Law; Basic Text* observes that "it is said that in *Macaura* the House of Lords was influenced by unproven allegations of fraud." Ellis and Wiltshire, in *Regulation of*

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85 *Ibid*, p.223.

86 [1962] IR 314.

87 High Court, 11 December 1987.

88 For example, *Glencar Exploration plc v Mayo County Council (No2)* [2002] 1 IR 84. Promissory estoppel too may be invoked, but it may be difficult factually to show a representation or reliance in this context: see also *McGrath v Minister for Defence* [2010]1 IR 560.

89 Corrigan and Campbell, *A Casebook of Irish Insurance Law*, p.91. In *Carrigan* for example the substantive defence was that the loss occasioned by fire had been caused by arson involving the insured.

Insurance in the UK, Ireland and EU also suggest that a test less onerous than possession of a legal interest or equitable represents Irish law. Some awareness of the need to liberalise the law is found in the wider literature. The 1976 O'Donoghue Report[91] commented on the need to extend insurable interest so as to cover instances of adoption and give the trustees of trust funds a right to insure where it would be commercially prudent to do so, but the O'Donoghue Report did not give a view on the relevant test. Ellis, in *Modern Irish Commercial and Consumer Law*[92] suggests a working definition of insurable interest, fusing this definition from a combination of the outcome in the *Carrigan* case and the views of Wilson J in *Kosmapoulos*:

> "insurable interest can be said to arise when a person stands in such relationship to the subject matter of the insurance that:
>
> (1) he benefits by its continued safety (or absence from liability in the case of liability insurance); or
>
> (2) is prejudiced by its loss (or incurring of a legal liability).
>
> In short, to possess insurable interest, a person must have some financial involvement with the subject-matter of the insurance."

2.56 It is arguable that as the *Life Assurance Act 1774* does not apply to fire insurance for buildings,[93] nor in relation to goods,[94] the most important question to be addressed in Ireland relates not to the test to be applied but whether the insurable interest requirement in life policies needs to be repealed or reformed.

2.57 It is clear that Irish courts give unmeritorious insurable interest arguments short shrift. Dissatisfaction has also been shown by non-judicial decision makers. The insurable interest issue arose on several occasions in relation to the question whether the non-statutory Insurance Ombudsman of Ireland could take jurisdiction over complaints made by employees arising out of disability claims arising out of group schemes. The Insurance Ombudsman found that an interest could be established when the complainant was required to pay the premium and initiate the claim,[95] or when the group scheme itself had been negotiated between the employer and a representative trade union.[96] Even in the case of a non-contributory group scheme the Insurance Ombudsman ruled that jurisdiction existed if the complainant could be regarded as an individual member;[97] change of position on the basis of assurances given also had the same effect.[98] However, where a life assurance policy that had been taken out by the proposer, the complainant's (now) estranged husband, the complainant being the life assured and responsible for paying the premiums, the Ombudsman indicated that she had no power to order the insurer to effect a transfer of title from the proposer to the complainant.[99]

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90 Buckley, *Insurance Law* 2nd ed (Round Hall 2008), at 36.

91 See the *Final Report of the Committee of Inquiry into the Insurance Industry* Prl.5530 (March 1976).

92 Ellis, *Modern Irish Commercial and Consumer Law* (Jordan's 2004), at para. 29.25.

93 *Church and General Insurance Co v Connolly* High Court 7 May 1981.

94 *Motor Insurer's Bureau of Ireland v PMPA Insurance Ltd* [1981] IR 142.

95 Case 3, Digest 1992-1988.

96 Case 6, Digest 1992-1998.

97 Case 4, Digest 1992-1998.

98 Case 5, Digest 1992-1998. In Case 6 the Insurance Ombudsman said the question whether an employee had an interest in the policy, "either directly or beneficially", it was necessary to consider both the spirit and the wording of the policy and to deduce the objective and aims of the parties in effecting the insurance.

99 Case 8, Digest 1992-1998.

E Conclusion on the insurable interest test

2.58 The Commission considers that the narrow test for an insurable interest, advocated by the UK House of Lords in the *Lucena* case in 1802 and in the *Macaura* case in 1925, is no longer acceptable. In any event, *Macaura* itself has never been endorsed in Ireland. The *dicta* of Brett MR in *Stock v Inglis*[100] sets out, in the view of the Commission, a compelling argument against a legal or equitable interest test being deployed:

> "in my opinion it is the duty of a court always to lean in favour of an insurable interest, if possible, for its seems to me that after underwriters have received the premium, the objection that there was no insurable interest is often, as nearly as possible, a technical objection, and one which has no real merit, certainly not as between the assured and the insurer."[101]

2.59 Accordingly, the Commission has concluded that legislation should provide that an otherwise valid insurance claim cannot be rejected by the insurer solely because the insured lacks an insurable interest as it has been traditionally defined, that is, a legal or equitable relationship between the insured and the subject matter of the insurance contract. The Commission has also concluded that insurable interest should, in the interests of certainty, be more broadly defined in legislation as an interest that subsists when a person may benefit from the continued existence or safekeeping of the subject matter of the insurance or may be prejudiced by its loss; and that this definition would apply both to non-life insurance (in particular property and liability insurance) and to life insurance.

2.60 The Commission provisionally recommends that legislation should provide that an otherwise valid insurance claim cannot be rejected by the insurer solely because the insured lacks an insurable interest as it has been traditionally defined, that is, a legal or equitable relationship between the insured and the subject matter of the insurance contract.

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F Insurable interest in Life Policies – common law and statute law

2.62 In *British Commercial Insurance Company v Magee*[102] Joanna Magee had insured the life of Daniel Ryan for a sum of £500, promising that Daniel Ryan was not in excess of 36 years of age and had not contracted small-pox or cow pox, had not suffered from gout or the spitting of blood, nor was affected by any disorder tending to shorten human life. Daniel Ryan was also not to go on the high seas, or beyond the boundaries of Europe, nor engage in military or naval service without the consent of the directors of the company. On Daniel Ryan's death, Joanna Magee's claim for the sum insured was met by a plea that she had no insurable interest in the life of Daniel Ryan and that the *Life Assurance Act 1774* was merely declaratory of the common law. Counsel for the company remarked that "[i]n some countries such contracts are prohibited on the ground of their furnishing a temptation to assassination."[103] On the central point concerning public policy, after noting that the *Life Assurance Act 1774* had not (at that time) been applied to Ireland, Bushe CJ, giving judgment for the plaintiff company in the Court of Exchequer Chamber stated:

> "no authority has been cited, to show that such an insurance has been held illegal, as being against policy or morals in any case decided in England before the Statute; and it is only necessary to look into the statute to be satisfied that it is not declaratory, for it does not recite

[100] (1884) 12 QBD 564.

[101] (1884) 12 QBD 564, at p.571. See also Bright J's views in the South Australian Case *Truran Earthmovers v Norwich Union* (1976) 17 SASR 1 at 6.

[102] (1834) *Cooke and Alcock* 182.

[103] (1834) *Cooke and Alcock* 182, at 188.

any existing doubt, or prevailing mistake as to the law [recital recognising the evil of gaming] and the necessity for preventing it *in future.*"[104]

2.63 The net effect of *British Commercial Insurance Co v Magee* is that, at common law, wagering policies, or policies upon the lives of persons in which the assured has no interest, are valid in Ireland. It is only through Statute law that such contracts may be void or unenforceable.

2.64 The *Life Assurance Act 1774,*[105] as applied to Ireland by the *Life Insurance (Ireland) Act 1866,*[106] was enacted at a time when wagering on lives (including, in 1774, the life of King George III) had become common, and one of main purposes was to ban this practice. The 1774 Act consists of 4 sections. Section 1 provides that insurance contracts on lives or other events[107] should not be affected where the person to benefit had no interest; contracts by way of gaming and wagering are also prohibited. Section 2 requires the names of persons for whose use, benefit or on whose account the policy is taken out to appear on the policy; this was amended in the *Insurance Act 1989* so as to cover group insurance policies whereby a class of person may be expressed on the policy. Section 3 limits the amount that can be recovered to the value of the interest (although life assurance policies are not indemnity policies). Section 4 excludes from the Act, for historical reasons, policies on ships, goods or merchandises. It is certainly arguable that the 1774 Act needs to be repealed. Section 1 is either superfluous or in need of restatement and expansion. Section 2 is, in the view of the English and Scottish Law Commissions', "superfluous" on the basis that section 2 is governed by section 1 in any event. Section 3, which in Ireland is limited to life insurance contracts, is incompatible with case-law establishing that life policies are contracts to pay a fixed sum on the occurrence of a stated event. Section 4 is a saver provision that was necessitated by virtue of the unpalatable consequences that would have followed had goods been caught up in the rest of the 1774 Act.

2.65 In New Zealand the 1774 Act has been repealed with no discernable consequences and the Commission has provisionally concluded that the Irish position should be the same. However, the Commission recognises that it is arguable that life insurance should continue to require some form of insurable interest and possibly a consent provision as an alternative basis for effecting a valid contract of life insurance. The requirement in section 2, even if it can be seen as a formalities provision, should not be tucked away in an old statute, especially when it provides a technical defence to an action on a life policy which renders the contract void. Section 3 has been identified as defective insofar as life insurance taken out to insure the life of a debtor, the debt being for other than a fixed term, will not allow for interest to be recoverable on such an expectancy. The most significant criticism of the 1774 Act is that it is simply unnecessary and ineffective in countering wagering contracts and dissuading persons from embarking on criminal pursuits via moral hazard.[108]

2.66 Section 2 is a source of some mischief and in section 26 of the *Insurance Act 1989* a caveat was added to section 2 of the 1774 Act so as not to allow the section to invalidate a policy of insurance for the benefit of unnamed persons if there is a specified class or description of those persons in the policy which will enable the identity of those persons to be established. This provision applies whether the policy was made before or after commencement of the section. The English and Scottish Law Commissions, in their Insurable Interest issues paper, also question the wisdom of retaining these "entering the names of interested persons" provisions.[109] In particular, such a matter as entering the

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104 (1834) *Cooke and Alcock* 182, at 192.

105 14 Geo.3, c.48. *Siu Yin Kwan v Eastern Ins Co* [1994] AC 199 holds indemnity insurance is outside the 1774 Act.

106 29 & 30 Vict. c.42.

107 It is this clause that raises issues about the scope of the 1774 Act. In Ireland the issue was settled by Costello J in *Church and General Insurance Co v Connolly,* High Court, 7 May 1981, in which he stated that "the 1774 Act only applies in this country to policies of life insurance" and that public policy considerations required illegality principles to apply in that case.

108 The Law Commissions, Issues Paper 4, para 4.12.

109 Issues Paper 4 paras. 6.9 and 6.10.

names of beneficiaries into policy documentation could be left as a regulatory requirement, to be supervised by the Central Bank of Ireland rather than allow policies to be avoided altogether.

2.67 *The Commission provisionally recommends the repeal of the Life Assurance Act 1774, as extended to Ireland by the Life Insurance (Ireland) Act 1866.*

G Should a remodelled section 1 of the Life Assurance Act 1774 be re-enacted as a formalities provision?

2.68 While section 1 of the *Life Assurance Act 1774* does not define the nature of the interest, there are four categories that have emerged via case-law.

(1) an interest arising out of natural love and affection;
(2) an interest arising out of a potential financial loss recognised by law which existed at the time of contracting;
(3) an interest arising out of statutory provisions;
(4) a miscellaneous category recognised by the courts.

(1) Natural Love and Affection

2.69 Natural love and affection will permit a person to insure their own life or that of their spouse. Other family relationships that cannot satisfy factor (2) or (3) above will not involve an interest that arises out of natural love and affection. Children and parents have no right to insure each others lives and, *a fortiori*, persons related by marriage, siblings, cousins, etc do not possess an insurable interest across such classes of relative. The most obvious instance in which this rather arbitrary position can be shown to be socially undesirable relates to cases where a child is born who will, or may, require care at some time in the future when the child's parents could then be expected to have died. Conversely, because a child is not at any stage charged with obligations to support a parent, no insurable interest will arise if an adult child, for example, seeks to effect insurance that will provide a financial lifeline for a parent who may require institutional care, or nursing home accommodation at some future date. Even some attempt to side-step the insurable interest requirement – for example, describing the policy a burial expenses policy when the proposer was seeking to insure his mother's life because she was also his cook/housekeeper will not be effective. One commentator[110] on the Law Commission's *Insurable Interest* Issues Paper has indicated that there is scant evidence to show that dependants find it difficult to effect insurance and that steps can be taken to avoid the 1774 Act, for example, by an assignment. These observations seem to be beside the point. There remains the possibility that the 1774 Act will frustrate a socially desirable objective and that avoidance techniques such as cross insurance and assignments complicate a process that should be simple and transparent. There are cases which show that the law can be capricious in the sense that insurable interests points may not be taken by the courts[111] or that a strict reading of the law *vis-a-vis* morally unobjectionable family arrangements may lead to unacceptable results when inadequate professional services have been rendered.[112]

2.70 Cohabitees and persons engaged to be married do not possess any insurable interest in each other's lives. This situation seems to the Commission to be unacceptable in the 21st Century, and when one considers that the insurable interest survives a decree of judicial separation or a divorce, a major anomaly clearly exists. The difficulty of legislating clear rules in relation to non-marital relationships and the insurable interest should not be underestimated but the law needs to be rationalised and clarified. It may be that such difficulties make outright repeal of an insurable interest requirement the most appropriate course of action.

110 Templeman, at 210 of Soyer, *Reformine Marine and Commercial Insurance Law* (Informa Law 2008).

111 *In Re Slattery* [1917] 2 IR 278.

112 *Hayes v Allied British and Foreign Life and Fire Insurance Co* (1881) 8 LR(Ir) 149. See also on assignment *In Re Power* (1882) 11 LR (Ir) 93 and *In Re Malet's Trusts* (1886) 17 LR (Ir) 424.

(2) A potential financial loss recognised by law which existed at the time of contracting

2.71 At the present time the insurable interest must be recognised by law and the interest that is recognised is limited to the interest that is so recognised. A creditor is thus entitled to insure the life of a debtor and where two persons buy a house on a joint and several basis for the mortgage debt, each person is able to insure the life of the other to cover the whole of the mortgage debt. As the English and Scottish Law Commissions point out, this category of insurable interest is problematical, firstly because the financial loss test, defined as a pecuniary interest that is capable of valuation, is difficult to define and excludes general considerations such as "reasonable expectation", as distinct from an enforceable legal entitlement. Secondly, the Law Commissions highlight the difficulty in recovering the sums insured when the courts incline towards giving the insured the amount lost rather than the value of the interest on the life assured, as of the date the policy was taken out. Thirdly, should the insured recover the sum of his/her loss (eg via a separate policy of insurance) this will exhaust the entitlement: *Hebden v West.*[113] The most important practical consequence of this restrictive category arises in relation to employee/employer and key employee insurance taken out by an employer.

(3) Statutory obligations

2.72 There are relatively few examples of this category in Irish statute law. The *Married Women's Status Act 1882*, s.11 provides that a policy of insurance taken out by a husband or wife, for the benefit of his/her spouse or children, creates a statutory trust and the benefits are payable directly to the beneficiary. There are also judicial decisions that overlap on this issue. A husband may have an insurable interest in his wife's property, to the extent that the parties to the marriage live together and use that property. Should the husband become insolvent and some chattels be removed from property that ought to be available to satisfy his creditors, that may be a fraud upon his creditors but will not prevent an insurable interest arising: *Goulstone v The Royal Insurance Company*.[114] Conversely, Lord Kenyon, in *Reed v Royal Exchange Assurance Company*[115] remarked that it is not necessary to show an insurable interest is held by a wife in her husband's property "as it must be presumed that the plaintiff [wife] was interested in his life."[116] The *Married Women's Property Act 1882* has proved an enduring precedent. Section 11 of the Act provided that a policy of insurance effected by a man or woman on his/her own life, and expressed to be for the benefit of his/her husband/wife or of their children is to create a trust in favour of those objects; the monies payable are not to form a part of the estate of the insured so long as any object of the trust remains unperformed. Case-law suggests that section 11 often produced litigation over the identity of the beneficiary (eg *Prescott v Prescott)*[117] and many judicial utterances are directed at the privity of contract problem rather than that of insurable interest.[118] Section 11 was replaced by section 7(1) of the *Married Women's Status Act 1957*, providing that a trust could arise in relation to a life assurance or endowment policy expressed to be for the benefit of, or by its express terms purporting to confer a benefit on, a wife, husband or child of the insured. Section 7(8) defined a child so as to include a stepchild, illegitimate child, adopted person or person to whom the insured stands *in loco parentis.*

2.73 The logic of the 1882 and 1957 legislation is clear: children or surviving spouses should have a source of income, to be provided out of private insurance. Whether this rationale is intelligible within the context of State welfare provision for adult and child dependants may be an open question, but there is no doubt that the failure of the legislature to allow adult children to be the subject of insurance cover so as to facilitate direct financial provision for the healthcare and maintenance requirements of elderly parents by private insurance is most unfortunate. While the law will already enable a parent to benefit from a life policy taken out by an adult child by way of assignment it would be preferable to facilitate direct provision

113 (1863) 3 B & S 579. This case is considered below at M, Valuation Difficulties, para 2.85

114 (1858) 1 F & F 276.

115 (1795) Peake Add Cas 70.

116 See MacGillivray paras. 1.066 to 1.069.

117 [1905] 1IR 156, following *In Re Adams Policy Trusts* (1883) L3 ChD 525. See also *In Re O'Donnell* [1968] NI 52.

118 Eg *Cleaver v Mutual Reserve Fund Life Association* [1892] 1QB 147 *per* Lord Esher at 152.

insurance contracts, not least because the insurance industry would be encouraged to develop new insurance products that would address the health care and maintenance needs of "the objects", to use the language of the 1882 legislation.

(4) The Miscellaneous Category

2.74 This category exists in English law as a result of Waller LJ's speech in *Feasey v Sun Life Assurance of Canada.*[119] This decision has not been considered by an Irish court and it has been doubted by English commentators. The existence of this category can be said to arise out of the inconvenience of an insurable interest requirement and how it may obstruct otherwise unobjectionable contractual arrangements in a commercial setting. Rather than heaping an exception onto an exception, it would be better to reform or even repeal the insurable interest requirement altogether.

(5) The limits of natural love and affection

2.75 The leading cases on the absence of natural love and affection being insufficient to create an insurable interest as between a parent and child generally revolve around old poor law maintenance and burial obligations, the effect of which is often to supplant arguments about legal support and contractual consideration. In Ireland, decisions such as *Farrington v Donoghue*[120] and *Pordage v Canter*[121] demonstrate that statutory obligations to support children born outside marriage were imposed upon mothers, but not fathers. Current Irish legislation imposes support obligations horizontally on parents: *Social Welfare Consolidation Act 2005*, section 345. However, in circumstances where a parent takes out insurance on the life of an adult child the weight of authority stands against an insurable interest being made out. In *Halford v Kymer*[122] a father took out a policy of insurance on the life of his son. The issue was whether the policy could be enforced on the basis that the chance that the father might be supported by his son in his old age afforded an insurable interest. Bayley J said of the father that "the parish is bound to maintain him, and it is indifferent to him whether he be maintained by the parish or his own son."[123] Recent English authority has cast some doubt on this case, Waller LJ, in *Feasey v Sun Life Assurance Co of Canada and others*[124] remarking that "one wonders whether the same decision would be reached in the modern era."[125] The fact that many of the cases appear to involve collusive acts by proposers and agents of the insurer (albeit agents with limited capacity) or even instances of innocent and ignorant persons being duped by insurance agents, was allowed to speak to the recovery of premiums paid by the *in pari delicto* rule but not the enforceability of the underlying contract. There are isolated cases however where the courts were prepared to allow family members to bargain for support obligations by analogy with creditor and debtor transactions. Case-law sometimes permitted recovery on a policy where a family member may have a legal duty to maintain another family member. In *Barnes v London, Edinburgh and Glasgow Life Insurance Company*[126] the plaintiff promised her mother to maintain a 10-year-old child, the promisor's step-sister; the evidence indicated that the plaintiff had commenced to perform her promise, taking out a life policy on the child. A self-imposed duty of this kind permitted the promisor to secure the repayment of the expenses incurred. Lord Coleridge CJ remarked that obligations of the sort undertaken by the promisor "were obligations the repayment of which was habitually secured in this way." Both the Chief Justice and AL Smith J regarded the promisor as having an insurable interest

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[119] [2003] EWCA Civ.885. See MacGillivray generally in Ch.1. Templeman, *op cit* at p.200 describes *Feasey* as commercially sensible but a legally doubtful decision as it recognises a pecuniary interest as sufficing to satisfy the 1774 statute.

[120] (1866) IR 1 CL 657.

[121] (1854) Ir Jus Rep (05) 246.

[122] (1830) 10 B&C 724.

[123] (1830) 10 B & C 724 at 730.

[124] [2003] EWCA Civ.885.

[125] *Ibid*, para 83.

[126] [1892] 1 QB 864. This case has been criticised in later English proceedings, discussed in the 2008 Insurable Interest Issues Paper 4 at para 3.14, footnote 8.

to the extent of monies actually expended. AL Smith J distinguished this situation from instances where a legal obligation to support a child is imposed by law, as in the case of a father and his son. Case-law holds that should a son seek to contractually recognise benefits obtained from his father no insurable or pecuniary interest will arise and any policy will be void as between the insurer and the insured: *Worthington v Curtis.*[127] The policy behind such instances varied somewhat; the most obvious instances being a desire to protect vulnerable persons[128] and require truthful disclosures by proposers.

2.76 The fact that natural love and affection was limited to spouses, judged at the time of taking out the insurance policy led to a range of legislative adjustments in the family context. Legislative provisions relating to payments upon the death of small children were contained in Friendly Societies legislation; the *Friendly Societies Act 1896* provided that no society should pay any sum of money on the death of a child under five years of age in excess of £6, or £10 in the case of a child between 5 and under 10 years of age.[129] Monies were also only to be aid to the parent of the child or the personal representative.[130] Section 67 specifically excluded these restrictions on insurances where the insurer had an insurable interest in the life of the person insured. Before looking at the 1909 and 1936 Acts, it must be said that although industrial insurance in Ireland has declined considerably, and the present trend is towards winding up this form of insurance, the law does reflect some important public policy considerations that remain valid today. Clearly children need to be protected against any moral hazard that may arise, but the existence of a cap on the amount payable under a policy on the invalidation of policies on the basis of absence of an insurable interest seem to be rather clumsy mechanisms which ignore the more effective deterrents, namely, the public policy proscription against persons benefiting from an illegal act and the general law against infanticide and murder.

2.77 The *Assurance Companies Act 1909*[131] was enacted to ameliorate the insurable interest requirement and the fear of a "parish burial". Section 36(1) of the 1909 Act provided that policies of assurance could be issued for the purpose of insuring money to be paid for the funeral expenses of a parent, grandparent, grandchild, brother or sister. Section 36(2) provided that no policy effected before or after the passing of the Act would be void on the grounds (*inter alia*) that the person effecting the policy had no insurable interest at that time, if such a person had a bona fide expectation that he would incur expenses in connection with the death or funeral of the assured, and the sum assured be not unreasonable for the purpose of covering those expenses. These life policies were intended to allow the poor and working classes to have enough money set by to permit a dignified death and burial, rather than suffer the ignominy of knowing that they would receive a parish or pauper's funeral and the case-law that the statute threw up involved a diverse range of issues such as agent's misrepresentation, proposer fraud and non disclosure, for example.[132] On the question of whether the 1909 Act created an insurable interest there was a difference of opinion between the Irish and English judges. In *O'Brien v The Irish National Insurance Co Ltd*[133] Sealy J observed that section 36(2) "comes to the relief" of the plaintiff who had taken out a policy in respect of her brother's life. Subsequently, in a similar case, *Gallagher & McPartland v The Industrial & Life Assurance Amalgamated Co Ltd,*[134] Dixon J observed that the 1909 Act "made it legal for a policy to be effected on the life of *inter alia*, a sister for the purpose of providing for

127 (1875) 1 Ch D 419 (on the basis, apparently, that consideration is past).

128 See Section 7 of the *Children Act 1908*, making it an offence for a nurse or a person maintaining a child to insure the child's life. The dangers of infanticide and easy availability of poisons in Victorian England contributed to such measures: See Whorton, *The Arsenic Century* (Toup, 2010).

129 *Friendly Societies Act 1896*, s.62. The consequences of non compliance were draconian: see *Connors v London and Provincial Insurance* (1912) 47 ILTR 148.

130 *Friendly Societies Act 1896*, s.63.

131 9 Edw. 7 Ch. 49.

132 These cases raised some difficult points of law: eg *Griffen v Royal Liver Friendly Society* (1942) 76 ILTR 82; *Wall and Wall v New Ireland Assurance Co Ltd* [1965] IR 386.

133 (1932) 66 ILTR 159.

134 (1946) 80 ILTR 99.

funeral expenses, and that provision, in my view implicitly conferred an insurable interest in the life of a sister."

2.78 In England Rowlatt J, on the other hand, questioned whether the 1909 Act created a new insurable interest; in *Goldstein v Salvation Army Assurance Society*[135] he thought it did not.

2.79 In Britain, the 1909 Act was repealed and replaced by the *Industrial Assurance and Friendly Societies Act 1929.*[136] A significant feature of the 1929 Act was the expansion into endowment policies; in the broader sense of social policy, individuals were being encouraged to make provision for dependants via a number of endowment and whole life policies. The 1929 Act did not specifically address the insurable interest question.[137]

2.80 Part V of the *Insurance Act 1936* effectively replicated the British 1929 Act, specifically providing however that any policy of industrial assurance effected under section 50 was deemed to create an insurable interest in the life of the person and that no such policy is to be deemed an indemnity policy. But even this legislative change, modest though it was, produced some very technical and difficult court decisions. Policies taken out in respect of funeral expenses under s.36(1) of the *Assurance Companies Act 1909* have been held to be policies of indemnity. When a proposer took out a number of policies on the life of his mother, for burial expenses, payment by one company was held to discharge the claim in full. Case-law holds that in the absence of fraud or a mistake of fact, the premiums were not recoverable as all of the companies were at risk during the currency of the policy: *Wolenberg v Royal Co-op Collecting Society.*[138] The existence of an insurable interest was also fatal to recovery of premiums. In *Gallagher and McPartland v The Industrial and Life Assurance Amalgamated Co Ltd,*[139] M took out life policies on his sister but after some time M's daughter, G, took over payment of the premiums. Clearly G had no insurable interest but M's insurable interest at the commencement of the policy rendered the contract valid until such time as M ceased to pay the premium: absent fraud by the company's agent, Dixon J held the premiums irrecoverable: see also *Wall and Wall v New Ireland Insurance Co.*[140]

2.81 Although industrial assurance legislation sought to prevent 'moral hazard' by restricting the availability of cover, there are other means of advancing criminal or undesirable practices. Sham transactions whereby a limited policy of insurance is taken out by the life to be insured – each person has an insurable interest in his or her life – with the premiums being paid by third party were likely to be invalid via the law of misrepresentation: *Wainewright v Bland.*[141] The leading decision on section 2 of the 1774 Act is *Shilling v The Accidental Death Insurance Company.*[142] Thomas Shilling took out a policy of life insurance upon his father James Shilling. Thomas effected the policy, apparently as agent of his father who was in a hazardous occupation; however, James was not aware that his son had effected the policy. When, following the death of James Shilling his Administratrix claimed on the policy, the company pleaded non compliance with section 2 of the 1774 Act, reasoning that if a close relative could take out insurance without that relative's knowledge or consent, the temptation to collect on the policy by materialising the risk (in this case causing James Shilling's death) could well be irresistible to some persons. The policy was held to be void. In *Reed v Royal Exchange Assurance Company*[143] Mrs Reed

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135 [1914] 2 KB 291.

136 19 & 20 Geo 5, c.28.

137 Section 1 of the 1929 Act provided that if a life cover was in place in such an endowment policy, only reasonable funeral expenses could be payable.

138 (1915) 112 LT W36.

139 (1946) 80 ILTR 99.

140 [1965] IR 386.

141 (1835) 1 M & Rob 481; see also *Collett v Morrison* (1851) 9 Hare 162 (extends to life and trustee when both appear on the policy).

142 (1858) 1 F & F 116.

143 (1795) 2 H & N 42. Recovery of premiums on such a wagering contract is not possible: *Howard v Refuge Friendly Society* (1886) 54 LT 644.

took out a life insurance policy on her husband six days before his death. While Lord Kenyon held that a wife is presumed to have an insurable interest in the life of her husband, after hearing the facts of the case and seeing the evidence, "particularly a letter from the plaintiff to a young man of her acquaintance" a claim on the policy was unseccessful (Mrs Reed was subsequently indicted for the murder of her husband but acquitted).

(6) Debtors and creditors

2.82 A debtor has no insurable interest in the life of a creditor unless there is some consideration present. Where a creditor promised a debtor that he would not seek to enforce a claim to a debt during the creditor's lifetime, such a promise could not create a pecuniary interest in that life: *Hebdon v West.*[144] In the case of a creditor who seeks to insure the life of a debtor, such a contract was at one time considered to be a contract of indemnity that would only enure to the benefit of the policyholder should the debt remain unpaid following the death of the creditor.[145] This was overruled in *Dalby v The India and London Life.*[146] The logic of *Dalby* case, that a policy of life insurance is a contract to a certain definite sum at a future time, in consideration for payment of the premiums, is illustrated by *Law v London Indisputable Life Policy Co.*[147] Law purchased from his son a contingent legacy of £3,000, payable to the son when he reached 30 years of age. Law insured his son's life for two years, the son being at that time 28 years and four months old. The son reached his 30th birthday and Law was paid the legacy. However, the son died shortly thereafter and within the two year period of insurance. Wood VC held the contract was one in which Law clearly had an insurable interest, even if the interest was not for the entire period insured. The contract was not a wagering contract, nor would the court cut down the sum payable in some way. MacGillivray[148] is critical of the "unrealistic situation" that the 1774 Act produces in this way, suggesting that in such case the American solution (whereby the creditor's interests should be the amount of the indebtedness at the time of death, and the cost of the insurance with interest, any balance being payable to the deceased debtor's estate) should be adopted into English law.

(7) Property insurance

2.83 Apart from Marine insurance and section 4 of the 1906 Act, there is no statutory insurable interest requirement in Irish law relating to property. Although the 1774 Act, as extended into Ireland in 1866 has been held not to require an insurable interest for property insurance, [149] property insurance cases also reflect a judicial sensitivity concerning fraudulent claims, particularly incendiarism. In *Sadler's Company v Badcock*[150] Mrs Strode leased a house which was insured for £400. Her tenancy expired and the property was destroyed by fire shortly thereafter. Mr Strode assigned the policy to the "ground-landlords" who sought to enforce the policy. As Mrs Strode was required to have a property in the thing insured at the time the insurance was made and at the time of the fire, she had no interest that could be assigned as this policy was intended to insure Mrs Strode from damage, rather that insure the property from damage. Lord Chancellor Hardwicke remarked that "if the insured was not to have a property at the time of the insurance or loss, any one might insure another's house, which might have a bad tendency to burning houses." In contrast, a wharfinger who insures a building and his own goods, as well as property bailed with him and held "in trust" for the owners of those goods is able to recover on the policy in respect of third party goods held by the wharfinger on behalf of those third parties: *Waters v Monarch Fire and*

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[144] (1863) 3 B & S 218. It is through this category that 'key employee' insurance is obtained for instance.

[145] *Godsall v Boldero* (1807) 9 East 72.

[146] (1854) 15 C.B. 365.

[147] (1855) 1 K & J 223.

[148] *MacGillivray on Insurance*, 12th ed, para 1-087.

[149] *Church and General Insurance Company v Connolly* High Court, 7 May 1981; *Brady v Irish Land Commission* [1921] 1 IR 56.

[150] (1743) 1 Wils. KB 8.

Life Insurance Company.[151] In *James v Royal Insurance Co.*[152] E entered a business partnership with J. in order to gain access to premises where the business was carried on. E promised the landlord M that he would insure fixtures and furniture located on the premises. The fixtures and furniture were destroyed or damaged by a fire. The insurance company resisted the claim on the basis of lack of insurable interest vesting in E but Lawson J said E had an insurable interest, both as bailee and by virtue of his being under a legal obligation to M to insure.

(8) Valuation Difficulties

2.84 On the question whether an employer has an insurable interest in the life of an employee, Irish law settled this point in 1841 in *Scott v Roose.*[153] 'Key employee' policies are a matter of common practice.

2.85 In relation to the converse position, the interest on an employee in an employer's life, the scope of the insurable interest is a matter of controversy because it is limited by the notion of a pecuniary interest. In *Hebden v West,*[154] H, a bank clerk, took out a policy of life insurance upon the life of P, the managing partner of the bank. That policy, for £5,000, was followed by another policy for £2,500 with another insurance company. H owed P £4,700, a sum which P promised would not be recovered during his lifetime, and H had a contract of employment, at £600 per annum, for seven years, at the date of P's death. The only pecuniary interest related to H's salary which over the period was computed at £4,200. Because the first insurer had paid out the insured sum of £5,000, an amount that more than covered H's pecuniary interest, an action to recover on the second policy failed on the basis that section 3 of the 1774 Act limited monies payable by reference to the pecuniary interest. The Law Commission is rightly critical of this decision arguing that the second company had collected the premiums from an insured who was clearly not gaming or wagering and that the court, incorrectly, aligned this contract with an indemnity contract. This limitation has a potentially devastating effect on the recoverability of assured sums. Key workers, for example, may be so important to an organisation or employer that the employer may seek to effect insurance on the life of that employee foreseeing that loss of that employee will have very adverse effects for the business. Some case-law[155] suggests that the employer's insurable interest is measured by the notice period that the employer is entitled to (eg a week, a month or year) rather than anticipated business losses. Mac Gillivray[156] also points out that the value of an employee may only become apparent after the insurance has commenced and that any early effort at fixing the mercantile value of any insurable interest does not really work in this context. The English and Scottish Law Commissions state that it is typical practice to value a key employee at a figure of up to 10 times annual salary and suggest that any such a round figure estimate may be contrary to the 1774 Act. Any other estimate, based upon likely future business generated by the employee, the English and Scottish Law Commissions argue,[157] would be an expectation interest rather than a pecuniary interest and thus fail to satisfy section 1 of the 1774 Act.

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151 (1856) 3 El. & Bl. 870. In marine policies carriers were also held to have an insurable interest in goods carried by them and for which they might be liable if lost: see Littledale J in *Crowley v Cohen* (1832) 3 B & Ad. 178. PPI policies are void where the 1906 Act applies: *Edwards (John) & Co v Motor Union Insurance Co* [1922] 2 KB 249.

152 (1875) 9 ILTR 194, following *Marks v Hamilton* (1852) 21 LJ Ex 109.

153 (1841) 31 Eq. R. 170.

154 (1863) 3 B & S 579, criticised by the English and Scottish Law Commissions in Issues Paper 4: *Insurable Interest*, para. 3.28.

155 *Simcock v Scottish Imperial Ins Co* (1902) 10 SLT 286; *Turnbull v Scottish Provident Institution* (1896) 34 SLR 146.

156 Paras 1-073 -1-074. Templeman, *op cit* p.213 queries whether these problems are theoretical rather than real, given that policies are enforceable in their own terms and the insurable interest point is never taken by the insurer.

157 Para 4.12.

2.86 The Commission invites submissions as to whether, on the issue of valuation, an insurer should be free to fix any value with the proposer at the time of concluding the policy of insurance.

H Reforming the insurable interest requirement in Ireland

2.87 In recommending that a contract should not be defeated solely because the insured lacks a legal or equitable claim or interest, the Commission leaves open the question whether there is any need to recommend additional reform of the insurable interest requirement. It is possible to take a somewhat sanguine view on this question: matters of definition *vis-à-vis* insurance contracts are generally side-stepped by legislators, regulators and the courts, once it is clear that the arrangement under review is an acceptable and commercially useful mechanism such as swap or option contracts. These contracts are intended to lay off risk on loans, debt securities or other assets by reference to a contracting party – it could be a multinational or even an entity closely linked to a sovereign state, for example, in exchange for either swap payments or the payment of a premium. Credit derivatives may thus resemble contracts of insurance, and it is clear that regulators seek to regard such commercial dealings as being regulated transactions, but the absence of an insurable interest in credit derivative transactions may count against them being regarded as contracts of insurance, *strictu sensu.*[158] The weight of opinion is against financial derivatives being considered to be wagering contracts on the basis that it cannot be said that both parties will have a common purpose and interest in concluding a wagering contract. The fact that such issues have not troubled the courts may suggest that commercial practices may legitimise financial dealings that do not cross over into gaming contracts or raise issues of moral hazard. While this may be so, the recent analysis of the two Law Commissions, in their Issues Paper 4, *Insurable Interest*[159] argues persuasively for not only the partial retention of the insurable interest requirement but a significant expansion of the range of persons who may have a statutory insurable interest and the circumstances in which such an interest may be established. The recasting of the insurable interest requirement along the lines found elsewhere in Europe and as proposed in the England and Wales 2008 Issues Paper will possibly stimulate new business for the industry and provide some very important and sound reforms, particularly in relation to life and healthcare policies *vis-à-vis* vulnerable adults, an area that the Commission has already considered more generally.[160]

2.88 The *Life Assurance Act 1774* renders void and illegal any policy of insurance where the applicant does not, at the taking out of the policy, have an insurable interest in the life of the person to be insured. It is established that a person will have an insurable interest in the life of his or her spouse, regardless of whether the death will cause any financial loss. Even if the marriage is ended by way of divorce, the insurable interest will remain. The *Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010*, through the financial adjustment orders provisions permits a court to require one civil partner to take out insurance policies for the benefit of the other civil partner, but the legislation stops short of holding that civil partners have an insurable interest in the life of the other civil partner. This is in marked contrast to the position in other jurisdictions where an insurable interest has been recognised by statute or case-law:[161] the UK Civil Partnership legislation makes express provision on this point.[162] The Commission believes that Irish law should do so also.

2.89 The Commission has decided that it would be prudent to define an insurable interest in such a way as to reflect the factual expectation test. In addition, the Commission believes that in respect of

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158 See Generally Smith, "The Legal Nature of Credit Default Swaps" [2010] LMCLQ 386.

159 Issues Paper 4: the Commissions "tentatively" proposed to retain the requirement in non-indemnity contracts for lives, para. 7.40.

160 Insurance policies in respect of wardship is discussed in the Commission's *Report on Vulnerable Adults and the Law* (LRC 83-2006).

161 See generally Kelly, the *Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010 – A Commentary* (Thomson Roundhall). Note that the *Finance (No. 3) Act 2011* adjusts taxation laws in respect of civil partnership.

162 *Civil Partnership Act 2004*, s.253.

general, that is, non-life insurance, it would be advisable to stipulate that an otherwise valid contract of insurance should not be defeated solely because the insured lacks a legal or equitable interest in the subject matter of the contract of insurance. These two recommendations can stand or fall separately, but these recommendations beg the question about whether the insurable interest requirement, such as it is, should remain a part of Irish law.

2.90 A broad approach to this question would start from the position that, at common law, there was no insurable interest requirement. The 1774 Act, as adopted into Irish law in 1866, has been held only to apply to life insurance. Property insurance does not require a statutory insurable interest to be shown. Indemnity insurance contains its own mechanism to control fraudulent claims and over-insurance, that is the indemnity principle. If the formalities provisions in the 1774 Act remain valid, they should be re-enacted in a modern statute. If gambling is to be regulated, it should be regulated via a gaming statute. If insurance is to be distinguished from other financial transactions, an insurable interest concept or requirement is an unsatisfactory way of doing so. In sum, there is no need to retain any insurable interest requirement.

2.91 In contrast, a narrow approach to the statutory insurable interest requirement would start from the position that the insurable interest, at least in life policies, remains a useful protection against gambling or moral hazard, it is in need of reform.

(1) Proposals for Reform – A Broad or Narrow Approach?

2.92 There is a considerable degree of consensus in favour of widening the categories of person who may be able to assert an insurable interest in relation to the natural love and affection route towards meeting the insurable interest requirement. As the Law Commissions point out, the New York position allows a court to rule that any person who has a close relationship, by blood or by law, may thus possess an insurable interest in another person's life. This right extends to the insurance contract being available for unlimited and stipulated amounts of money, as distinct from being pegged to the insurable interest *per se*. The Law Commissions, while mentioning this as a possible approach tentatively inclined towards the Canadian and previously proposed Australian model of setting out persons in defined relationships.

> "We tentatively propose that the following groups should be deemed to have insurable an interest arising out of natural affection:
>
> (1) any person – in his or her own life and in the life of his or her spouse or civil partner;
>
> (2) any person who is cared for and dependent on his or her parent or guardian – in the life of his or her parent or guardian;
>
> (3) any parent – in the life of his or her adult child;
>
> (4) any person – in the life of his or her cohabitant."[163]

2.93 The Commission considers this proposal to represent a modest and worthwhile restatement and expansion of the law, reflecting contemporary developments in terms of social policy (eg recognition of the rights of carers) and the fact that many persons are in cohabitation relationships. However, there will have to be some attention paid to defining persons in a cohabitating relationship, which the Commission assumes, is to include same-sex cohabitionship. For this purpose the Commission refers to the definition of "cohabitants" in the *Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010*, which implemented the key elements of the Commission's 2006 *Report on the Rights and Duties of Cohabitants.*[164]

2.94 A related question that the Law Commissions did not address was the impact that payments made on the foot of any insurance contract may have in respect of social welfare payments and health care benefits. Should these payments made under an insurance contract be seen as a collateral benefit that is to have no impact on social insurance entitlements such as social assistance payments and medical benefits? Further, if some insurance payments are to have an impact on social welfare or health care (eg via means tested assessment mechanisms) how should these two systems of private insurance

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[163] Issues Paper 4, para. 7.62.

[164] Law Reform Commission *Report on the Rights and Duties of Cohabitants* (LRC 82-2006).

and social provision be integrated with each other? The Commission has previously considered these questions from the perspective of how to integrate considerations of legal principle with social justice and social solidarity: see the Commission's 2002 *Report on Section 2 of the Civil Liability (Amendment) Act 1964*.[165] The Commission appreciates that our recommendation that an insurable interest is to vest in cohabitants raises a number of issues that must be considered in broader socio-economic terms but that such considerations go way beyond the ambit of this Consultation Paper.

2.95 The Law Commissions, in *Issues Paper* 4, also invited submissions on what should be done in respect of other relationships, in particular:

> "(1) should parents have an interest in the lives of their children under 18?
>
> (2) should fiancé(e)s have interests in each other's lives?
>
> (3) should siblings have interests in each other's lives?
>
> (4) should grandparents and grandchildren have interests in each other's lives?"[166]

2.96 The fact that these relationships have been separated from the position pertaining or proposed by the Law Commissions in respect of spouses or civil partners, persons cared for and dependant on a parent or guardian, parents and adult children, and cohabitees, tends towards an implicit assumption that siblings, for example, are less likely to be in close or supportive relationships than a married couple. While this may be so in many cases, it is just as foreseeable that two unmarried brothers may form a dependant relationship that could render some insurance arrangement a prudent and socially desirable step for them to take. Whether the moral hazard – the possibility that one family or blood relative might take the life of another for financial gain – is stronger as between married persons than siblings is presumably a matter of idle speculation but any actuarial information on this and other matters would be welcome.[167]

2.97 *The Commission provisionally recommends that, in connection with life insurance, the following should also be deemed to have an insurable interest in the life policy: (a) spouses in relation to each other; (b) civil partners in relation to each other; (c) cohabitants in relation to each other; (d) a child in relation to his or her parent or guardian; and (e) a dependant parent in relation to his or her adult child.*

2.98 *The Commission invites submissions as to whether, in connection with life insurance, the following should also be deemed to have an insurable interest in the life policy: (a) a grandparent in relation to his or her grandchild; and (b) siblings in relation to each other.*

(2) Non Indemnity Insurance and the Insurable Interest

2.99 Non indemnity insurance, that is insurance which pays a fixed sum upon the risk materialising, is generally associated with life policies but property insurance of many kinds is also effected on a non indemnity basis. As Irish law does not currently contain an insurable interest requirement, the 1774 Act not applying outside the area of life cover, an argument would have to be made for legislating for the introduction of an insurable interest requirement to be introduced in non indemnity, non life insurance. The only basis upon which such an argument can proceed revolves around either that of moral hazard/deterrence, or public policy considerations that proscribe gambling. In the Commission's view, neither of these considerations necessitate the introduction of an insurable interest requirement where it does not currently exist.

(3) Moral hazard/deterrence

2.100 The argument that an insurance claim should only be honoured when the claimant can show an insurable interest in order to deter fraud, or moral hazard, does not make very much sense. The arsonist who has no interest in a property but who has an insurance policy in relation to that property might fall under a greater degree of suspicion than any householder or property owner who has such an

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165 Law Reform Commission *Report on Section 2 of the Civil Liability (Amendment) Act 1964* (LRC 68-2002).

166 *Issues Paper 4*, para. 7.64.

167 The Law Commissions in their recently published Joint Consultation Paper 2011: *Post Contractual Duties and Other Issues*, support broadening the categories of persons who may insure the life of another.

interest. Furthermore, the liberal interpretation placed upon the requirement in some of the pre *Church and General Insurance Co v Connolly*[168] decisions such as *Brady v Irish Land Commission*[169] and *Coen v Employers Liability Assurance Co*[170] suggests that, as a threshold test, there is no effective purpose to be served by insisting upon an insurable interest requirement; illegality, and fraud are more likely to constitute effective barriers to an improperly constituted insurance claim. The Commission believes that legislation directed at preventing criminals from profiting form criminal acts such as the *Proceeds of Crime Act 1996*[171] and the *Criminal Justice (Theft and Fraud Offences) Act 2001*[172] represent a more direct and effective means of dissuading persons from engaging in criminal activity, while at the same time allowing due process to be observed.[173] Similar considerations suggest to the Commission that Irish Society is less concerned with the distinction between gaming and wagering on the one hand, and insurance and other financial products on the other. The National Lottery, scratch cards, on-course and off-course betting on horses and greyhounds, as well as the explosion in spread betting and betting exchanges suggest that the issue is not whether to facilitate such activities as a part of the leisure industry; rather, the question is how best to regulate activities that often straddle the boundary between recreational wagering and financial investment activities. This question goes beyond the scope of the current analysis of insurance contract law. Nevertheless the Commission does not see any case for introducing an insurable interest requirement (in the traditional *Macaura* sense) in non-indemnity insurance that does not involve life insurance.

2.101 It certainly is arguable that the *Life Assurance Act 1774* no longer serves any useful purpose. As the Australian Law Reform Commission graphically put it:

> "The legislative requirements relating to the interest which an insured must have in the subject matter of an insurance contract are the result of a combination of imprecise drafting and historical accident rather than coherent implementation of clear legislative policy... Even in 1774, there was no reason why that Act should extend to contracts of indemnity, since the nature of such a contract prevents gaming and wagering in the form of insurance."[174]

2.102 The *Gaming Act 1845,*[175] which was repealed and replaced by the *Gaming and Lotteries Act 1956*, provided the most obvious means of counteracting wagering contracts that were dressed up as insurance transactions, and although the 1956 legislation is generally regarded as in need of root and branch reform, the provision in section 36(1), which provides that every contract by way of gaming or wagering is void, still can provide a sound basis for regulating the boundary between wagering and insurance contracts under Irish law.

2.103 In *Byers v Beattie*[176] Shares were purchased by the plaintiffs on the foot of an agreement that if a resale was effected on disadvantageous terms, the plaintiffs would be entitled to the difference and commission and other charges from the defendant. The transaction was held to be void as a wager. Even where an insurable interest is evident, the Irish courts are able to identify undesirable transactions

168 High Court, 7 May 1981. See MacGillivray, para. 1.-044 for the contrasting British position.

169 [1921] 1 IR 56.

170 [1962] IR 314.

171 Section 2 (interim orders), as amended by the *Proceeds of Crime (Amendment) Act 2005.*

172 For example, section 6 (making a gain or causing a loss by deception).

173 Contrast the situation where the insurer declines to honour a policy merely upon suspicion of fraud or destruction of property by the insured. Both the Insurance Ombudsman of Ireland and the Financial Services Ombudsman have held such powers to be incompatible with the Constitution of Ireland: see the discussion below.

174 ALRC Report 1982, para 117.

175 8 & 9 Vict,. c.109. The *Gaming and Lotteries Act 1956* also repealed the *Gaming Act 1892*, re-enacting the terms of s.1 of the 1892 Act in section 36(1). For a recent decision on restitutionary remedies being available notwithstanding s.1 of the 1892 Act, see *Close v Wilson* [2011] EWCA Civ 5.

176 (1870) IR 1 CL 209; *Morgan Grenfell & Co v Welwyn Hatfield District Council* [1995] 1 All ER 1.

and deny enforceability. The leading case is *Wall and Wall v The New Ireland Assurance Co.*[177] the plaintiff, with the connivance of agents of the defendant insurance company, took out a number of policies in his own name or the life of his mother, ostensibly under section 50(1)(a) of the 1936 Act, that is, to cover reasonable expenses in connection with the death and funeral of his mother. The first two policies were regarded as being potential losses, given the premiums and his mother's longevity, so three additional policies were taken out as a form of insuring himself against such a remote loss on the first two policies. While the five policies in question produced an assured sum that would not in itself have been regarded as an unreasonable amount, the Supreme Court endorsed the trial judge's view that these later three policies were gaming policies and therefore illegal under section 1 of the 1774 Act. The Supreme Court also reasoned that it was possible to approach this case from the perspective of illegality even through, on the facts, knowledge of the illegal purpose as between the proposer and the insurer's agents could not be attributed to the insurer. Walsh J, giving the main judgment for the Supreme Court[178] stated:

> "It does not appear to me that an insurance company should, nor is it contended for by the respondents in this case, in the absence of knowledge on its own part be at the mercy of the secret and undisclosed intentions of the person effecting such a policy of insurance if, on the face of it, the transaction is legal. If, therefore, the plaintiff, Mark Wall, while ostensibly effecting these five policies for the purpose of funeral expenses had the secret intention of using three of them as a form of insuring himself against financial loss on the first two policies, that fact or intention alone would not, even if proved to exist at the time, invalidate or render illegal the policy. On the other hand I am satisfied that if it can be proved not merely that the plaintiff had that intention but had communicated that intention to the Assurance Company or if the Company had actual or imputed knowledge of that intention at the time the policy was effected, the policy would, notwithstanding its ostensible purpose, be illegal."

(4) Pleas of illegality

2.104 While public policy considerations are sometimes used to explain why the law requires an insurable interest to be shown by an insured – "if the insured was not to have a property at the time of the insurance or loss, any one might insure another's house, which might have a bad tendency to burning houses"[179] – it should be noted that the insurable interest requirement is not the only means of deterring fraudulent claims based on deliberate acts of destruction, for example. An assured cannot recover on the foot on an insurance policy in respect of a loss caused by this own criminal or tortious act.[180] If the deliberate act has caused a loss which is the natural or probable result of that act then the necessary causal element will be present: *Hardy v Motor Insurer's Bureau.*[181] Clearly in cases where the insured is found by a court to have deliberately set fire to his property there can be no right to enforce a fire insurance policy, eg *Michovsky v Allianz,*[182] but the High Court ruled, in *Gray v Hibernian Assurance Co,*[183] a case in which the (deceased) insured was suspected of having commissioned others to set fire to his Dundalk public house, that the onus rests on the insurer to show the illegal bargain. The fact that in

[177] [1965] IR 386.

[178] Ó Dalaigh CJ, Walsh, Lavery, Kingsmill Moore and Haugh JJ.

[179] Lord Chancellor Hardwicke in *Sadler's Company v Badcock* (1743) 1 Wils KB 8.

[180] See generally MacGillivray, *Insurance Law* 11th ed (Sweet & Maxwell 2008) Chapter 14.

[181] [1964] 2 QB 745. Even negligent conduct causing loss may be caught in certain instances: *Gray v Barr* [1971] 2 Q.B. 554. On moral hazard and *Gray v Barr* situations in South Africa, see Van Niekerk, "The Bloody-handed, Homicidal Beneficiary and the Materialisation of the Life Insurance Risk" (2009) 21SA Merc LF 126, distinguishing international conduct and unlawful or wrongful conduct, citing Ellison *Kahn, Bloody Hand! Wills and Crime* (2003).

[182] [1964] IEHC 43.

[183] High Court, 27 May 1993. For a decision of the Financial Services Ombudsman see July-December 2006 Complaints. Here, an insurer refused to honour an accident cash plan, suspecting the injury had occurred in the cause of an illegal act. No criminal proceedings were possible. Applying Articles 34.1 and 38.1 of the Constitutioon, the Ombudsman directed the insurer to pay the claim.

these kind of cases the owner of the property clearly has an insurable interest suggests that it is through illegality or public policy considerations – *ex turpi causa non oritur actio* – that moral hazard dangers are most effectively addressed. Any reduction in insurable interest requirements will have no effect on moral hazard considerations which, the Commission believes, can be effectively addressed without the need to retain any insurable interest requirement. It is also arguable that because public policy and common law illegality doctrines contain a degree of flexibility – certainly in contrast to s.1 of the 1774 Act which declares the contract "to be null and void to all intents and purposes whatsoever" – the judiciary is better able to respond to the individual facts and circumstances of borderline cases. Two Canadian decisions illustrate this point.[184]

(5) Options for reform under the Law Commissions Issues Paper – the regulatory definition question

2.105 As has been shown, Irish law differs radically from English law insofar as the Irish courts have ruled that an insurable interest is not a common law requirement and that the 1774 legislation only applies to contracts of life assurance. In the Insurable Interest Issues Paper the Law Commissions ask whether an insurable interest is necessary in order to identify and distinguish insurance from other products which lack an insurable interest. The Law Commissions concluded that the retention of a strict insurable interest requirement is unnecessary for regulatory purposes.

2.106 The *Financial Services and Markets Act 2000*, the governing UK legislation, does not define a contract of insurance but deems contracts listed in a statutory instrument to be contracts of insurance. In relation to certain types of financial product, regulatory agencies and representative bodies such as the International Swaps and Derivatives Association have avoided the temptation to review the boundary between insurance and other financial products on the ground that such a scrutiny could damage market consensus and undermine confidence in economically significant products, particularly when the market does not see such products as gambling activities.[185] The Law Commissions concluded that the Financial Services Authority regard the "assumption of risk by the [service] provider" as the key factor in identifying insurance for regulatory purposes; this factor however is not the same as the statutory insurable interest requirement under English law.

2.107 In terms of identifying insurance itself for regulatory proposes, the Law Commissions emphasise that the three key factors in Scots law and English law concur: they are requirements of payment, uncertainty and interest. The Law Commissions conclude that both the Scottish and the English Courts require the insured to have an interest in the subject matter of the contract. However, the Law Commissions are of the view that the leading cases do not equate such an interest with a pecuniary loss recognised by law: "it is an interest in something so that one would be adversely affected if it were to be lost."[186]

2.108 The Law Commissions conclude that "interest loosely defined does play a role in distinguishing insurance from other contracts although staturoty insurable interest...does not". The Law Commissions refer to tax guidance and Insurance Premium Tax requiring an insurable interest, which is described as "a financial or other loss on the happening of the isured event." This definition looks more like the legitimate expectation test as canvassed in the *Kosmonpoulos* decision in Canada. While this test may be required under fiscal and other statutes for accountancy and tax purposes, it is not to be equated with a statutory insurable interest: in other words, these important governance and regulatory functions would not be subverted if a statutory insurable interest requirement were to be removed from the UK statute book.

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184 If the "moral hazard" materialises and public policy prevents a spouse who has murdered his or her spouse from recovering, should proceeds from the policy to the benefit of the estate of the murdered spouse? Should public policy allow a windfall benefit to the insurer? See *Brissette Estate v Westbury Life Insurance Co* [1992] 3 SCR 87 and *Oldfield vTransamerica Life Insurance* (2002) 210 DLR (4th) 1.

185 For an interesting review of the boundary under UK and Irish law see Devaney, "Gambling's Changing Face – Do new forms of gambling pose a new regulatory challenge?" [2009] CLP 28.

186 Para 7.20. See the example given in para 7.24.

(6) Defining Insurance Contracts in Irish Law

2.109 The leading Irish decision is *International Commercial Bank plc v Insurance Corporation of Ireland plc*.[187] The case concerned a credit guarantee insurance agreement whereby ICI provided an indemnity if (as happened) a company that borrowed monies from the plaintiff bank defaulted on the loan. ICI resisted the claim on the grounds that the contract was one of credit insurance and as such caught by *uberrimae fidei*. Failure by the bank to disclose certain material facts gave ICI, the defendant, a right to avoid the policy. Blayney J, following *Seaton v Heath*[188] found the contract was one of guarantee, not insurance. Blayney J, looked at the question by reference to the substance of the case. *In* Seaton *v Heath* Romer LJ had said*:*

> "Contracts of insurance are generally matters of speculation where the person desiring to be insured has means of knowledge as to the risk, and the insurer has not the means or not the same means. The insured generally puts the risk before the insurer as a business transaction, and the insurer on the risk stated fixes a proper price to remunerate him for the risk to be undertaken; and the insurer engages to pay the loss incurred by the insured in the event of certain specified contingencies occurring. On the other hand, in general, contracts of guarantee are between persons who occupy, or ultimately assume, the positions or creditor, debtor, and surety, and thereby the surety becomes bound to pay the debt or make good the default of the debtor. In general, the creditor does not himself go to the surety, or represent, or explain to the surety, the risk to be run. The surety often takes the position from motives of friendship to the debtor, and generally not as the result of any direct bargaining between him and the creditor, or in consideration of any remuneration passing to him from the creditor. The risk undertaken is generally known to the surety, and the circumstances generally point to the view that as between the creditor and surety it was contemplated and intended that the surety should take upon himself to ascertain exactly what risk he was taking upon himself.[189]

2.110 In an article on the legal nature of credit default swaps,[190] Smith argues that by focusing on the substance of credit default swaps, that is, that the payment obligation under a credit derivative is not conditional on the payee's loss,[191] it is possible to avoid both the conclusion that a credit default swap is not indemnity insurance and the rather inconvenient result that *uberrimae fidei* duties attach thereto. The Commission has been advised that these issues of form and substance, unsatisfactory as they are, are approached in an identical manner in Ireland, that is, precise definition and classifications are eschewed. In any event, this point is of much less importance in Ireland because the *Life Assurance Act 1774*, a source of some mischief in this context in the United Kingdom[192] is confined to life policies in this jurisdiction.

(7) The insurance/gaming divide – current review of gambling legislation

2.111 The Department of Justice and Equality is currently (November 2011) engaged in a major review of Irish gambling law, currently regulated by the *Gaming and Lotteries Act 1956*, with a view to developing "a new and comprehensive legal and organisational framework governing the gambling architecture in the State."[193] Building on the Report of the Casino Committee Report, *Regulation Gaming in Ireland*[194] the then Minister announced that one of the premises that most modern gambling codes are

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187 [1991] ILRM 726.

188 [1899] 1QB 782.

189 At p.792-3.

190 Smith, "The Legal Nature of Credit Default Swaps" [2010] LMCLQ386 at 409.

191 The so called Post Option: see generally Castignini, *Derivatives: The Key Principles* 3rd ed (Oxford University Press 2009).

192 Smith, "The Legal Nature of Credit Default Swaps" [2010] LMCLQ 386 at 409.

193 Response of the Minister for Justice to a Parliamentary Question, October 7, 2010.

194 Available at www.justice.ie.

built upon is "that gambling is kept free of crime."[195] The Commission expects that the "complex and comprehensive legislation"[196] that may arise in the future may not address the insurance/gambling dichotomy directly. In the most recent discussion document the Department of Justice and Equality observe that any new regulatory architecture for gambling will pursue three central objectives:

- that young people and the vulnerable are protected;
- that gambling should in all respects be fairly and openly conducted
- that gambling is kept free from crime.

2.112 It is a central point in the discussion document to note that the emphasis is on better regulation, not deregulation. This observation, in relation to gambling policy, also holds true in relation to the Commission's recommendations in relation to reform of the insurable interest rules. It is of interest to note that many of the central recommendations in relation to changing the gambling regulation architecture – the creation of a regulatory authority, licensing of operators with strict compliance rules, a power vested in the Minister to fine-tune rules by way of secondary legislation – resemble the insurance regulation landscape as it currently exists. Because it is to be a feature of gambling reform that definitions of gambling will be written into Irish law for the first time[197] and the statutory rules preventing the enforcement of gambling contracts will not be continued,[198] a co-ordinated but not integrated approach to insurance and gambling regulation will be required. Commercial and cultural developments such as the expansion of betting exchanges and spread betting illustrate that certain types of risk hedging or avoidance will straddle the boundary between gaming regulation and insurance/financial services authorisation.[199]

2.113 Currently, spread betting and Contracts for Difference products (CFDs) are regulated by the Central Bank of Ireland, and press reports in 2011[200] indicate that compliance with regulatory requirements in Ireland are not being fully met by the 29 companies that are approved to offer such products within the State. These matters are seen as consumer protection matters rather than moral hazard issues and attest to the fact that any insurable interest requirement, as a legislative proxy for counteracting socially undesirable contracts of speculation, has no part to play in modern Irish law.

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195 Response of the Minister to a Parliamentary Question, October 7, 2010.

196 *Ibid.*

197 *Options for Regulating Gambling* (December 2010).

198 Paras 2.8 and 3.8.

199 Para 3.34. See Devaney [2009] CLP 28.

200 Eg. "Spread-bet firms may face regulator enforcement" *The Irish Times* 16 June 2011. Regulation by means of bookmakers' licences and the Markets in Financial Instruments Directive (2004/39/EC) could be described as patchy at best, with consumer protection being limited to financial spread betting.

CHAPTER 3 DUTY OF DISCLOSURE

A Introduction

3.01 The duty of a proposer to volunteer information to an insurer when that information would appear to a prudent insurer to be material to a decision whether to accept the risk, and on what terms, is long-established. In this Chapter, the Commission notes that the duty of disclosure is mandated by both the common law and the *Marine Insurance Act 1906* as being applicable to all insurance contracts. The duty is rooted in "special knowledge" of a risk as being likely to be solely in the possession of the proposer. Whether this remains the case is open to some doubt in the light of telecommunications and other advances. The duty has always been balanced by reference to the insurer's duty to disclose and investigate circumstances within the insurer's competence and expertise. In some jurisdictions the duty of disclosure has been offset or indeed removed altogether by an insurer's obligation to ask specific questions.

B The Duty of Disclosure in Insurance Contracts

3.02 Under section 18(1) of the *Marine Insurance Act 1906* (generally regarded as applicable to all forms of insurance, except in respect of the constructive knowledge issue, discussed below) a person who is seeking to obtain insurance:

> "must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract."

3.03 The basis upon which the duty of disclosure rests is disparity of information and bargaining power. Insofar as the proposer may, in the many situations, possess superior knowledge of the facts and circumstances that attend the risk, particularly those personal to the proposer, it is entirely appropriate that the proposer should reveal those facts and circumstances to the insurer. In *Carter v Boehm*[1] Lord Mansfield contrasted situations where "special facts" are held by one party to a negotiation from instances where "either party may be innocently silent, as to grounds open to both, to exercise their judgment upon". Because Lord Mansfield observed that "insurance is a contract or speculation", the law requires that such "special facts" as either party has access to must not be suppressed. Even if the suppression were to happen through a mistake, even without fraudulent intent, Lord Mansfield observed that the policy would be void "because the risque run is really different from the risque understood and intended to be run, at the time of the agreement." So, the suppression of factual information, whether fraudulent or otherwise would allow the insurer to treat the contract as void. Lord Mansfield reasoned that:

> "The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only; the under-writer trusts to his representation and proceeds upon confidence, that he does not keep back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance did not exist, and to induce him to estimate the risque, as if it did not exist."[2]

1 (1766) Burr 1905; of this case see Watterson, *Carter v Boehm* in Mitchell and Mitchell, *Landmark Cases in the Law of Contract* (Hart, 2008). Hasson, in "The Doctrine of Uberrima Fides in Insurance Law – A Critical Evaluation stresses that Lord Mansfield was concerned with 'fraudulent concealment': (1969) 32 MLR 615 at 618. Later judges have lost sight of this.

2 (1766) Burr 1905, at 1909-10

3.04 *Carter v Boehm* of course is also at the heart of another cardinal principle of insurance law that is similarly enshrined in statute law, s.17 of the *Marine Insurance Act 1906:*

> "A contract of marine insurance is a contract based on utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party."

3.05 The utmost good faith principle, and the duty of disclosure,are in most instances linked together. However, there are cases where judges have stressed that non-disclosure may occur even though the proposer did not act *mala fides*.[3] Most traditional jurisprudence however inclines towards placing the emphasis on the duty of disclosure as a means of protecting the insurer, decoupling the duty from the wider implications of the (mutual) duty of utmost good faith. [4]

3.06 In *Manor Park Homebuilders Ltd v AIG Europe (Ireland) Ltd,*[5] the proposer for fire insurance in relation to a property failed to make disclosures in relation to security measures concerning that property. McMahon J held that these matters were on the facts not material but went on to consider whether the insurer's failure to examine the property or investigate this risk was pertinent in a case of non-disclosure:

> "The principle of *uberrimae fidei*, which applies to all insurance contracts, imposes a heavy onus of disclosure on the insured. Without this obligation to divulge information frequently available only to the insured, the insurer would have great difficulty in assessing the risk or in calculating the premium. This does not, however, mean that the insurer can cover its eyes or abstain from making normal inquiries or investigations, in the expectation that, in the event of the risk materialising, it can point to the insured's omission and repudiate the contract. The insured's duty is balanced by a reciprocal duty on the insurer to make its own reasonable inquiries, to carry out all prudent investigations and to act at all times in a professional manner. In fact the onus to do this, because of its experience and expertise, lies primarily on the insurer. The law is willing to assist this process by obliging the insured to volunteer information not easily available to the underwriter and which is material to the risk. The *uberrimae fidei* principle applies with the greatest force to situations where the relevant facts are peculiarly within the knowledge of the insured and are not easily available to the underwriter. Where, however, the full extent of the risk can readily be defined without the insured's participation, the law does not insist on full disclosure..."

3.07 The emphasis that this 'knowledge' exception places upon the insurer to follow up on facts that are disclosed and to carry out an examination of the property, the medical condition of the assured, and so on, cannot be overstated. American judges have voiced their opposition to an over broad duty of disclosure on the basis that where a proposal can be examined by the insurer, a duty of disclosure is inappropriate. In explaining why *Carter v Boehm* was never extended into fire insurance underwriting, in

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3 *Curran v Norwich Union Life Insurance Society* [1987] IEHC 5. Irish case law, however, particularly in relation to life cover and income protection does treat good faith and non-disclosure as closely related: see *Keating v New Ireland Insurance Co* [1990] 2 IR 383 and *Coleman v New Ireland Insurance Co* [2009] IEHC 273.

4 See generally MacDonald Eggers, Picken and Foss, *Good Faith and Insurance Contracts* (3rd ed) (2010) (Eggers, et al): Bennet, *"Mapping the Doctrine of Utmost Good Faith in Insurance Law"* [1999] LMCLQ 165; Bennett *Reflections on Values* in Soyer, *Reforming Marine and Commercial Insurance Law* (Informa Law 2008); Bridge, *"Does Anglo-American Contract Law need a doctrine of Good Faith" (1984) 9 Can Bus LJ 385.* Butcher, in *"Good Faith in Insurance Law: A Redundant Concept?"* [2008] JBL 375 argues that the doctrine has led to "serious problems" such as the development of a series of structured rules emerging from a sweeping principle, the unfair operation of the sole remedy of recission, the vagueness of the law and uncertainty as to the scope of the doctrine. Butcher prefers statutory reform of insurance contract law, opining that such reforms would render the good faith principle otiose. The Commission has much sympathy with this approach.

5 [2009] 1 ILRM 190. See Ahern, 'The Formation of Insurance Contracts and the duty of Insurers' [2009] CLP 84.

the Ohio case of *Hartford Protection Insurance Co v Harmes*[6] it was said that there is no need to impute a need for reliance on information from the proposer:

> "in fire insurance no such necessity for reliance exists, and, if the underwriter assumes the risk without taking the trouble to either examine, or inquire, he cannot very well, in the absence of all fraud, complain that it turns out to be greater than he anticipated."[7]

3.08 These remarks were made as long ago as 1853. As such, the decision of McMahon J in *Manor Park Homebuilders Ltd v AIG Europe (Ireland) Ltd,* also a fire insurance case, in which the insurer failed to inspect the property or follow up on information provided, resonates across the centuries. McMahon J wrote that "*uberrimae fidei* is not a charter for indolent insurers."[8]

3.09 In contrast, in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co*[9] regarded as the leading modern English case, Lord Mustill, speaking of the importance of *Carter v Boehm,* stated:

> "Whilst it is true that this decision has been criticised on the facts, and that the wide general contractual duty of good faith which Lord Mansfield propounded has long since ceased to hold sway, the courts have never been deflected from the high standard of duty prescribed in this judgment. The assured is not to keep anything back which goes to the computation of the 'contingent chance', for otherwise there is no 'fair representation', and the underwriter is led to approach the 'risk understood to be run' on a false basis. Such is the principle on which insurance law has been developed and insurance contracts made for more than 200 years and I would do nothing to dilute it now."

3.10 Lord Mansfield was seeking to establish a general contractual duty of good faith, not simply a specific rule that would operate in insurance law, but this general duty of good faith has not taken root in the common law world.[10] As such, the duty of disclosure in contracts of insurance has been classified as a contract *uberrimae fidei*, a contract of 'utmost good faith', and, along with a diverse but expanding range of *sui generis* contracts,[11] is regarded as an exception to the *caveat emptor* or *caveat venditor* approaches to contractual liability.

3.11 The stricter view is that the duty of disclosure does not depend on the proposer's awareness of the existence of the duty. The proposer is under a duty to disclose material facts, even if the insurer or a broker fails to ask questions or the insurance is negotiated without the use of a proposal form.[12] Even if questions are asked the proposer must still disclose material facts that the questions might not have alluded to (subject to the possibility of a waiver or a similar argument). The question, what is a material circumstance, requires the proposer to have an awareness of the factors that would be relevant to an insurer, even if the insurer has not explained the insurer's business or prompted the proposer in any way. The *Marine Insurance Act 1906* directs in section 18(2) that "every circumstance is material which would influence the judgment of a prudent insurer on fixing the premium, or determining whether he will take the risk". This test was endorsed by Kenny J on behalf of a unanimous Supreme Court, in a case of property insurance,[13] thus indicating that the test has a horizontal effect across all insurance contracts, with the possible exception of life policies and the like other policies (eg income protection cover).

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6 2 Ohio St. 452 (1853).

7 Cited with approval by the ALRC in Report No 20 *Insurance Contracts* para 176 (1982). The commercial benefits undertaking surveys in property insureance cases from a broker's perspective, is underlined by Cole in " A Practitioner's Perspective on Placement duties of Insurance Brokers and Reflections on the Proposal of the Law Commissions", in Soyer, *Reforming Marine and Comercial Insurance Law*, (Informa Law 2008) Ch 5.

8 [2009] 1 ILRM 190 at 213.

9 [1994] 3 All ER 581 at 605; Bennett, "Utmost Good Faith in the House of Lords" (1995) 111 LQR 181.

10 See generally Zimmermann and Whittaker (eds), *Good Faith in European Contract Law* (CUP, 2000).

11 See Chapter 2 of Eggers et al.

12 See generally MacGillivray, paras 17-017 to 17-021.

13 *Chariot Inns Ltd v Assicurazioni Generali Spa* [1981] IR 199, at 226. See below para 3.19.

3.12 On the question of whether the proposer is to be fixed with constructive knowledge of facts that the proposer ought to have discovered had he or she undertaken reasonable inquiries, section 18(1) of the Act is generally regarded as providing a specific rule for business insurance, the section directs that "the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him".

3.13 In cases of health insurance and similar insurance areas Irish case-law suggests that a distinction is to be drawn between cases where the proposer honestly believes that a symptom, medical episode, or medical condition has, or will have, no serious or long lasting consequences, from situations where the proposer simply is unaware of the medical condition. In this first situation, cases such as *Curran v Norwich Union Life Insurance Society*[14] suggest that if the symptoms being experienced by individuals have alerted a medical practitioner to prescribe medication, for example, this would be enough to trigger a duty of disclosure, even if the patient does not believe the suspected illness is likely to manifest itself or develop into a serious medical condition. In contrast, the fact that the individual is not made aware of the prognosis will not constitute non-disclosure: *Coleman v New Ireland Assurance plc.*[15] In the decision of the Supreme Court, in a leading life insurance case, *Keating v New Ireland Assurance Company*[16] a policy of life insurance was executed in June 1985. At a medical examination that took place prior to the policy being concluded the life in question disclosed that he had received treatment for a gastric disorder two months previously and the he had been prescribed medication. The life in question did not know what his underlying condition was and that the medication was used in treating *angina pectoris*, not a gastric disorder. The condition led to the death of the individual some five months later. The insurer declined to pay up on the policy on the grounds of non-disclosure, the argument centring on the fact that in undergoing tests investigating the gastric disorder, an angiogram and ECG test were undertaken. McCarthy J observed that while the doctors treating the patient were aware of his heart condition, the patient was not:

> "The insurers were not informed of these material facts; was it a non-disclosure? One cannot disclose what one does not know, albeit that this puts a premium on ignorance. It may well be that wilful ignorance would raise significant other issues; such is not the case here. If the proposer for life insurance has answered all the questions asked to the best of his ability and truthfully, his next-of-kin are not to be damnified because of his ignorance or obtuseness which may be sometimes due to a mental block on matters affecting one's health."[17]

3.14 In *Aro Road and Land Vehicles Ltd v Insurance Corporation of Ireland*[18] McCarthy J also limited the duty of disclosure by reference to the underlying good faith standard. In this case the proposer failed to disclose criminal convictions that had been secured against him some 19 years previously, the insurance being property insurance obtained over the telephone, in circumstances of some urgency, without detailed questioning of the proposer or the use of a proposal form. After invoking the utmost good faith standard McCarthy J asked:

> "how does one depart from such a standard if reasonably and genuinely one does not consider some fact material; how much the less does one depart from such a standard when the failure to disclose is entirely due to a failure of recollection? Where there is no spur to the memory, where there is no proposal form with its presumably relevant questions, how can a failure of recollection lessen the quality of good faith?"[19]

3.15 McCarthy J also seems to have considered the underwriter to have forfeited the right to insist upon full disclosure in circumstances where the proposer is not questioned about a particular matter, on

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14 [1987] IEHC 5. See also *Lindenau v Desborough* (1828) 8 B&C.586.

15 [2009] IEHC 273. See also *Zeller v British Companion Insurance Co* [2008] UKPC 4.

16 [1990] 2 IR 383.

17 *Ibid* at 392.

18 [1986] IR 403.

19 *Ibid* at 414.

the basis that the insurance contract is a contract of good faith on both sides. Similarly, in *Kelleher v Irish Life Assurance Company*[20] the terms of the proposal form, which intimated that the policy would issue on the basis of a "medical free offer" dispensed with a duty of disclosure.

3.16 In contrast to *Aro Road* (and it should be said that in *Aro Road* Walsh J and Hederman J concurred with the more radical approach articulated by McCarthy J), a more traditional view of the duty of disclosure was expressed by the Supreme Court in *Chariot Inns Ltd v Assicurazioni General Spa*.[21] Kenny J, giving judgment for a unanimous Supreme Court, stated:

> "A contract of insurance requires the highest standard of accuracy, good faith, candour and disclosure by the insured when making a proposal for insurance to an insurance company. It has become usual for an insurance company to whom a proposal for insurance is made to ask the proposed insured to answer a number of questions. Any misstatement in the answers given, when they relate to a material matter affecting the insurance, entitles the insurance company to avoid the policy and to repudiate liability if the event insured against happens. But the correct answering of any questions asked is not the entire obligation of the person seeking insurance: he is bound, in addition, to disclose to the insurance company every matter which is material to the risk against which he is seeking indemnity.
>
> What is to be regarded as material to the risk against which the insurance is sought? It is not what the person seeking insurance regards as material, nor is it what the insurance company regards as material. It is a matter or circumstance which would reasonably influence the judgment of a prudent insurer in deciding whether he would take the risk, and, if so, in determining the premium which he would demand. The standard by which materiality is to be determined is objective and not subjective."[22]

C Constructive Knowledge and Non-disclosure

3.17 Section 18(1) of the Marine Insurance Act 1906, for business insurance, broadens the duty of disclosure to facts which ought to have been known by the proposer. The Commission believe that this is a difficult standard to operate. It is arguable that a better approach may be to ask whether the proposer should, in those circumstances, have made the disclosure in question. This is a less mechanistic test. Nevertheless, the Commission recognise that such an approach is not widely favoured, even within circles that are pressing for reform of the duty of disclosure. The Commission give two examples. The pattern set by the PEICL and some of the recent reform proposals from other common law jurisdictions suggest that the duty of disclosure should apply to

> "circumstances of which he is or ought to be aware",[23] and/or
>
> "facts which the business insured knew or which it ought to have known."[24]

3.18 This question of constructive knowledge and the duty to volunteer or disclose facts (as distinct from answer questions) that the proposer does not know raises difficult, if not metaphysical, issues. Perhaps the proposer has forgotten previous incidents, particularly incidents that occurred many years ago. Perhaps the proposer is aware of facts or events but regards them as irrelevant or unimportant. It may be that the proposer is aware of facts but does not make the connection with other facts or possibilities that would be highly material to the insurer.

3.19 The decisions of the non-statutory Insurance Ombudsman of Ireland provide some compelling examples of how difficult is may be to draw the line. In one case, the Insurance Ombudsman asked whether a proposer for holiday (cancellation) cover should be taken to know that a parent is terminally ill

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20 [1993] ILRM 643, following *Hair v Prudential Assurance Co Ltd* [1983] 2 Lloyd's Rep 667.

21 [1981] IR 199.

22 *Ibid* at 226-7.

23 PEICL, Article 2:101.

24 Law Commissions Consultation Paper 2007, para 5.44.

(pre-existing medical condition).[25] The Insurance Ombudsman held not. In another case, she dealt with a case in which a prison officer died after he suffered a heart attack while restraining a prisoner. Prior to taking out a life policy, and while attending the family GP in regard to treatment of his children, he mentioned one episode of chest pain. The doctor prescribed aspirin and told him to return for an examination which he did not do. While the Insurance Ombudsman felt that this episode of chest pain was a material fact she recommended a proportionate settlement of 50% be made. The Ombudsman's observations are of interest even though the Commission considers that, in terms of the law, the insurance company acted reasonably; even under the Commission's proposals in relation to reform of misrepresentation, the company would be entitled to refuse to meet the claim if the company could show it would have declined the proposal. The Insurance Ombudsman stated:

> "On the one hand, the Company's position can be appreciated. There is no doubt that a life assurance underwriter would be interested in the episode of chest pain and that it is, therefore, a material fact. If made aware of it a prudent underwriter would have required it to be investigated before offering assurance.
>
> From the layman's point of view it is understandable that a person might close his mind to such an episode and in the absence of renewed symptoms take no further action. Whether there was only one instance of chest pain and whether the matter had completely left the life assured's mind by the time the application form was being completed is not possible to know.
>
> There is always difficulty where there has been no medical diagnosis. No illness was diagnosed in this case by the deceased's GP. In our day to day lives wehave many symptoms and only in a minority of instances do we consult a doctor. Occasionally, as it transpired in this case, the symptoms were an indication of a sinister underlying condition.
>
> Do I, therefore, concede that the Company are legally correct and support their repudiation or do I acknowledge that the life assured had erased the matter from his mind and being human did not disclose the "casual" consultation with his doctor.
>
> It was not for me to attempt to retrospectively underwrite this Policy but at the same time, in my view, further investigation would have led to assurance being offered, but at an increased premium."[26]

3.20 Indeed, the duty of disclosure is capable of producing some singular situations, none more so than the dispute between Frank Godfrey and Lloyd's of London. An exterior wall of Mr Godfrey's cottage in County Meath had a mural of the 1690 Battle of the Boyne painted on it for over 25 years but, ironically, the Peace Process led to its apparent destruction by arsonists only days after the then Taoiseach and then Northern Ireland First Minister had launched an official tourism centre nearby in April 2008. Lloyd's of London declined to honour the fire insurance policy taken out by Mr Godfrey on the basis that he had not disclosed the existence of the mural.[27] In 2009 the Financial Services Ombudsman found against Mr Godfrey, ruling "that by virtue of the nature of the subject, [the mural] would have been the source of some provocation, albeit to a limited number of intolerant individuals." Press reportsindicated that, while an appeal to the High Court, may be under consideration, a separate fund-raising campaign led to the mural being re-painted.[28]

3.21 The Commission considers that the duty to volunteer information can only be seen in the context of the Commission's provisional recommendations on the insurer's duty to seek information from proposers in the shape of precise questions being put to a proposer[29]. The IIF Code of Practice on Non Life Insurance states that insurers "should avoid asking questions which would require knowledge beyond

[25] Case study 26 of 2000. .

[26] Case study 10, 1999.

[27] See "Insurance Company refuses payout for Battle of the Boyne Cottage", *Daily Telegraph* 23 June 2010.

[28] See "Drive to rebuild burned-out 'Boyne' Cottage after insurance claim", *Irish Times* 2 February 2010 and "Mural on cottage 'will be repainted'", *Irish Independent* 1 September 2010.

[29] Para. 4.14 below

that which the signatory could reasonably be expected to possess", suggesting that insurers may seek to extend s.18(1) beyond business insurers. The Commission considers that judicial decisions after *Aro Road* satisfactorily resolve these problems in the light of the flexibility of the disclosure test. Indeed, the Commission notes that because *Aro Road* was written as a marine insurance policy, the Supreme Court may well have confined s.18(1) to issues of "wilful ignorance" in any event. The Commission concludes that a proposer will be in breach of the pre-contractual duty of disclosure where it can be shown that the proposer, in applying for insurance cover, remained wilfully ignorant to material facts or circumstances. This is in line with the decison of the UK Court of Appeal in *Economides v Commercial Union*[30] where "failing to disclose what he would have seen if only he had opened his eyes" was seen as an example of actual knowledge and not constructive knowledge.

3.22 *The Commission provisionally recommends that the pre-contractual duty of disclosure in insurance contract law should be retained, but that it should (in accordance with authoritative case law in Ireland) be restricted to facts or circumstances of which the person applying for insurance cover – the proposer – has actual knowledge; and that the duty of disclosure would not, therefore, extend to every fact or circumstance which ought to be known by him or her (constructive knowledge). The Commission also provisionally recommends that this modified pre-contractual duty of disclosure shall apply to all insurance, other than Marine, Aviation and Transport (MAT) insurance, which would continue to be regulated in this respect by the Marine Insurance act 1906.*

3.23 It is of interest to note that the leading English text, *MacGillivray on Insurance Law*, cites *Chariot Inns* as articulating 'the common law test of materiality'[31] while the *Aro Road* decision is not cited anywhere in the current edition. This difference in perspective clearly holds forth the prospect of an Irish court being able to limit the duty of disclosure, in circumstances where the underwriter seeks to provide cover without assisting the proposer in being made fully aware of the existence and scope of the duty itself. As such, Irish law may not be open to the same level of criticism that Professor Malcolm Clarke has levied against English law:

> "Applicants in England may complete the form with scrupulous care, but still find that there was something else material to prudent insurers which, apparently, the particular insurer did not think to ask about but which, nonetheless, the applicant was expected to think of and disclose."[32]

3.24 Evidence of materiality may be put before the court from a number of directions. Expert witnesses who are engaged in the insurance business and other relevant professionals such as medical practitioners in respect of life assurance, for example, may be expected to provide assistance to the court. MacGillivray states that:

> Expert evidence on the materiality of undisclosed facts ought to be admitted whenever it is the usual practice of insurers to be guided by the opinions of that class of experts whose evidence is offered in the case in question."[33]

3.25 However, the question whether a fact is material or not rests upon the courts as the trier of fact. In *Aro Road* the Supreme Court overruled Carroll J at first instance when deferring to the opinion of expert witnesses on materiality, and a healthy degree of caution is often demonstrated by judges in relation to issues of moral hazard in particular. *Roselodge Ltd v Castle*[34] and *Aro Road* itself provide good examples. The court will require the expert witness to indicate that the fact would be material in the sense that it would influence the decision to take on the risk, and on what terms, or affect the rate of the

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30 [1997] 3 All ER 636.

31 MacGillivary, *Insurance Law,* 11th ed (Sweet & Maxwell 2008), para 17-035.

32 Observation quoted in the Law Commission's 2007 Consultation Paper at para 2.37.

33 Para 17-043.

34 [1966] 2 Lloyds Rep. 113. McNair J rejected evidence on a moral hazard issue from two experts on the basis of the extreme views these witnesses had expressed during cross-examination.

premium. Evidence that the prudent insurer, if notified that the proposer was suffering from a heavy cold would have led to suspension of a policy was held not material in *Harney v Century Insurance*[35]

3.26 The Commission has suggested above that in certain circumstances Irish courts have relaxed the duty in recent years. Even if this is so, the boundaries of the duty of disclosure in Irish law are not coherently set out by Irish case-law. The Commission considers that, insofar as the outcome of a case may turn on whether a proposal form was or was not used, as set out in *Aro Road,* the Irish courts have provided an invaluable starting point, but that a thorough and systematic overhaul of Irish insurance contract law can best be achieved through legislation. In this context, the Commission considers that these adjustments should recognise that the principle of utmost good faith and the duty of disclosure are complementary to one another in most cases. The Commission thus considers that Irish law should reflect the approach to the good faith principle set out by McCarthy J in *Aro Road* and *Keating* and by McMahon J in *Manor Park Homebuilders.*

3.27 *The Commission provisionally recommends that legislation should continue to provide that, because the proposer possesses more relevant information than the insurer, the pre-contractual duty of disclosure should continue to be the basis on which a contract of insurance is a contract of utmost good faith.*

3.28 *The Commission provisionally recommends that legislation should provide that, in respect of all contracts of insurance, an insurer shall not be permitted to repudiate liability on the basis of non-disclosure of material facts of which the insured could not reasonably be expected to have actual knowledge at the time of applying for cover.*

D Materiality and Inducement

3.29 In *Pan Atlantic Insurance Co. Ltd v Pine Top Insurance Co. Ltd*[36] the UK House of Lords adopted an inducement test that sits alongside the traditional prudent insurer test for materiality. Thus, to quote from Lord Mustill's speech, a judgement which is generally regarded as being the most authoritative:

> "...there is to be implied in the [*Marine Insurance Act 1906*] a qualification that a material misrepresentation will not entitle the underwriter to avoid the policy unless the misrepresentation induced the making of the contract, using 'induced' in the sense in which it is used in the general law of contract."[37]

3.30 The *Marine Insurance Act 1906* does not contain any inducement test and, prior to *Pan Atlantic* there was no clear view in England on the issue of inducement. Indeed, even experienced insurance judges in England had no clear settled view on this point, Sir Michael Kerr in particular having famously changed his mind on this question.[38] The English law on inducement has been recently summarised by Clarke LJ as follows:[39]

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35 *Harney v Century Insurance Co* [1983] IEHC 16, applying *Mutual Life Insurance Co of New York v Ontario Metal Products* [1925] AC 344. *Mutual Life* itself was a central prop in Lord Lloyd's argument in *Pan Atlantic Insurance Co. Ltd v Pine Top Insurance Co. Ltd* [1994] 3 All ER 581 at 632 that the "decisive influence" test represented English law.

36 [1994] 3 All ER 581.

37 *Ibid,* at p 617; see also *St Paul Fire and Marine Insurance Co (UK) v McConnell Dowell Constructors Ltd* [1996] 1 All ER 96 and *Drake Insurance plc v Provident Insurance plc* [2004] QB 601.

38 *Berger v Pollock* [1973] 2 Lloyds Rep 442 at 463, repudiated in *Container Transport International Inc v Provident Insurance plc* [1984] Lloyd's Rep. 476. In *Pan Atlantic* Lord Mustill observed that Kerr J's instinct in *Berger v Pollock "was right"*.

39 *Assicurazioni Generali Spa v Arab Insurance Group* [2003] 1 WLR 577 followed in *Laker Vent Engineering v Templeton Insurance Ltd* [2009] 2 All ER (Comm) 755.

"(i) In order to be entitled to avoid a contract of insurance or reinsurance, an insurer or reinsurer must prove on the balance of probabilities that he was induced to enter into the contract by a material non-disclosure or by a material misrepresentation.

(ii) There is no presumption of law that an insurer or reinsurer is induced to enter in the contract by a material non-disclosure or misrepresentation.

(iii) The facts may, however, be such that it is to be inferred that the particular insurer or reinsurer was so induced even in the absence of evidence from him.

(iv) In order to prove inducement the insurer or reinsurer must show that the non-disclosure or misrepresentation was an effective cause of his entering into the contract on the terms on which he did. He must therefore show at least that, but for the relevant non-disclosure or misrepresentation, he would not have entered into the contract on those terms. On the other hand, he does not have to show that it was the sole effective cause of his doing so."

3.31 There is no clear authority on the issue of inducement in modern Irish law although some *dicta* in *Anderson v Fitzgerald* may appear to support the proposition. Such opinion as there is appears against an inducement test. Keane J in *Chariot Inns*, at first instance, favoured the Australian decision in *Mayne Nickless Ltd v Pegler*[40] while Kenny J in the Supreme Court also favoured *Mayne Nickless*, observing that the law did not require an insurer to establish

"that the matter not disclosed did affect (and not merely might have affected) their judgement."[41]

3.32 Insofar as *Chariot Inns* suggests that inducement is not part of Irish law, the Commission would favour the adoption of a provision requiring an insurer to show that non-disclosure of a material fact played a part in the insurer's decision to enter the contract.

3.33 *The Commission provisionally recommends that an insurer should be required to show that non-disclosure of a material fact played a part in the insurer's decision to enter the contract*.

(1) Materiality: decisive influence or "what the insurer would like to know"

3.34 In the context of the duty of disclosure, where a broker or a team of brokers have been engaged in assisting in the underwriting process, both *Chariot Inns* and the majority of the judges in *Pine Top v Pan Atlantic* have favoured a disclosure test that is often criticised as being too favourable to the insurer, unduly uncertain in its scope and impractical in terms of application. To state that a material fact is one that a prudent insurer "would want to know about", even if the fact would not ultimately affect the underwriting decision, was, in the view of the majority of the Law Lords, the result of section 18(2) of the 1906 Act. This conclusion was heavily criticised by the two dissenting judges: Lord Templeman said that, in his opinion, "the judgment of a prudent insurer cannot be said to be influenced by a circumstance which, if disclosed, would not have affected acceptance of the risk or the amount of the premium."[42] Lord Templeman went on to comment that if materiality was to be determined by reference to what a broker would have "wanted to know" or "would have taken into account," even if it would not have affected any decision to take the risk or fix the premium, the law would "give carte blanche to the avoidance of

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40 [1974] 1 NSWLR 228.

41 [1981] IR 199, at p 231.

42 [1994] 3 All ER 581 at 585. Lord Lloyd at p.638 summarised what he thought the law should be thus: "whenever an insurer seeks to avoid a contract of insurance or re-insurance on the ground of misrepresentation or non-disclosure, there will be two separate but closely related questions. (1) Did the misrepresentation or non-disclosure induce the actual insurer to enter into the contract on those terms? (2) Would the prudent insurer have entered into the contract on the same terms if he had known of the misrepresentation or non-disclosure immediately before the contract was concluded? If both questions are answered in favour of the insurer, he will be entitled to avoid the contract, but not otherwise. The evidence of the insurer himself will normally be requied to satisfy the court on the first question. The evidence of an independent broker or underwriter will normally be required to satisfy the court on the second question. This produces a uniform and workable solution, which has the further advantage, as I see it, of according with good commercial common sense."

insurance contracts on vague grounds of non-disclosure supported by vague evidence even though disclosure would not have made any difference."

> "If an expert says, '*If I had known I would not have accepted the risk or I would have demanded a higher premium',* his evidence can be evaluated against other insurances accepted by him and against other insurances accepted by other insurers. But if the expert says, *'I would have wanted to know but the knowledge would not have made any difference'* then there are no objective or rational grounds upon which this statement of belief can be tested."

3.35 The central criticism of "the wish to know" test is that it is difficult to challenge on rational and objective grounds: as the law seeks to make the test one which is independent of the actual views or conduct of the insurer, a "wish to know" test seems to inject an unpredictable element into the law. The other dissenting judge, Lord Lloyd, commented that the purpose behind the prudent insurer test was

> "to establish an objective test of materiality, not dependent on the actual insurer's own subjective views. The test should therefore be clear and simple. A test which depends on what a prudent insurer would have done satisfies this requirement. But a test which depends, not on what a prudent insurer would have done, but on what he would have wanted to know, or taken into account, in deciding what to do, involves an unnecessary step. It introduces a complication which is not only undesirable in itself but is also, in the case of inadvertent non-disclosure, capable of producing great injustice."[43]

3.36 In response to this controversy the Law Commission recommended a two stage test of materiality that one critic has lambasted as an "untested and unserviceable model"[44] that tends to ignore the context in which *Pine Top* was decided, that is, a large commercial insurance dispute in which the role (and possible downstream liability) of experienced brokers was a central concern. These circumstances should not, in our view, deflect our attention from trying to establish a test of disclosure that takes account of the commercial context – kind of insurance, method of sale or negotiation, role of an intermediary, etc – and yet has a degree of ease of application.

3.37 *The Commission invites submissions as to which of the following two definitions of "material facts" should be provided for in legislation:* ***either*** *(a) facts which, in the circumstances, a reasonable insured would know to be highly relevant and should be disclosed;* ***or*** *(b) facts which, in the circumstances, a reasonable insured would know to have a decisive influence on the insurer's decision in accepting the risk or in setting the level of the premium (the price).*

(2) Examples of the Duty of Disclosure in Operation

3.38 The duty of disclosure requires the proposer to reveal any matters that would influence the rate of the premium which the underwriter might require the proposer to pay, even if that matter would not strike the proposer as having that effect: *Dalgish v Jarvie*[45]is often cited as an early authority for this proposition, but Hasson[46] makes the point that this case has nothing to do with insurance and that until Jessel M.R. laid out a broad duty of disclosure in *London Assurance v Mansel*[47] the weight of opinion was in favour of a fairly narrow duty of disclosure insofar as the duty did not extend to matters that the insurer could discover by an act of fair inquiry and the exercise of due diligence. *London Assurance v Mansel* concerned a life assurance policy in respect of which the proposer had failed to disclose the fact that an earlier proposal had been declined by another company. Believing that his proposal had been turned down for reasons other than considerations of health, the proposer felt that the matter was not material. This was held not to be a justifiable basis for non-disclosure. There is a significant difference between

[43] [1994] 3 All ER 581 at 625.

[44] Wier, "Materiality: The Search for Practicality", in Soyer, *Reforming Marine and Commercial Law* (Informa Law 2008)

[45] (1850) 2 M&G 231.

[46] Hasson, "Uberrima Fides in Insurance Law" (1932) 32 MLR 613 at 620.

[47] (1879) 11 Ch 363.

withholding information on the basis of a belief that the matter is not material from instances where a private individual fails to disclose what he or she does not know. In *Economides v Commercial Union*[48] the Court of Appeal regarded 'Nelsonian blindness' - "failing to disclose what he would have seen if only he had opened his eyes" as an example of actual knowledge and not constructive knowledge.[49]

3.39 It should be noted that the factual issue of what is a material circumstance is a matter of fact and that the onus rests upon the insurer: *Joel v Law Union Insurance Co*[50] and *Kreglinger and Fernau Ltd v Irish National Insurance Co Ltd.*.[51] In commercial risk insurance the old view that an underwriter is under an obligation to inform himself about the practice of the trade in which he insures, regardless of the generality of the practice in question suggests a narrow perspective on business to business insurance of this kind, and some recent English case-law suggests that a restrictive view of what factors may be regarded as material is taking root. In *Meisels v Norwich Union Insurance Ltd*[52] failure to disclose a proposer's various difficulties with the Inland Revenue did not invalidate a property insurance policy. Tugendhat J held that allegations of criminality were not necessarily material. A test of proportionality was held to be applicable. Having regard to the nature of the risk and the moral hazard some matters might be too remote in time or too trivial to require disclosure, whether or not the insured could put forward some persuasive explanatory material, (ie disprove the allegations made against the proposer). However, a distinction is to be drawn between unproved allegations of dishonesty and cases where a claimant has acted dishonestly, (eg preparing false invoices for a commercial prupose even if the purpose has no link with the loss or the claim: *Sharon's Bakery (Europe) Ltd v Axa Insurance UK plc.*[53] Such facts are material and must be disclosed.

3.40 In general terms the predominant view of materiality has tended to provide insurers with a convenient means of avoiding policies. Even if a reasonable proposer would not see any connection between the risk and the facts not disclosed, older English cases posit sweeping duties of disclosure in many situations. In *Locker & Woolf Ltd v Western Australian Insurance Co*[54] failure to disclose the fact that the proposer had been refused motor insurance allowed the company to avoid a policy of fire insurance. In *Schoolman v Hall*[55] the insured responded to a claim on a domestic contents policy arising out of a burglary by invoking the proposer's failure to disclose a criminal record, the most recent conviction being some 15 years prior to taking out the policy. In this case (like *Regina Fur Co v Bossom*[56] where the non-disclosure related to a receiving stolen goods conviction some 20 years previously, a claim being brought for theft on an "all risks" policy) material non-disclosure was made out. The duty of disclosure also attaches to criminal convictions recorded against family members, notwithstanding that a considerable period of time has elapsed since the conviction and the fact that embarrassing matters such as a criminal past are likely to be shunted into a remote part of a person's consciousness: *Lambert v Cooperative Insurance Co*[57]*.* In the area of life insurance, failure to disclose that the life assured was exhibiting symptoms of consumption some four years previously,[58] or had habits or addictions that could

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48 [1997] 3 All ER 636.

49 *Ibid* at p 653 *per* Peter Gibson LJ and p 648 *per* Simon Brown LJ.

50 [1908] 2 KB 863.

51 [1956] IR 116.

52 [2007] 1 All ER 1138.

53 [2011] EWHC 210 (Comm), following *Gate v Sun Alliance Insurance Ltd* [1995] LRLR 385 and *Insurance Corporation of the Channel Islands v The Royal Hotel Ltd* [1998] Lloyd's Rep IR 151. See Ryan [1997] CLP 78; Davey [2006] LMCLQ 517.

54 [1936] 1 K B 408.

55 [1951] 1 Lloyd's Rep 139: *Quinby Enterprises v General Accident* [1995] 1 NZR 736.

56 [1958] 2 Lloyd's Rep 425.

57 [1975] 1 Lloyd's Rep 169.

58 *Geach v Ingall* (1845) 14 M & W 95; *Morrison v Muspratt* (1827) 4 Bing 60.

be prejudicial to the life of the assured[59] is a material non-disclosure,[60] even in the absence of specific questions being presented.

E What the Proposer does not have to disclose

3.41 The Commission believe that many examinations of the duty of disclosure is flawed insofar as there can be an undue emphasis placed upon the nature of the duty and materiality – that is, attention is drawn to the nature of the information – rather than the context in which negotiation has taken place. The correct approach to the duty of disclosure must marry the duty with the exceptions thereto in order to accurately state what must be disclosed.[61] While *Carter v Boehm*[62] is correctly regarded as creating a duty of utmost good faith that requires full disclosure of material facts, it should be noted that, in the result, the insurer was held not to be entitled to avoid the policy. In a recent article in which *Carter v Boehm* was given a rigorous re-examination Watterson concludes that the exceptions created by Lord Mansfield suggest that the duty of disclosure is much more limited than is generally thought and that *Carter v Boehm* is not a pro-insurer case.[63] The exceptions that *Carter v Boehm* provided to the duty of utmost good faith have been put onto a statutory footing in the form of section 18(3) of the *Marine Insurance Act 1906*.

3.42 These exceptions have been used very liberally by Irish judges and they afford a variety of counterweights to the duty of disclosure. An insurer who fails to inspect a property for example, or who fails to ask questions relating to a risk will be in danger of being held to have waived the need for disclosure. A specialist in a particular industry who has been put on notice of the existence of facts which he or she, as a prudent insurer should investigate, may be fixed with the knowledge that such an underwriter will be deemed to possess.

(1) Knowledge

3.43 Knowledge of any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know.[64]

3.44 MacGillivary treats this exception to the duty of disclosure as being divided into two distinct classes. Firstly, there is "no duty to disclose matters of common knowledge and public awareness of which any reasonably well informed person is presumed to be aware".[65] In *Leen v Hall*[66] Ballyheigue Castle County Kerry was insured against damage by riot, civil commotion, war, rebellion and fire. It was destroyed by the IRA in 1921, the proposer failing to disclose that the Crown had used the dungeon to house Sinn Fein prisoners previously. The jury apparently concluded that civil commotion was public knowledge in the County at that time. As in many instances of insurance contract law, the test is easier to state than to apply and the individual facts or each case are critical. The leading case is *Bates v Hewitt*[67] A confederacy cruiser, *The Georgia* was dismantled and sold to the plaintiff who obtained insurance from the defendant underwriter in 1864. In 1863 and early 1864 *The Georgia* had attracted considerable

59 *Joel v Law Union Insurance Co* [1908] 2 KB 863.

60 Most cases are in fact misrepresentation cases, that is, a question was asked but answered incorrectly.

61 This is reflected in the IIF Non-Life Code of Practice which states that an insurer will not repudiate liability "on grounds of non-disclosure of a material fact which a policyholder could not reasonably be expected to have disclosed."

62 (1766) Burr 1905.

63 In Mitchell and Mitchell, *Landmark Cases in the Law of Contract* (Hart 2008).

64 *Marine Insurance Act 1906*, section 18(3)(b).

65 Inspection by an insurer of the risk or property in question will generally involve acquisition of constructive knowledge: *Pim v Lewis* (1862) 2 F & F 778.

66 (1923) 16 2 ILR 100.

67 (1867) LR 2QB 595.

public interest in running blockades mounted by the Union forces and the vessel had been laid up in Liverpool for some time. The underwriter admitted that he had been aware of The Georgia's earlier exploits, but at the time of granting the policy he did not associate the confederate vessel with the risk being proposed. While the insurer had the means of discovering that the confederate cruiser and the ship being proposed were one and the same, he was under no duty to investigate and the proposer was not discharged from the duty of disclosure. Mellor J in his speech indicated that if a proposer was to be able to calculate just how little was needed in order to discharge the duty, this would be to introduce "a most dangerous principle into the law of insurance",[68] and the judge stressed that the duty to provide a full and frank disclosure is at the heart of the duty.

3.45 The second sense in which an insurer may not invoke non-disclosure of material fact is where the fact is one that an insurer is deemed to know. An insurer who is active in a specific trade or industry will be deemed to know what the characteristics of the sector are - the kind of goods used and activities that are undertaken respectively. Unusual risks or activities must be disclosed, however, but it is not necessary for the proposer to do anything more than disclose material facts. The proposer is not required to disclose any assessments or opinions or conclusions the proposer has made: insofar as the insurer is able to make these for himself, non-disclosure is not an invalidating factor. In *Kreglinger and Fernau Ltd v Irish National Insurance Co Ltd*[69] the defendants refused to honour performance bonds taken out in respect of meat processing contracts on the basis that specific undertakings in contracts had not been disclosed to them. In regarding this contract as a contract of utmost good faith, Davitt P considered that no breach of the duty of disclosure had taken place. The President drew a distinction between disclosure of the existence of a contract, the details of which had not been set out, and non-disclosure of material facts:

> "While the duty to make full disclosure of all matters material to the risk rests upon the insured, and it does not fall to the insurer to relieve him of that duty, by making inquiries, the converse is to this extent true, that the insured does not have to conduct the insurer's business for him. Where the contract, the performance of which the insurer is asked to cover, contains a clear intimation that a matter, which is specifically referred to but not fully set out, is of importance, and full information is to be had for the asking, it would be quite unreasonable and unjust to allow the insurer to repudiate liability on the grounds that he did not know and was not told the details of something which he was in fact told about."[70]

3.46 Other illustrations of this exception to the duty of disclosure are provided by some decisions approved and followed by Davitt P in *Kreglinger and Fernau*. In *The Bedouin*[71] the insurer was not told that he was insuring freight under a time charter. The charter contained a standard cesser clause that in the view of the Court was practically universal in time charters and the insurer was held to have been given sufficient information to fix him with notice of the risk. Lord Esher MR remarked that the assured is neither bound to tell the insurer what the law is; nor is he required to tell him of every fact, but only material facts.

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68 *Ibid* at 608. Hasson (1969) 32 MLR 615 at 620 is critical of this decision. The 'dangerous principle' referred to by Mellor J was concerned with preventing a proposer being encouraged to calculate how little need be disclosed in order to fix the insurer with knowledge.

69 [1956] IR 116. *Manor Park Homebuilders Ltd v AIG Europe (Ireland) Ltd* [2009] 1 ILRM 190. The Canadian courts are moving towards a due diligence standard for insurers on the basis that "technology has reduced the one-sidedness of the obligation of good faith with the growth and availability of information accessible to particular industries and the public generally." *Per* Howden JA in *De koning v Vector Insurance Network (Ontario) Ltd* [2009] Can LII 43644 (Ont) discussing *Coronation Ins Co v Taku Air Transport Ltd* [1991] 3 SCR 622. These cases cover transportation policies against statutory rules on disclosure of facts to regulatory bodies by insureds.

70 [1956] IR 116 at 154.

71 [1894] P.1.

(2) Factors reducing the risk

3.47 "Any circumstance which diminishes the risk". The *Marine Insurance Act 1906*, section 18(3)(a) provides that factors that make a loss less likely to occur need not be disclosed.

In *Carter v Boehm* Lord Mansfield said that

> "the underwriter needs not to be told what lessens the *risque* agreed and understood to be run by the express terms of the policy…if he insures a voyage, with liberty of deviation, he need not be told what tends to show there will be no deviation."[72]

In *Manor Park Homebuilders Ltd. v AIG Europe (Ireland) Ltd*[73] an unoccupied building was the subject of a proposal for fire insurance cover. The proposal failed to disclose that steel shutters to the lower floor had been removed and the windows and doors were bricked up with concrete blocks. McMahon J. held that this was not a material non-disclosure on the basis that this measure rendered the building more, rather than less, secure. MacGillivray remarks that this exception

> "may seem obvious, but such a fact does literally fall within the definition of a material fact, since it would influence the underwriter in deciding whether to take the risk or not, or in fixing the premium."[74]

(3) Factors covered by any warranty

3.48 Any circumstance which it is superfluous to disclose by reason of any express or implied warranty. If a material circumstance is not disclosed, but the facts not disclosed are the subject of an express or implied warranty, or an exclusion clause, non-disclosure will not provide a basis for repudiating the contract because the insurer will be entitled to rely upon the contractual promise or limitation in question: *Ross v Bradshaw*.[75]

(4) Waiver

3.49 "Any circumstance as to which information is waived by the insurer": see the *Marine Insurance Act 1906* section 18 (3)(c). This is perhaps the most difficult and unpredictable exception to apply in practice.

3.50 There are several Irish cases in which waiver plays a part in explaining why the contract of insurance remained enforceable, often in conjunction with other factors. For a waiver to be made out however it will be necessary for the insurer to conduct his business in such a way as to intimate that certain facts are not required to be disclosed. The proposer may have disclosed sufficient facts that will require insurers to investigate those surrounding details or circumstances to the prudent insurer standard.

3.51 In the first situation an insurer may specifically state that no duty to disclose is required - over the telephone motor policies are increasingly concluded on this basis. In *Aro Road and Land Vehicles v Insurance Corporation of Ireland*[76] the minority judgement of Henchy J indicated that where travel or transport insurance was concluded 'over the counter' between an agent of the insurer, the proposer being given no opportunity to furnish all material information, the conduct of the insurer will preclude full disclosure. The broader view of the majority was that in cases of over-the-counter insurance, absent fraud, the proposer needs only to answer the questions asked. McCarthy J said that:

> "if the insurer were to have the opportunity of denying or loading the insurance one purpose of the transaction would be defeated. Expedition is the hallmark of this form of insurance."[77]

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72 (1766) Burr 1905 at 1909.

73 [2009] 1 ILRM 190.

74 Para 17-081.

75 (1761) 1. Wm. Bl. 312.

76 [1986] IR 403.

77 *Ibid* at 415.

In *Manor Park*, McMahon J. took a similar approach, indicating that because the insurer issued the policy for its own reasons (to maintain a good relationship with the proposer's broker) while failing to issue appropriate documentation and carry out inspections of the property, the insurer was in breach of it's duty

> "of *uberrimae fidei* in failing to adequately inform itself of the facts and in failing, for improper reasons, to deal fairly with the insured or consider his interests."[78]

3.52 In cases where a proposal form is used, even McCarthy J in *Aro Road* conceded that the *Chariot Inns* approach to the duty of disclosure may still hold sway. The failure to ask a question directed at a particular subject or risk does not amount to a waiver (*Roselodge Ltd v Castle*[79]) but it is possible that questions posed on the proposal form may imply a waiver of the insurer's right to obtain information on related matters. It all depends on the questions and context, and some questions may, in particular instances, serve to broaden the duty by reminding the proposer of the common law duty. However, in general, the effect of questions asked will be to limit the duty of disclosure.

> "if questions asked on particular subjects and the answers to them are warranted, it may be inferred that the insurer has waived his right to information, either on the same matters but outside the scope of the questions, or on matters kindred to the subject-matter of the questions. Thus, if an insurer asks, 'How many accidents have you had in the last three years?' it may well by implied that he does not want to know of accidents before that time, though these would still be material. If an insurer asks whether individual proposers have ever been declared bankrupt, he waives disclosure of the insolvency of companies of which they have been directors. Whether or not such a waiver is present depends on a true construction of the proposal form, the test being, would a reasonable man reading the proposal form be justified in thinking that the insurer had restricted his right to receive all material information, and consented to the omission of the particular information in issue?"[80]

3.53 The wording of any declaration on the proposal form may be important. *Kelleher v Irish Life Insurance Co Ltd*[81] demonstrates that a declaration in a proposal form, and the context in which a policy is offered – in that case as a special promotional deal to a large group of potential customers – can lead to a conclusion that all the insurer is concerned about will be a possibility that the proposer made a misrepresentation. The decision of the Financial Services Ombudsman, in Case 20 of his December 2007 Summary of Complaints, illustrates that the wording of the declaration may be important. Here, a Group Policy covering employees was held to require the policyholder to disclose the fact that a senior employee was seriously ill. The Financial Services Ombudsman held that the questions asked had not limited the duty of disclosure, distinguishing *Aro Road* and *Kelleher* on the facts.

3.54 In cases where the proposal form is not completed, some questions being ignored or the space for insertion of an answer being left blank, it may be that the inference to be drawn is that a negative answer was intended. In *Roberts v Avon Insurance Co*.[82] a question asking about previous losses was not answered; the policy was avoided for fraudulent concealment on the basis that the proposer had effectively answered that there were no previous losses. However, in general terms, if on the face of the proposal form a question is not completed or an answer given is obviously incomplete, an insurer who issues a policy without seeking additional information might be held to waive the requirement of full disclosure, thus having to rely on some other basis for avoiding the policy such as fraudulent concealment or misrepresentation. If, following discovery of the proposer's failure to disclose all material facts the insurer elects to continue with the contract, the insurer will be held to have affirmed the contract.

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[78] [2009] 1 ILRM 190 at 216.

[79] [1966] 2 Ll LR 113.

[80] MacGillivray, para 17-019 (footnotes omitted). See on vague questions and specific questions: *Bruwer v Nova Risk Partners Ltd* 2011(1) SA 234. On SA Law generally see Van Niekerk, "Goodbye to the Duty of Disclosure" (2005) 17 SA Merc LJ. 150, 323.

[81] [1993] ILRM 643. This view is not confined to health insurance: see *FBD Insurance plc v Financial Services Ombudsman* [2011] IEHC 315 (motor insurance).

[82] [1956] 2 Lloyd's Rep 240.

This will normally require the insurer to unequivocally communicate to the insured an intention to affirm the contract: *Peyman v Lanjani*.[83] Receipt of a premium, even in a case of fraudulent concealment of a material fact was held to be an act of affirmation in *Armstrong v Turquand.*[84]

(5) The IIF Life Assurance Code of Practice and Ombudsman Adjudications on Non disclosure

3.55 The Irish Insurance Federation *Code of Practice on Life Assurance: Duty of Disclosure* contains a number of important provisions which are intended to direct IIF Members on how the member is to respond to incidents of non disclosure, misrepresentation and breach of warranty. The Code addresses precontractual issues and avoidance under three headings, Proposal forms, Policies and accompanying documents, and Claims.

3.56 Under the code itself, which is confined to policies of life assurance effected in a private capacity by individuals resident in the Republic of Ireland, a number of provisions are couched in neutral language. Requirements or obligations under this code are not mandatory: words like "should" and "may" appear to condition the binding nature of the Code particularly in relation to the provisions or proposal forms and policies accompanying documents. Nevertheless, the Life Assurance Code provides "best practice" benchmarks that could usefully form the basis for future legislation.

3.57 In relation to proposal forms the Life Assurance Code states:

> If the proposal form calls for the disclosure of material facts a statement should be included in the declaration, or prominently displayed elsewhere on the form or in the document of which it forms part: -
>
> (i) drawing attention to the consequences of failure to disclose all material facts that an insurer would regard as likely to influence the assessment and acceptance of a proposal;
>
> (ii) warning that if the signatory is in any doubt about whether certain facts are material, these facts should be disclosed.

3.58 On issues of substance, the *Life Assurance Code of Practice* seems to suggest that the onus rests upon insurers to elicit information about material facts from proposers by way of specific questions in proposal forms, a proposition that is at variance with the traditional view concerning the duty of disclosure:

> In relation to those issues upon which insurers wish to base their underwriting decisions, clear questions should be included in proposal forms on those matters which have been commonly found to be material.

3.59 The code also goes on to state that insurers "will continue to develop clearer and more explicit proposal forms".

3.60 The *Life Assurance Code of Practice* also contains a very significant limitation on the asking of questions concerning matters that could be viewed as being within the constructive knowledge of the proposer. The Code states:

> Insurers should avoid asking questions which would require knowledge beyond that which the signatory could reasonably be expected to possess.

3.61 These provisions are broadly replicated in the IIF *Code of Practice on Life Assurance Selling* and in the IIF *Code of Practice – Non Life Insurance*. While these codes do not appear to be in widespread circulation any longer, it is arguable that even these limited and legally unenforceable statements of good practice reflect an awareness on the part of the Insurance Industry that the duty of utmost good faith requires proposer and insurer to engage in a dialogue and an exchange of information

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[83] [1985] Ch 157.

[84] (1858) 9 ICLR 32. On affirmation generally see *Insurance Corporation of the Channel Islands v Royal Hotel Ltd* [1998] Lloyd's Rep. IR 151, applied in *Persimmon Homes Ltd v Great Lakes Reinsurance (UK) plc* [2011] Lloyd's Rep. IR 101, see also *Argo Systems FZE v Liberty Insurance PTE Ltd* [2011] EWHC 301 (Comm).

at the precontractual stage. The decisions of the Insurance Ombudsman, under the Insurance Ombudsman of Ireland Scheme reflect this.

- In a life assurance case where the person to be insured had a serious cardiac condition the agent of the insurer failed to investigate the circumstances or explain the duty of disclosure to the proposer. There was clearly non disclosure of material facts but there was an award of 50% of the sum assured, the non disclosure being mitigated by the agent's failings.[85]
- In one case of non disclosure of a previous claims history in relation to household insurance, an accidental non disclosure was condoned and the claim met in the usual way.[86]
- Due to an ambiguity in one of the questions on the proposal form, a response was held to be a misrepresentation, not non disclosure. The Ombudsman applied a proportionality remedy for the insurer, allowing the insured to recover 70% on a household policy claim.[87]

3.62 The decisions of the Insurance Ombudsman in the 1999 to 2004 period continued to demonstrate a similar approach to non disclosure issues with cases going either way.[88] For example

- An assured died of cancer 12 months after a life policy came into force. This policy was an upgrade on three other policies that went back for a period of six years. At the time when the first policy was taken out, there was non disclosure of the fact that the proposer was on medication for high blood pressure. That condition had no link with the cause of death but it was probably material.

3.63 The Insurance Ombudsman observed that this kind of situation:

> "where the death is due to a condition unrelated to the cause of death, assurers occasionally take the view that a reasonable approach is to pay the sum assured on an ex-gratia basis, or if a significant extra premium has been lost because of the non-disclosure of the pre-existing condition to make some downward adjustment to their payment."

3.64 The Insurance Ombudsman held that the refusal to pay on the claim was in all the circumstances of the case "too harsh" and she upheld the complaint.[89]

- A proposal form for life cover asked, "if you have given up drinking alcohol, please state how long since stopping, reason for discontinuing and previous consumption". The reply, "3 years due to ulcer" was incomplete. Further inquiries would have revealed a history of abuse involving hospitalisation. Death was the result of lung cancer, caused by smoking, a habit which was disclosed on the proposal form. The Insurance Ombudsman noted that:

  > "the Company went on to admit that there was a degree of disclosure, which should have prompted it to make some further enquiries. In view of the fact that recognising what constitutes a "material fact" may be obvious to an underwriter but not necessarily to a member of the general public, the Company reviewed its position and agreed to admit the claim in amount £30,000." [90]

- In one case of non disclosure on an industrial life policy, where medical reports were available, the insured did not exercise the option to send the proposer for a medical examination. Because both parties "were remiss" an ex gratia award was recommended.[91]

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85 Case Study 50 of the Digest.

86 Case Study 76 of the Digest. Contrast Case Study 4 in Annual Report 2010, p.60.

87 Case Study 159 of the Digest.

88 For instances finding for the insurer see Case Study 15, 2000, Case Study 14, 2003.

89 Case Study 8, 1999. See also Case Study 10, 1999 where a proportionate settlement of 50% of a claim was reached.

90 Case Study 22, 2000.

91 Case Study 16, 2002.

3.65 Although the Financial Services Ombudsman's powers and jurisdiction in relation to the investigation of complaints stand on a statutory footing, there appears to be a significant element of continuity and uniformity of approach to non-disclosure defences. The following examples show that the decisions the Financial Services Ombudsman has reached demonstrate both a willingness to uphold the *uberrimae fidei* principle and recognise that the principle has implications for proposer and insured.

- A life assurance death benefit policy was avoided by the insurer when the proposer completed a Declaration of Health Form which asked a number of relevant questions in relation to the proposer's health and contained a warning that a failure to detail all material facts "may invalidate a future claim". The insurer referred specifically to the fact that the proposer had not disclosed a consultation with his GP in relation to a serious health problem just two weeks prior to completion of the Form. The Ombudsman found that the Company was entitled to repudiate the claim, stating that:

  > "the principal characteristic of an insurance contract is that it is a contract of utmost good faith: both the insurance company and the person looking for insurance must exercise utmost good faith in their dealings with each other. If the person looking for insurance fails to disclose circumstances which would influence the decision of the insurance company in fixing the premium or in determining whether or not to accept the risk, the insurance company may be entitled to decline liability under the policy".[92]

- In a guesthouse theft insurance case, the proposer had been asked specific questions relating to any previous losses and the consequences of non disclosure had been set out in the Proposal Form. Two questions were incompletely answered. While the facts appear to set out instances of misrepresentation, the Ombudsman referred to the *uberrimae fidei* principle and the duty of disclosure, holding that the insurer was entitled on these facts to avoid the policy from its inception.[93]

- In an important ruling on the duty of disclosure in relation to the ill health of an employee to be covered under a Group Policy, the Ombudsman upheld the duty to make full disclosure of all relevant information, rejecting an argument that the medical condition of this high profile executive was a matter of common knowledge.[94]

- A failure to disclose a medical condition that had arisen out of a road accident that had occurred after the proposal form was completed but before the cover was commenced gave rise to a right to avoid the policy. The Ombudsman stressed that the duty to advise of changed circumstances prior to commencement of cover had been set out on the Proposal Form.[95]

3.66 There are however a number of situations in which the non disclosure of material facts has not been dispositive before the Financial Services Ombudsman. For example, the Ombudsman has been prepared to hold that the non disclosure relied upon was based on illegal or improper inferences drawn by the insurer, or that, despite non disclosure, other mitigating circumstances were present.

- As a general principle, a decision by an insurance company to decline to meet a claim on the basis that he insured has committed an unlawful act may, in the absence of a finding by a court of law, be an improper inference, the Ombudsman citing articles 34 and 38 of the Constitution.[96]

- In medical treatment insurance contracts the waiting period or pre-existing condition exclusion may raise issues of non disclosure by the proposer/the proposer's medical adviser. There are

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[92] December 2009, p. 24-5.

[93] July 2009, p. 25-6.

[94] December 2007, p.21-3.

[95] September 2005 – Income Protection Policy – Policy voided for non disclosure not upheld but contributions refunded.

[96] January 2007. "Only the courts determine whether an insured person committed or attempted to commit an unlawful act." See also Case Study 3 in the *Annual Report 2010*. See also the presumption against crime in *O'Hagan v Sun Life Assurance Co of Canada* [1932] IR 741.

decisions in which the Ombudsman has found in favour of the proposer on the basis that the evidence did not establish the pre-existing condition as a matter of fact.[97]

- Where the non disclosure can be due to a failure by the insurer's representative to follow standard procedures, the Ombudsman has observed that an award of compensation may be made because of the way in which the policy was sold. The insurer will be able to avoid the policy itself for non disclosure.[98]
- Even if an insurer has justifiable grounds for refusing a claim on the grounds of non disclosure of a prior condition, an unrelated risk that materialised led the Ombudsman to award 50% payable on a holiday cancellation policy.[99]

(6) Non-Disclosure – the 1957 Reform Proposals in England and Wales

3.67 There have been a number of reviews of English insurance contract law. In the first of these exercises, the Law Reform Committee was asked by Lord Chancellor Simonds to consider the position in law, of insurance companies when using special conditions and exceptions in insurance contracts, as well as the consequences of non-disclosure of material facts by a proposer. The Law Reform Committee issued its report, *Conditions and Exceptions in Insurance Policies*[100] in 1957. The Committee said that the use of special conditions and exceptions in policies was open to potential abuse insofar as an insurer could invoke a number of technical matters against even an honest and careful proposer in order to avoid indemnifying the proposer in respect of a claim. While the Committee indicated that there were some isolated instances of abuse, the Committee took the view that there was no evidence this was widespread in the industry. The Committee accepted the assurance of the industry that no reputable insurer would invoke a technical defence to defeat an honest claim. Notwithstanding these assurances, the Committee was critical of the fact that the law allowed an insurer a broad discretion in forming an assessment of the honesty of the proposer. Such was the scope of the latitude that express contractual terms could provide to an insurer, the Committee felt that a limited number of provisions could be enacted which would provide some counterbalance, whilst not interfering with the principle of freedom of contract.

3.68 The most important recommendation concerned materiality:

> "For the purposes of any contract of insurance no fact should be deemed material unless it would have been considered material by a reasonable insured."

3.69 The 1957 Law Reform Committee Report was produced at a time when English and Scottish law had no real conception of consumer protection and there was no attempt to distinguish between the position of a proposer acting within his or her private sphere and proposers acting within a business or commercial context. English judges at this time were attempting to protect contracting parties from the effects of draconian or far reaching limitation or exclusion clauses by adopting crude techniques such as the fundamental breach doctrine, and in the area of sales law Parliament ultimately intervened in the form of a number of legislative measures that sought to counteract abuse of the principle of freedom of contract – something the 1957 Law Reform Committee report felt unable to recommend, as a matter of principle. The Law Reform Committee considered that making proposals to counteract unfair contractual practices went beyond the specific terms of reference that the Committee had been given. Nevertheless, the materiality provision, referred to in the paragraph above, has retained its attractiveness as a reform proposal.

(7) The English Law Commission's 1979 Working Paper[101]

3.70 After setting out the nature and scope of the duty of disclosure in English law. The English Law Commission drew attention to a number of criticisms that have been levied against the duty,

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97 July 2009, p.19-20 and see also p.23-4; see also December 2005, p.6-7.

98 July 2008, p.13-14.

99 July 2008, p.16-17.

100 (1957) Cmnd. 62.

101 Working Paper No. 73, *Insurance Law: Non Disclosure and Breach of Warranty*.

particularly the Law Reform Committee's view that the duty may catch honest and careful proposers, and judicial criticisms voiced in 1975 in *Lambert v Co-operative Insurance Society Ltd*[102] and in earlier cases.

3.71 The provisional conclusion reached by the Law Commission was that the duty of disclosure "should be retained across the board" but the Law Commission went on to distinguish between cases where the insurer did not make use of a proposal form from situations where a proposal form was utilised.

3.72 In cases where no proposal form was used the duty

> "should be to disclose those facts which a reasonable man in his circumstances would consider to be material in the sense that they would influence the judgment of a prudent insurer in accepting the risk or fixing the premium. The insured should however only be under a duty to disclose facts which he either knows or which a reasonable man in his circumstances ought to know."[103]

3.73 The Law Commission explained that the formulation of the test, in particular the reference to "a reasonable man in his circumstances," sought to direct attention to the circumstances of the particular insured rather than imposing a wholly objective standard of "a reasonable insured". The standard might depend on "whether the insured was a businessman or consumer", but no recommendations on the precise range of relevant circumstances were made. Benefits of such a test were said to include dispensing with the need for expert evidence as to what would influence a prudent insurer. In opting for a constructive knowledge factor, such knowledge could be attributed to the reasonable man, the Law Commission sought to clarify the law and bring non marine insurance contract duties into line with the marine insurance duty, as set out by section 18(1) of the *Marine Insurance Act 1906*.

3.74 In cases where a proposal form was used the Law Commission suggested a radical approach that hinged upon the Commission's dissatisfaction with the existing law:

> "Our provisional recommendation is that if a proposal form has been completed by the insured, insurers should not be permitted to say that a fact outside the scope of the questions asked is material and ought therefore to have been disclosed. Insurers should be taken to have waived the duty of disclosure in regard to that fact."[104]

3.75 The proposer will be held to have discharged the duty of disclosure and the good faith obligation by providing complete and accurate answers to the questions asked. However, the proposal form must itself contain a statement in respect of the duty and the consequences of non compliance.

3.76 The Law Commission identified two difficulties in relation to the reformulated duty of disclosure *vis-à-vis* proposal form-based insurance contacts. The first obstacle to effective reform was the possibility that a proposer might well *know* something that would be material: for example, a proposer has received threats to burn down property from a disgruntled former employee but goes ahead in arranging fire insurance, the threat being outside the ambit of questions put in the proposal form. For this reason the English Law Commission recommended a residual duty "not deliberately to conceal facts which he knows to be material and of which he has actual knowledge."[105] The second obstacle to effective reform was the possibility that the insurer might ask a general question concerning any facts that a prudent insured should consider relevant. If` this were possible, the reforms would be side-stepped via a contract clause that would fill the gap left by waiver of the duty of disclosure. For this reason the English Law Commission recommended that "an insured should be entitled to ignore any such question and insurers should be deprived of any remedy in respect of false information supplied in answer to any such question".

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102 [1975] 2 Lloyd's Rep 485.

103 See paragraphs 59-64 of Working Paper No. 73.

104 Paragraph 66.

105 Paragraph 73.

(8) The English Law Commission's 1980 Report[106]

3.77 When the Law Commission produced its Report on *Insurance Law: Non-Disclosure and Breach of Warranty* (October 1980) some significant differences between the provisional recommendations in the Working Paper and the final recommendations became evident. While the analysis of defects in the existing law relating to non-disclosure remained the same, the consultation exercise persuaded the Law Commission to row back from some of the more innovative recommendations, but on the question whether non consumer insurance should be treated differently in a formal sense, the Commissioners held to their view.

3.78 The Law Commission rejected the argument that an attenuated duty of disclosure should be imposed on consumers. Suggestions that the duty should be limited to cases of fraudulent non-disclosure were rejected on the basis that fraud is difficult to prove and that a limited duty would not assist insurers in estimating the risk – after all, this is the primary reason why the duty exists. In this context the Law Commission returned to its core theme, that, save for MAT insurance, the goal of retaining a unitary body of legal rules and contractual practices should be pursued:

> "it seems to us that any separate regime for consumers and non-consumers would lead to anomalous results in practice. This can again be illustrated by a shopkeeper who lives above his shop. He applies for fire and burglary cover in respect of both his shop and his flat at the same time: the former application would be made in the course of a business, but the latter would not. It would be odd, to say the least, if the resulting contracts were subject to different vitiating factors."[107]

3.79 The Law Commission returned to the Law Reform Committee Report from 1957 and proposed that, save for marine insurance contracts, the standard set in that Report should be adopted. Thus:

> "for the purpose of any contract of insurance no fact should be deemed material unless it would have been considered material by a reasonable insured."[108]

3.80 This rejection of the prudent insurer test replicates the view initially set out in the 1979 Working Paper. However, the Law Commission treated the duty of disclosure in a significantly different way when it came to examine the duty of disclosure *per se* and the duty of disclosure when a proposal form, of whatever kind, is in use. In the Working Paper a much more stark contrast was drawn between these two situations. In the Report the Law Commission set forward a set of recommendations in insurance contracts generally, with a significant gloss being added to the general recommendations when a proposal form was employed by the insurer.

(9) The general duty of disclosure in the 1980 Report

3.81 The Law Commission recommended that the duty of disclosure should be modified in the following way:

> "A fact should be disclosed to the insurers by the applicant if: -
>
> (i) it is material to the risk;
>
> (ii) it is either known to the applicant or is one which he can be assumed to know;
>
> (iii) it is one which a reasonable man in the position of the applicant would disclose to his insurers, having regard to the nature and extent of the insurance cover which is sought and the circumstances in which it is sought."

3.82 In relation to (i) above, the Law Commission indicated there was no intention to change the definition of materiality, save in relation to the need to expand the range of potential responses by "the prudent insurer". Rather than decline the risk or charge a different premium, a prudent insurer could well

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106 Cmnd. 8064.

107 *Ibid,* paragraph 4.42.

108 Cmnd 62, paragraph 14.

load an excess or exclude some risks via an exclusion clause. Such responses were recommended as a relevant consideration in determining materiality.

3.83 In relation to (ii) above, the Law Commission sought to classify the situation where proposers can be shown not to have known of a particular circumstance – the Law Commission distanced itself from the constructive knowledge epithet used in the Working Paper, and was content to recommend that a proposer:

> "Should be assumed to know a material fact if it would have been ascertainable by reasonable enquiry and if a reasonable man applying for the insurance in question would have ascertained it."

3.84 In relation to (iii) above, the English Law Commission explained that the words, "in the position of the proposer", had been employed in order to make it clear that the negotiating parties and ultimately the court were not being invited to consider the idiosyncrasies of the proposer – education, intellectual ability etc: the test directs the court "to have regard to the knowledge and experience to be expected of a reasonable person in the position of the applicant. Thus, more would be expected of the large company with an insurance division than of the small shopkeeper."[109]

3.85 In cases where insurance cover was obtained via the use of proposal forms, the English Law Commission retreated from the position taken in the Working Paper whereby an insurer would be deemed to have waived any need for disclosure, save in respect of specific questions directed at the proposer. Furthermore, general questions were to be impermissible under paragraph 74 of the Working Paper. Following upon representations from the insurance industry, the English Law Commission decided to support a residual duty of disclosure where a proposer would be aware of facts any reasonable person would consider relevant to the risk, citing *inter alia* the example of the hypothetical proposer for fire insurance who has received arson threats to property. The Law Commission also reaffirmed the legitimacy of using general questions to elicit further information on the basis that the proposer gets the benefit of having his/her attention drawn to the existence of the duty.

3.86 While the Law Commission recognised that this approach left open the central weakness of the existing law – answering specific questions did not supplant the duty to volunteer material facts, the Law Commission felt that the general reforms, and residual doctrines such as waiver, would go some way towards addressing this point. However, the Law Commission suggested that the use of "certain clear and explicit warnings to the insured, presented in a prominent manner, together, with appropriate sanctions wherever such warnings have not been given"[110] afforded a more practical solution than inviting litigation over whether general questions in a proposal form have triggered a new duty of disclosure. The Law Commission went on to provide a number of recommended warnings and suggested that, in general, the appropriate sanction for non compliance will be to deny the insurer the right to rely on any failure by the insured to disclose any material fact, save where the insurer's failure was not prejudicial to the proposer.

3.87 The 1980 Law Commission Report sought to present a reform model that was essentially unitary in nature. With the exception of MAT insurance, the central duty of disclosure did not distinguish between consumer insureds, and what would now be small to medium enterprise (SME) proposers, and large company/multinational proposers. However, the tests found in several of the recommendations – references to "the position of the proposer" as distinct from a proposer "in his circumstances", the standard recommended in the Working Paper, had the advantage of allowing the court to differentiate between the individual circumstances of the proposer, the nature and size of the risk, and the circumstances in which the contract was negotiated such as broker involvement.

109 Cmnd 8064, para 4.51.

110 *Ibid,* paragraph 460. A similar approach has been taken in the 1998 and 2003 South African Statutes: materiality is tested by reference to "the point of view of the notional reasonable and prudent person" – *per* Boruchowitz J in *Mahadeo v Direct Dial Insurance Ltd* 2008(4) SALR 80 at 86.

(10) Australia

3.88 In ALRC Report No. 20, *Insurance Contracts*,[111] the Australian Law Reform Commission examined misrepresentation and non disclosure together and concluded that the duty of disclosure required modification on the basis that while the duty can require proposers to reveal facts which, as a reasonable man, the proposer should appreciate as being relevant, the duty may also require disclosure of facts of whose relevance the proposer is rightly ignorant. The ALRC was tempted to suggest that the duty should be re-cast as a duty not to conceal a material fact, avoidance not being avoidable for innocent non disclosure. A residual duty of disclosure was to be balanced by a shift to the "reasonable insured" standard, with a duty being placed on the proposer to give the proposer a clear and prominent warning at the time when the proposal form is filled in. However, the ALRC felt that difficulties of proof made a "fraudulent concealment" standard impractical; the ALRC ultimately recommend that:

> "the duty of disclosure should be retained in modified form. An insurer which wishes to rely on innocent non-disclosure should warn the insured of his duty of disclosure before the contract is entered into. The duty should itself extend to facts which the insured knew, or which a reasonable person in the insured's circumstances would have known, to be relevant to the insured's assessment of the risk."[112]

3.89 The *Insurance Contracts Act 1984* sought to separate the (post contractual) duty of utmost good faith from any pre-contractual obligations placed upon the proposer. Although Professor Merkin comments that this boundary "has given rise to some difficulty under the 1984 Act"[113] he summarises the redacted duty of disclosure thus:

> "As regards disclosure, the assured's duty of disclosure is retained by s.21, but is subject to three significant restrictions: the test of materiality is no longer based on the prudent underwriter but rather focuses on the prudent assured; under s.21A the duty of disclosure is waived in respect of most forms of domestic policy unless the insurers have asked specific questions; and under s.22 the insurers are under a duty to inform the assured of the duty of disclosure, failing which they cannot rely on it unless the assured has been fraudulent."[114]

3.90 Any analysis of the duty of disclosure must take account of how the law reacts to non-compliance and the 1984 legislation does this. The major changes to the provisions on remedies involve an analysis of the state of mind of the proposer on completion of the proposal form. Absent fraud, the insurer will in general be put in the position they would have been in had there been no breach of duty: s.28. Pre contractual non disclosure and misrepresentation are normally addressed by reference to the presence or absence of fraud particularly on the question whether the insurer can avoid the policy. Post contractual breaches of the implied duty of good faith are answered by reference to contractual remedies.

(11) New Zealand

3.91 In contrast to Australia, the New Zealand provisions relating to non disclosure have been somewhat tentative. Some of the provisions in the New Zealand 1977 reform legislation were innovative,[115] but on the duty of disclosure the 1977 legislation was silent. The position in New Zealand is a complex one because life insurance is regulated in a separate statute that goes back to 1908, and the *Insurance Law Reform Act 1977* must be seen in the context of innovative New Zealand contract law statutes such as the *Contractual Mistakes Act 1977* and the *Contractual Remedies Act 1979*, statutes that have addressed many of the remedial shortcomings of the common law of contract. Because of the closeness of the Australian and New Zealand insurance markets, the two post 1984 New Zealand Law Commission Reports look closely at Australian reform measures, especially on disclosure.

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[111] ALRC Report No. 20, para. 175.

[112] ALRC Report No. 20, para. 183.

[113] Merkin, "Reforming Insurance Contract Law: Is there a case for Reverse Transportation?" *Para. 3.6.*

[114] Ibid,para. 3.7: Lewins, "Reforming Non-Disclosure in Insurance Law: The Australian Experience" [2008] JBL 158.

[115] *Insurance Law Reform Act 1977* (eg sections 4 to 7 on misrepresentation).

3.92 In the two subsequent reports the New Zealand Law Commission has sought to restrict the insurer's common law right to avoid a contract of non disclosure to cases where:

- the insurer seeks to avoid the contract within 10 working days of the risk attaching, giving an insurer time to inquire into facts, especially on provisional insurance matters;
- the contract is one of re-insurance;
- the non disclosure relates to a fact that the proposer either knew, or that, a reasonable person in the circumstances would have known would have influenced the judgment of a prudent insurer in fixing the premium or deciding to take the risk on substantially the same terms;
- the answer given to a question that was expressly asked is substantially incorrect, because of the non disclosure;
- In the case of a prospective avoidance, *ie* the insurer seeks to exercise the common law right before the risk materialises, such a common law right should not be affected.

3.93 The New Zealand Law Commission, in its 1998 Report examined the Australian reforms of 1984 but did not recommend that New Zealand law should be reformed along Australian lines, concluding that these provisions in Australia made the scope of the duty uncertain and that the proportionality remedies "involve difficult assessments as to the insurers likely response had the insured disclosed the information."[116] These New Zealand proposals were described in the 2004 Report as "provisional measures",[117] pending a fuller review when the 2003 Australian Treasury Review of the 1984 Act was completed.[118]

(12) The Principles of European Insurance Contract Law (PEICL)

3.94 The PEICL authors have set out a number of proposals that qualify the duty of disclosure and restrict the insurer's right to avoid the policy save in cases of fraudulent breach. The applicant's pre-contractual information duty, insofar as the provisions are relevant to this chapter are as follows:

> Article 2:101
>
> Duty of Disclosure
>
> (1) When concluding the contract, the applicant shall inform the insurer of circumstances of which he is or ought to be aware, and which are the subject of clear and precise questions put to him by the insurer.
>
> (2) The circumstances referred to in para.1 include those of which the person to be insured was or should have been aware.
>
> (3) The insurer shall not be entitled to terminate the contract if the policyholder is in innocent breach of Article 2:101, unless the insurer proves that it would not have concluded the contract, had it known the information concerned.

Article 2:102 sets out provisions governing breach of Article 2:101, specifically an insurer's right to propose a reasonable variation of the contract or elect to terminate the contract. Termination for innocent breach requires the insurer to prove that it would not have concluded the contract had it known the information concerned. Where the insured event occurs prior to variation or termination, and it is caused by an element of the risk that was the subject of negligent non-disclosure or misrepresentation by the policyholder, no insurance money is payable if the insurer would not have concluded that contract. Where the premium would have been adjusted however, a proportionality remedy will be available to the insurer. Article 2:102 is governed by Article 3:103:

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116 *Some Insurance Law Problems* (NZLC R-46)(1988). The second report, from 2004 *Life Insurance* (NZLC R-87)(2004) with text of a draft Bill appended. For the text of these proposals see Draft Bill, clauses 14 and 15.

117 See the 1988 Report, para. 23; 2004 Report, para. 8.33.

118 Paragraph 8.40

Article 3:103

Exceptions

The sanctions provided for in Article 2:102 shall not apply in respect of

(a) a question which was unanswered, or information supplied which was obviously incomplete or incorrect;

(b) information which should have been disclosed or information inaccurately supplied, which was not material to a reasonable insurer's decision to enter into the contract at all, or to do so on the agreed terms;

(c) information which the insurer led the policyholder to believe did not have to be disclosed;

(d) information of which the insurer was or should have been aware.

Article 2:104

Fraudulent Breach

Without prejudice to the sanctions provided for in Article 2;102, the insurer shall be entitled to avoid the contract by the policyholder's fraudulent breach of Article 2:101. Notice of avoidance shall be given to the policyholder in writing within two months after the fraud becomes known to the insurer.

(13) British Consumer Insurance (Disclosure and Representations) Bill 2011

3.95 In a series of documents, ranging from a 2007 Joint Consultation Paper to the *Consumer Insurance (Disclosure and Representations) Bill,*[119] the Law Commissions have sought to promote changes in relation to the duty of disclosure, misrepresentation and warranties. The 2007 Consultation Paper initially contained recommendations in respect of all three topics, addressing these problems in respect of consumer and business insurance. The 2009 Report and 2011 Bill however confined themselves to consumer insurance and misrepresentation. The difficulty in getting agreement on reforming commercial insurance appears to be the main reason for this revised approach.

3.96 In the sole context of consumer insurance the Law Commissions,[120] in their December 2009 Report and 2011 Bill, recommended that the section 17 duty of utmost good faith in consumer contracts, be replaced by a duty to take reasonable care not to make a misrepresentation. This duty should apply *vis-a-vis* disclosure and representations to the insurer by the consumer proposer. This amends both section 17 and any common law rule but does not supplant any post formation duty of utmost good faith that the consumer may be under (save in cases of variation of an insurance contract).

3.97 *The Consumer Insurance (Disclosure and Representations) Bill 2011*, introduced into the House of Lords by the UK Government in 2011, is the first legislative proposal to emerge from the deliberations of various law reform agencies in Britain dating back to the 1957 Report. This Bill is seen as being non-controversial and the Law Commissions are of the view that, in the words of Law Commissioner David Hertzell:

> "The introduction of this Bill is a significant achievement. This is the first time that consumer groups and the insurance industry have reached a consensus on this issue."[121]

3.98 Clause 1 of the 2011 Bill confines the reforms to consumers who enter or propose to enter a consumer insurance contract, defined as a contract of insurance between a person who carries on the

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119 Joint Consultation Paper, *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (Consultation Paper No 182); *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319); *Consumer Insurance (Disclosure and Representations) Bill 2011* (HL Bill 68).

120 Law Com No 319.

121 May 17 2011 Press Release.

business of insurance (with or without the necessary legislative permissions) and "an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession."

3.99 In relation to the duty of disclosure, clause 2(4) provides that the duty set in clause 2(2) of the Bill "replaces any duty relating to disclosure or representations by a consumer to an insurer which existed in the same circumstances before this Act applied." The clause 2(2) duty is "the duty of the consumer to take reasonable care not to make a misrepresentation to the insurer." Clause 2(5) modifies any rule of law stating that a consumer insurance contract is one of the utmost good faith, to the extent required by the Bill and renders section 17 of the *Marine Insurance Act 1906* subject to the provisions of the Bill insofar as it is a consumer insurance contract. Clause 11(1)(a) of the Bill completes the process of closing off non-disclosure which does not involve a misrepresentation by the consumer proposer by providing that any rule of law having the same effect as section 18 of the *Marine Insurance Act 1906* is abolished. Section 18 of the 1906 Act is also rendered inapplicable to contracts of marine insurance which are consumer insurance contracts, this being achieved via clause 11(2), adding a new subsection (6) to section 18 of the 1906 Act.

F General Conclusions

3.100 The net effect of the reforms in the 2011 Bill will be to remove any duty that the proposer was generally under to disclose material facts even if unprompted by a question. It is not so clear however whether the insurer may ask questions that may, through the back door, reinstate a right of avoidance by inducing the proposer to make a material misrepresentation. The Commission considers that this danger becomes evident when one considers the background to the 2011 Bill. Although the Law Commissions, in the December 2009 Report and draft Bill recommend the abolition of the duty of disclosure – more specifically a consumer's duty to volunteer information – it is suggested that, because the Law Commissions recommended that insurers would be entitled to ask general questions as well as detailed/precise ones, a general question in a proposal form might render the abolition of the duty to volunteer information ineffective. The Law Commissions wrote in December 2009:

> "To take an example raised by a broker in their response: a buildings policy proposal might ask "are there any other hazards we should know about?" We think that a consumer who makes fireworks at home would be required to mention this fact. This hazard is so obvious and extreme that it is the sort of thing that a reasonable consumer would mention. However, it may not be reasonable to expect consumers to state that they lived near rivers: if insurers want information to assess flood risk, they should ask for it."[122]

3.101 The Commission's view is that if the hazard is "so obvious and extreme" then a recalibrated duty of disclosure, requiring a proposer to volunteer special facts highly relevant to the risk, should remain in place. Such a horizontal duty, applying to both consumer and business proposers seeking standard, mass market insurance products, would keep the law relatively simple and indeed avoid introducing additional complexities into the law such as whether or not a general question was included in the proposal form. In the case of the Battle of the Boyne Cottage dispute, the cottage displaying the mural depicting the 1690 Battle of the Boyne had been a tourist attraction for most of the 25 years that preceded the opening of the official visitor centre that probably precipitated the arson attack on Frank Godfrey's property. Such facts could raise similar issues to the hypothetical fireworks enthusiast mentioned by the Law Commissions above and it may also add the complication of a business or dual use activity question, thus raising issues of classification across boundaries such as consumer/non consumer insurance and consumer/small business insurance. The Commission would prefer to retain a duty of disclosure, in a significantly redacted form, with bilateral pre-contractual duties to take reasonable care in transferring and processing information, which, after all, are at the core of the utmost good faith principle.

3.102 In conclusion, and subject to the provisional recommendations for reform already made, the Commission considers it is useful to set out here why, in general terms, the duty of disclosure should be retained:

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122 Law Com No 319, para 5.34.

- it is desirable to retain the duty; it is regarded as a necessary part of the PEICL and is an integral part of the common law in countries like Australia and New Zealand
- the existing law of insurance does not distinguish between consumer contracts and commercial contracts. The Commission sees no necessity to introduce such a distinction now
- apart from insurance contract law, consumer proposers and insureds will be able to rely on other statutory reliefs via the Unfair Contracts Terms Regulations and the *Consumer Protection Act 2007*, as well as continue to use the Financial Services Ombudsman service
- the Commission considers that a redacted duty of disclosure, one which clarifies and narrows down the duty, provides a uniform approach to disclosure issues, with the benefit of greater certainty and ease of application, afford benefits that should not be undervalued. There will still be marginal situations even where the consumer proposer will be aware of facts and circumstances that, should be disclosed so as to allow the insurer to assess the risk and set the terms, and the Commission believes these situations can best be policed by reference to issues of negligent or fraudulent non-disclosure
- such a uniform duty of disclosure avoids difficult marginal issues of definition eg mixed use insureds. The Commission notes that the Law Commission's approach sits uneasily with recognition that small businesses obtain insurance cover much in the same way that consumers do, increasingly via telephone or on-line with no broker assistance.[123]

3.103 *The Commission provisionally recommends that the insurer should be under a statutory duty to explain to a proposer both the nature of the duty of disclosure and the consequences of non-disclosure.*

[123] Issues Paper 5, April 2009, Micro Businesses.

CHAPTER 4 PRE-CONTRACTUAL MISREPRESENTATION AND INSURANCE CONTRACTS

A Introduction

4.01 In this Chapter, the Commission discusses the duty in section 20 of the *Marine Insurance Act 1906* to give "true" answers, and discusses this in the wider context of the law on misprepresentation as it applies to insurance contracts. When a proposer is seeking insurance, the proposer will, in most instances, be asked a series of questions aimed at eliciting from the proposer information concerning a variety of facts and circumstances relating to the risk, the proposer's circumstances and related matters.[1] Indeed, the proposer may be asked to express his or her opinion concerning matters that the proposer may have no accurate information on, such as the state of the proposer's health, particularly a medical condition that may not have been diagnosed at that time. This process is perfectly legitimate within the context of any underwriting exercise which is directed at gathering up "the special facts upon which the contingent chance is to be computed, [for] these lie most commonly in the knowledge of the insured only".[2] But the statutory codification of insurance contract law effected by the *Marine Insurance Act 1906* is of general application and it is not always predicated on the superior factual knowledge of the proposer. Section 20(3) of the 1906 Act provides that a representation "may be either a representation as to a matter of fact, or as to a matter of expectation or belief." Section 20(5) directs that a matter of expectation or belief is true if it be made in good faith. It is section 20(1) that creates the central obstacle to a nuanced and flexible system of responding to inaccurate statements made during negotiations. Absent some contractual modification, every "material representation made by the assured…must be true." Should the representation "be untrue the insurer may avoid the contract." Avoidance is the sole remedy available to the parties under section 20.

4.02 Where the insurer is the more reliable source of data and can access a more economic or efficient means of collecting relevant facts, circumstances or statistical information, the law of misrepresentation can operate extremely harshly. In historical terms, the primary remedy available in equity to a person who has been induced into entering into any contract by any misrepresentation is rescission, that is, the misrepresentee may set aside the contract, often with retrospective and prospective effect. The contract is voidable and the remedy of rescission is available regardless of the degree of fault or culpability that can be attributed to the proposer. An innocent misrepresentation entitles the insurer to rescind the contract because equitable reliefs for misrepresentation did not include more proportionate responses such as damages in lieu of rescission. The development of alternative causes of action via contractual express terms, negligent misstatement and under statute, as well as a trend towards seeing damages as the most appropriate remedy, makes insurance law look increasingly anachronistic when seen in the broader context of how contract and tort rules and remedies have evolved in the last 140 years or so.[3]

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1 See generally Bakes, "Pre-Contractual Information Duties and the Law Commission's Review*",* in Soyer *Reforming Marine and Commercial Insurance Law* (Informa Law 2008); Bennett "Reflections on Values*",* in Soyer, *Reforming Marine and Commercial Law* (Informa Law 2008); Hudson*,* "Making Misrepresentations*"* (1969) 85 LQR 524.

2 Lord Mansfield in *Carter v Boehm* (1766) 3 Burr 1905 at 1909-10.

3 Rose, "Informational Asymmetry and the Myth of Good Faith" [2008] LMCLQ 181 argues forcefully that the law that has been applied in relation to insurance contracts concluded on the basis of a misrepresentation is contract law generally, good faith being limited to non disclosure.

B Judicial approaches to limiting actionable misrepresentation

4.03 There are a number of ways in which the courts have sought to limit the law relating to actionable misrepresentation.

(1) "Reading down" the statement

4.04 Statements that are laudatory, imprecise or bombastic might be held to be non actionable "puffs". [4] Statements of opinion or belief about a state of facts will only be misrepresentations if the opinion or belief is not actually held.[5] If the opinion or belief is held, the fact that it may not be the opinion or belief that a prudent or well informed person would hold is not sufficient to make the resulting statement as to opinion or belief a misrepresentation.

(2) Honest belief

4.05 In *Economides v Commercial Union Insurance Ltd*[6] the owner of a flat relied upon his father's views as to the value of the contents of the flat when obtaining contents insurance. The replacement value of the contents considerably exceeded the declared amount (£30,000 as against the £16,000 declared value). The Court of Appeal held that the proposer had an honest belief and reliance upon his father's assessment provided a satisfactory basis for the opinion. Simon Brown LJ pithily observed that "what the appellant's father told him here was a sufficient basis for his representation: he was under a duty of honesty, not a duty of care".[7] However, a statement made on the basis of a pure guess or without any foundation could well be a fraudulent misrepresentation, and a statement made while ignoring related facts – "Nelsonian blindness" – will preclude a successful plea of honest belief.[8]

4.06 Where the proposer is not however a lay insured then greater knowledge and a higher duty – one approaching a duty of care – may be expected: *Sirius International Insurance Corp v Oriental Insurance Corp.*[9]

(3) Agent liability

4.07 For present purposes it is sufficient to state that Irish case-law[10] clearly allows the insurer to avoid the policy on the basis of a proposer's agent's misrepresentation:

> "The agent owes his client a duty to take reasonable skill and care in assisting him to complete a proposal form where that is required. If the agent himself fills in the form he must be careful to check with the proposer that the answers are correct. The fact that the proposer should check the answers before signing the proposal form does not necessarily relieve the agent of responsibility for misstatements due to his negligence" [11]

(4) Ambiguous questions

4.08 The issue of how ambiguous or misleading questions are to be treated by the proposer[12] has been examined by the Irish judiciary on a number of occasions. While ambiguity may arise in relation to

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4 *Smith v Lynn* (1954) 8 ILTR 57.

5 As section 20(5) of the 1906 Act requires statements of opinion to be true but provides a statement will be deemed to be true if it is honestly held, issues of fraud via recklessness arise as in *McAleenan v AIG (Europe) Ltd* [2010] IEHC 128.

6 [1998] QB 587.

7 *Ibid.* See also *Zeller v British Caymanian Insurance Co Ltd* [2008] UKPC 4.

8 See Vincent, *Nelson* (New Haven), p. 424 on Nelson's use of a telescope against his blind eye at the Battle of Copenhagen. On statements of fact and belief generally see Bennett, (1998) 61 MLR 886.

9 [1999] 1 All ER (Comm) 699; *McAleenan v AIG Europe Ltd* [2010] IEHC 128.

10 *Chariot Inns v Assicurazioni Generali SPA* [1981] IR 199.

11 For harsh results of this rule see *Connors v London and Provincial Assurance* Co (1913) 47 ILTR 148. See however section 51 of the *Insurance Act 1989*.

12 MacGillivray on *Insurance Law*, 11th ed (Sweet & Maxwell 2008) at 36-28.

verbal or written questions at formation stage, as well as at post formation stage *vis-à-vis* policy terms and exclusions, the weight of Irish authority is in favour of viewing and interpreting ambiguous questions in a proposal form, and provisions within the policy itself against the party who prepared the question or contract term. In *Rohan Construction Ltd v Insurance Corporation of Ireland Ltd*[13] Keane J cautioned against giving a meaning to a contractual term which is strained or artificial:

> "if there is any ambiguity in the language used it is to be construed more strongly against the party who prepared it, *i.e*. in most cases against the insurer. It is also clear that the words used must not be construed with extreme literalism, but with reasonable latitude, keeping always in view the principal object of the contract of insurance"

4.09 In the context of ambiguities in a proposal form the leading case is *Re Sweeney & Kennedy's Arbitration.*[14] An application form asked the proposer if any of his drivers are "under 21 years of age or with less than 12 months experience". The proposer truthfully answered in the negative but at a later date he hired a driver who failed to satisfy these conditions. An attempt to avoid the policy on the basis that a promissory warranty as to the future was implicitly built into the contract failed. In *Analog Devices BV v Zurich Insurance Company*,[15] the Supreme Court has specifically endorsed the view that exclusions from cover in an "all risks" policy should be read *contra proferens*. More recently, in *McAleenan v AIG (Europe) Ltd*[16] Finlay Geoghegan J has reaffirmed these propositions in the context of professional indemnity insurance, pointing out however that *contra proferens* interpretation only arises if there is an ambiguity in the first place, Finlay Geoghegan J finding such an ambiguity over whether the policy in question was a composite and not a joint policy, creating individual contractual rights for employees of the firm.

4.10 While Keane J's view in *Rohan Construction* and the *contra proferens* approach mandated in *Analog* are not necessarily irreconcilable, there is a tension between these approaches in the sense that reading a clause against the party who prepared it need not necessarily be the same approach as giving the question or term the meaning that a reasonable person would deduce from the words themselves. There are English cases that do not favour *contra proferens* interpretation of exclusions,[17] and after the House of Lords had distanced itself from *a priori* rules of construction in *Investors Compensation Scheme Ltd v West Bromwich Building Society*,[18] there is a clear movement away from using the *contra proferens* approach in insurance contracts. In *McGeown v Direct Travel Insurance*[19] Auld LJ said that too early a recourse to *contra proferentem* involved a danger of creating an ambiguity where there is none. Clarke J, in *Danske Banke v McFadden*[20] has recently expressed agreement with the view that the *contra proferens* approach to interpretation may not be suitable where contractual terms may have been individually negotiated, and in any event Clarke J did not find it of assistance in interpreting the terms of a guarantee coauthored as a joint effort by the parties.

4.11 It may be that the issue of how to interpret an ambiguous question should best be left for future judicial development. In *Analog* the Supreme Court specifically endorsed both *contra proferens* interpretation and Lord Hoffmann's speech in *West Bromwich* and the tension between these approaches

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13 [1986] ILRM 419. See also *Walkers v London and Provincial Insurance Co* (1888) 22LR Ir 572.

14 [1986] ILRM 419.at 423-4: see Griffin J's "reasonable persons" test in the Supreme Court [1988] ILRM 373.

15 [1950] IR 85.

16 [2010] IEHC 128; *Emo Oil Ltd v Sun Alliance* [2009] IESC2.

17 See also *O'Reilly v Irish Life Assurance plc* [2005] IEHC 449 (rejection of consumer insured test).

18 [1998] 1 All ER 98.

19 [2004] 1 All ER (Comm) 609. In *Clear Homes v Sarcon No 177 Ltd* [2010] NI Ch 16 Deeny J characterised *contra proferens,* in the light of Lord Hoffmann's analysis, as a rule of last resort when all other rules of interpretation fail.

20 [2010] IEHC 116, citing in particular *Levinson v Farin* [1978] 2 AllER 1149 and *Oxonica Energy Ltd v Neuftec Ltd* [2008] EWHC 2127 (Pat).

will no doubt arise in the future. On the other hand, greater legal certainty will be engendered via a statutory solution.

4.12 The Australian judiciary has adopted what the 1982 ALRC Report[21] described as a rule of fair and reasonable construction, an approach that the Privy Council endorsed in *Condogianis v Guardian Assurance Co,*[22] in contrast to an approach endorsed by Isaacs J in the High Court of Australia in which it was argued that a question which the proposer bona fide believes to have a certain meaning should be favoured, as long as that meaning was not beyond the bounds of reason. This issue has been resolved in the Australian 1984 Act, s.23 of which provides in part that:

> "Where:
>
> (a) a statement is made in answer to a question asked in relation to a proposed contract of insurance…and
>
> (b) a reasonable person in the circumstances would have understood the question to have the meaning that the person answering the question apparently understood it to have;
>
> that meaning shall, in relation to the person who made the statement, be deemed to be the meaning of the question."

4.13 In commenting on s.23 Professor Merkin noted that the section represents a departure from *contra proferens* interpretation and that it applies regardless of whether the proposal form is drafted by the insurer or the broker.[23]

4.14 *The Commission provisionally recommends that legislation should provide that the insurer shall ensure that any question posed in writing to the proposer is drafted in plain , intelligible language; that any such question should be specific as to the information being sought by the insurer; and that where there is a doubt about the meaning of any question, it should be interpreted by reference to a standard of what is fair and reasonable.*

(5) Interpretation of Ambiguous Answers

4.15 In *Condogianis v Guardian Assurance Co*[24] the Privy Council expressed the view that the rule of fair and reasonable construction was also to be applied to answers given in response to questions. A literal interpretation will not be applied if answers given in relation to a question relating to past or existing fact, as distinct from future intention or events, are in substance false. Contrast *Holt's Motors Ltd v South East Lancashire Insurance*[25] with *Re Sweeney & Kennedy's Arbitration.*[26]

(6) Are questions asked presumed to be seeking to identify material facts?

4.16 Where specific questions are contained in a proposal form and the question is answered incorrectly, can the insurer avoid the policy on the ground that the answer was false? This is certainly likely to be the case if a warranty or basis of contract clause is present, but a false answer *per se* will not necessarily allow avoidance, save in relation to matters of fact – see section 20(5). The Materiality question will also be relevant. Section 20(1) of the *Marine Insurance Act 1906* requires the representation to be material, that is, it would influence the prudent insurer in deciding to fix the premium or take the risk.

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21 Report No. 20 *Insurance Contracts* para 169.

22 (1921) 29 CLR 341. See also *Revell v Lords General Insurance Company Ltd* [1934] 50 Lloyd's List LR 114 and *R & R Developments Ltd v Axa Insurance Plc* [2010] Lloyd's Rep 521.

23 Merkin, "Reforming Insurance contract Law: Is there a case for Reverse Transportation?" Para 4.29.

24 (1923) 29 CLR 341.

25 (1930) 35 Com. Cas 281.

26 [1950] IR 85.

4.17 Case-law also prescribes an inducement test.[27] Can an insurer satisfy materiality and inducement by pointing to specific questions which are intended to obtain information on which the proposer has answered incorrectly? This point is answered succinctly by the Law Commissions in the 2007 Consultation Paper:

> "It might be thought that when a proposal form asks a question, the answer would always be material and, if it were inaccurate, would amount to a misrepresentation. However this is not so. Many questions are asked in rather general terms and it is difficult to know the full extent of what is wanted. For example, an insured who is asked if they have had medical tests for illness may not interpret this as referring to routine tests (for example blood pressure checks) or even to non-routine tests that were completely negative. Their answer may be inaccurate or incomplete. Whether the insurer will have a remedy depends on whether or not the incorrect or missing information was material within the meaning of section 20(2). If it was, the insurer will have a remedy for misrepresentation. If it was not, the insurer will have no remedy even though the proposer knew that its answer was not wholly accurate."[28]

4.18 In the context of privacy law and data protection the insurer is only entitled to information that can be held to be within the data protection principles, one of which is that a data controller must only obtain personal data that is adequate, relevant and not excessive "*vis-à-vis* the processing operations for which the personal data is intended." These processing operations themselves must be "specified, explicit and lawful" and the *Code of Practice on Data Protection for the Insurance Sector* (2008)[29] provides that the Data Protection Commissioner will examine the data capture practices of insurers "on an ongoing basis to ensure that only relevant information is sought and provided." In fact the Commissioner, in Case Study 1 of 2002 held that when insurance companies sought to collect personal data relating to marital status as a standard question, this practice could not be relevant to issues of risk and motor insurance. The Commissioner was "pleased to read that the companies agreed to delete the question and I trust [he wrote] that all companies in the industry are so doing." At paragraph 4.99 of the 2007 Consultation Paper the Law Commissions however suggest that consideration should be given to enacting a statutory presumption that the proposer would know that an issue is relevant to the insurer if a specific question about that issue is asked by the insurer. The 2009 Report[30] and clause 5(5)(b) of the Consumer Insurance (Disclosure and Representations) Bill 2011 provides such a presumption within the context of an insurer's contention that the proposer acted fraudulently. While the Commission sees some force in such a presumption, applying as it does to specific questions only, the Commission questions whether such a presumption would be useful to insurers at formation of the contract stage. However there may be some practical disadvantages. Such a presumption might encourage some insurers to make the task of completing proposal forms burdensome and unduly inquisitive and bring about situations that privacy law and the data protection principles are intended to prevent.

(7) Is a failure to answer questions misrepresentation?

4.19 Where the questions are set out in a proposal form and the proposer provides no answer or an obviously incomplete answer, the courts have often struggled to provide a satisfactory response. At one level a proposer who leaves a question blank might be suspected of doing so because he/she is unwilling to provide information (eg on a criminal record or history of illness). Such conduct is consistent with fraudulent concealment. On the other hand the question may not be answered because it is clearly irrelevant, either in the view of the proposer or on any objective basis. Some proposal forms seek to deal with this by directing that if an answer is not provided to a specific question it will be deemed to be a negative answer, but MacGillivray gives examples of how such a deeming provision may not address

[27] *Pan Atlantic Insurance v Pine Top Insurance* [1994] 3 All ER 581.

[28] Para 225.

[29] www.dataprivacy.ie.

[30] Paragraph 6.33 of Law Com 319.

questions that are incapable of a yes/no answer.[31] The ALRC suggested that provisions of this kind should be "rendered ineffective. They lead to uncertainty and confusion."[32]

4.20 The ALRC instead took a very robust approach to the problem although this issue was treated as a non-disclosure issue.

> "An insurer should be deemed to have waived the duty of disclosure to the relevant extent where it has failed to pursue unanswered or obviously incompletely answered questions contained in a proposal form. If an insurer requires more information, it should make further inquiry."[33]

4.21 This is an area of law where the non-disclosure and misrepresentation fields overlap but the ALRC proposal has the advantages of clarity and consistency. The Law Commissions also cite this approach with enthusiasm, observing that where a question has been met with an obviously incomplete answer "the onus should be on the insurer either to decline the application or follow up the issue with the insured."[34] The *Consumer Insurance (Disclosure and Representations) Bill 2011* does not however contain a provision like section 21(3) of the Australian 1984 Act. While there are some relevant provisions in the 2011 Bill, the Commission believes that there is a lack of clarity on this point. Clause 2(2) imposes a duty on the consumer to take reasonable care not to make a misrepresentation to the insurer, but silence will not constitute a misrepresentation in ordinary contract law. Clause 3(3) states that the failure by an insurer to comply with an insurers request to confirm or amend previously submitted particulars may be a misrepresentation, suggesting that should no follow up request be made, an incomplete form will not include any misrepresentations by virtue of unanswered questions. There are decisions under the Insurance Ombudsman of Ireland complaints procedures where the failure to follow up an incomplete proposal forms in relation to material matters affected the insurer's right to avoid the policy, the Ombudsman deciding on a proportionate remedy[35] or settlement.

4.22 There is another point where the Commission thinks it would be desirable to be clearer than the UK 2011 Bill appears to be. Take the case of a proposer who left a question blank (eg "have you ever suffered from clinical depression") when the proposer should answer yes. The proposer's hope that the insurer overlooks the omission is realised, and the misstatement comes to light much later. Is this a case of fraudulent omission or concealment that might trigger avoidance? The formula in section 27 of the Australian Act – omission is not a misrepresentation "by reason only" of the failure would be of assistance, suggesting that other factors may justify a conclusion of fraud.

4.23 *The Commission provisionally recommends that if an insurer does not follow up on the failure by the proposer to answer a question, or in respect of an obviously incomplete answer, this should be regarded as a waiver by the insurer of the duty of disclosure and the duty to answer questions honestly and fairly; this would not apply where there has been fraudulent concealment by the proposer (intentional or reckless concealment)*

4.24 This solution would leave it open to a court to hold that, on the facts, the proposer was aware of the incomplete nature of the answer and had abstained from giving a complete answer in order to conceal material facts. As the Commission has proposed the retention of a redacted duty of disclosure as well as allowing an insurer appropriate relief against misrepresentation, this reform would not lead to wholesale fraud by allowing proposers to provide intentionally misleading information, or ignore questions, or supply fragmentary answers to questions, in proposal forms.

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31 Para 16-032.

32 Report No. 20, *Insurance Contracts* para 184, implemented via section 21(3) of the 1984 Act for non disclosure and section 27 for misrepresentation.

33 *Ibid.*

34 2007 Consultation Paper, para. 4.44.

35 Eg Case Study 49 in the Digest.

(8) Spent Convictions

4.25 In the 2007 *Report on Spent Convictions*,[36] the Commission considered the general question of whether Irish law should contain provisions permitting a convicted person to lawfully refuse to disclose past convictions. The Commission noted that the debate "begins with an acknowledgment that a criminal record is not necessarily a good predictor of an individuals current or future behaviour." The *Spent Convictions* Report recommends, and s.4(2) of the Draft *Spent Convictions Bill 2007* contained in the Report provides, that a rehabilitated person who is asked questions in relation to previous convictions may treat that question as not relating to a spent conviction; nor is the rehabilitated person to be prejudiced by failure to disclose or acknowledge that conviction. The draft *Spent Convictions Bill* directs that a conviction is spent if, following custodial sentence for a term not exceeding six months, seven years have elapsed from the date of conviction, the period is five years following the conviction or when the order ceases to have effect, whichever is the earlier. Questions put to a person are not to be regarded as disclosure of spent convictions, save where the conviction relates to a conviction for fraud, deceit or an offence of dishonesty in relation to an offence of dishonesty in relation to an insurance claim and the fact in question is not excused form disclosure on any insurance proposal form. Subject to limiting provisions section 4(4) of the Bill provides that "an obligation imposed on any person by any rule of law…shall not extend to requiring him or her to disclose a spent conviction or any circumstances ancillary to a spent conviction" (as defined). The Bill provides exceptions in the form of excluded sentences and for disclosure to be made in respect of excluded employment, as therein defined. The focus of these legislative initiatives is quite properly upon the rehabilitation of offenders, and the Commission has concluded that it is appropriate to consider spent convictions with a view to providing a proportionate but focused response to the "moral hazard" concerns of insurers. In this respect, the Commisison notes that the Government Legislation Programme, Autumn Session 2011, proposes to publish a *Spent Convictions Bill* in 2012.

4.26 The Commission invites submissions as to whether the existing duty of disclosure and/or rules on misrepresentation, intended by insurers to identify the moral hazard that an underwriter may be facing, need to be reconsidered; and in particular, in relation to convicted persons, whether there are circumstances where a conviction (other than for insurance fraud) should be exempt from the duty to disclose or the duty to answer questions carefully and truthfully.

C Misrepresentation – rescission as the primary remedy

4.27 The law of contract, in historical terms, does not have any controlling influence on the consequences that follow on from the provision of false or misleading information prior to a contract being concluded. Until relatively recently oral statements made during negotiations were not freely incorporated into a contractual relationship.[37] The law of tort and principles of equitable relief tended to fill the void, with equity providing a misrepresentee with the somewhat draconian remedy of rescission of the contract, ie the right to withdraw from the transaction in certain circumstances.[38] This right was available in equity even if the misrepresentation was made innocently, that is without fraud or was not carelessly given. One of the purposes behind the UK *Misrepresentation Act 1967*,[39] which is broadly comparable to Part V of the *Sale of Goods and Supply of Services Act 1980*, was to curtail rescission by giving a court a discretion to award damages in lieu of rescission. While in theory these provisions apply to insurance contracts, the effect of the *Marine Insurance Act 1906* has been much more influential as the 1906 Act creates a parallel right of avoidance, rather than termination, to an insurer for a proposer's misrepresentations.

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[36] Case Study 22 of 2000.

[37] *Report on Spent Convictions,* para 1.29.

[38] Eg: *Bank of Ireland v Smith* [1966] IR 161; *Carey v Independent Newspapers* [2003] IEHC 67.

[39] For England and Wales. For Northern Ireland see the *Misrepresentation Act (Northern Ireland) 1967*. Section 3 of both 1967 Acts was replaced by s.8(1) of the *Unfair Contract Terms Act 1977.*

(1) Marine Insurance Act 1906 and misrepresentation

4.28 The provisions of s.20(1) of the *Marine Insurance Act 1906* set out in very stark terms the onus that rests upon a proposer who makes statements of material facts, expectation or belief, and the subsection also prescribes a very sweeping remedy for the insurer where the duty is not met.

> "Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract."

4.29 Section 20(3) provides that a representation may relate to a matter of fact, expectation or belief, while s.20(5) softens the force of the absolute duty to make statements that are true by providing that representations relating to expectation or belief are true if made in good faith.

4.30 The decision of Clarke J in *Coleman v New Ireland Assurance plc*[40] provides a graphic illustration of this good faith situation. Here, the proposer seeking critical illness cover as part of mortgage protection insurance answered questions relating to her medical history incorrectly. In particular she did not indicate that she had seen a specialist some eight years previously in connection with difficulties with her vision. Neither the specialist or her GP told here she was highly likely to develop MS. The insurer sought to avoid the policy, *inter alia*, on the ground that the answers given were untrue. Clarke J held that the policy could not be avoided on the grounds of misrepresentation because the proposal form required the proposer to answer questions "to the best of [her] knowledge". While it was not necessary for Clarke J to refer to s.20(5), this decision is noteworthy because it is another case in which the Irish judiciary have sought to limit an insurer's right to avoid a policy for innocent misrepresentation. After citing McCarthy J in *Keating v New Ireland Assurance*, Clarke J indicated that Irish law does not permit a policy to be avoided where an incorrect answer is given by an honest proposer because he or she has simply forgotten events or completely put an incident that took place some years previously out of her mind. Clarke J stated:

> "insofar as the answers to questions raised in a proposal form is concerned, a party will only be exposed to the risk of the contract of insurance being voided *where the party fails to answer such questions to the best of the party's ability and truthfully*. This would be so even where an answer is inaccurate as a result of ignorance or even, in the words of McCarthy J., the "obtuseness which may be sometimes due to a mental block on matters affecting ones health"."

4.31 This comes very close to holding that rescission for an innocent [mis]representation is no longer available to an insurer under Irish law.[41] The weight of authority is the other way in cases where section 20(5), statements of opinion or belief, are not concerned. Lord Hobhouse in *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank Casualty and General Insurance Ltd v Chase Manhattan Bank*[42] said:

> "If a material misrepresentation is untrue even though made in good faith, the insurer may avoid the contract: s.20. This duty is, like the disclosure duty, strict. It does not depend on dishonesty, negligence or fraud though it may arise from such a fault. Fault will only become relevant if some other remedy than avoidance is being sought by the insurers such as damages or denial of the restitutionary obligations to repay the premium: s.84"[43]

4.32 The duty to make statements that are true can apply to a variety of circumstances. The statement might be made voluntarily by the proposer without prompting by the insurer; it might be the subject of a verbal question (eg an over the telephone question in which the proposer may be given little or no time to reflect on and give the proper answer), or it may be the subject of a specific written question

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40 [2009] IEHC 27.

41 On rescission in equity/avoidance for material misrepresentation and non disclosure see *London Assurance v Mansel* (1879) 11 Ch 363.

42 [2003] 1 All ER (Comm) 349.

43 *Ibid*, at p.375.

on a proposal form or in a 'tick box' user interface on a website. The duty is to provide 'true' answers; whatever a true answer is may depend on specific circumstances. The duty is not to answer questions honestly and carefully. The duty does not afford an innocent belief that the answer given to a factual question is honestly held any weight. Even should the proposer have a reasonable belief in the veracity of his or her statements, the duty will be broken nevertheless. The Commission considers that this requires too much of the consumer and "small business" proposer seeking standard, mass cover insurance.

4.33 Section 20(1) also prescribes one remedy for breach: Should the misrepresentation be made, absent the decision of the insurer to waive the breach, the insurer may rescind or avoid the contract. The breach of s.20(1) resembles a breach of a condition in the *Sale of Goods Act 1893* sense; breach of s.20(1) does not give a right to damages only (ie it is not to be treated as a term analogous to a warranty under the 1893 Act). Nor does s.20(1) countenance the possibility of the obligation being classified as an innominate term, leaving the remedy to be tailored by reference to the consequences of breach.[44] The failure of the 1906 Act to provide proportionate remedies for misrepresentation is due to the fact that for wholly innocent misrepresentations, unless some intervening factor is present (third party rights, etc), equitable rescission was the primary remedy. In the context of insurance the effect of this rather blunt remedial mechanism can be striking. The contract can be rescinded at any time after the misrepresentation was made, particularly so in cases where the risk has already materialised. Where the insurer elects to rescind, s.84(3)(a) of the 1906 Act entitles the proposer to the return of premiums, save where fraud or illegality by the insured is present, in which case the premiums are forfeit.

4.34 *The Commission provisionally recommends that section 20 of the Marine Insurance Act 1906 should be repealed in relation to consumer insurance and mass market insurance products (including mass market insurance products to all businesses, not limited to the jurisdictional limit of the Financial Services Ombudsman); and that the duty in section 20 of the 1906 Act to furnish "true" answers should be replaced by a duty to answer specific questions honestly and carefully.*

(2) Limited reforms in Sale of Goods and Supply of Services Act 1980

4.35 Limited efforts to inject some flexibility into the law relating to remedies following upon a misrepresentation have been attempted in England and Wales, Ireland, Hong Kong, Singapore and some Australian States via statutory provisions that find their origins in England and Wales in the form of the *Misrepresentation Act 1967*.[45] Section 2(1) affords a misrepresentee with a statutory cause of action in damages following upon an innocent (*ie* non-fraudulent) misrepresentation, while section 2(2) gives a court a discretion to award damages in lieu of rescission. These provisions are replicated in this State by section 45(1) and (2) of the *Sale of Goods and Supply of Services Act 1980* respectively. Because a contract of insurance is a contract for services and thus within section 43, it is possible for the Irish judiciary to abridge an insurer's rights of rescission accordingly. There is a technical difficulty of course because the 1906 Act speaks of "avoidance" not "rescission". However, there are apparently no cases from across the common law world in which these provisions exist in which a court has applied them in the context of an insurance contract. Indeed, the two Law Commissions in the 2007 Consultation Paper note judicial hostility exists to the use of such powers in the context of commercial insurance.[46] While this may be understandable in the context of large risk insurance or reinsurance, the failure of counsel or the judiciary to invoke these provisions in consumer and standard form business insurance disputes is puzzling.

44 While judicial attitudes have differed, the general view is against holding questions asked in proposal forms to be innominate terms, for generally sould policy reasons. See Chapter 10: Remedies.

45 For England and Wales. For Northern Ireland see the *Misrepresentation Act (Northern Ireland) 1967*. Section 3 of both 1967 Acts was replaced by s.8(1) of the *Unfair Contract Terms Act 1977.*

46 *Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (July 2007) page 25.

(3) Should the right to rescind be lost in cases where the proposer makes a negligent misrepresentation?

4.36 Should a misrepresentee's right to rescind for a negligent misrepresentation be abridged? The approach initially adopted in the 2007 Law Commission's Consultation Paper is very much along the lines of that adopted in Australia in the 1984 Act. The decision was taken in Australia to confine the insurer's right to avoid the contract for non-disclosure and/or misrepresentation to cases of fraudulent non-disclosure or fraudulent misrepresentation. In the ALRC Report this position was defended on the ground that avoidance or rescission of an insurance contract results in disproportionate consequences:

> "The remedy or avoidance of rescission of a contract is not unique to insurance. But there is a vital difference between the operation of that remedy in insurance and its operation in relation to other contracts. Avoidance of a contract for, say, the sale of land does not usually result in great hardship to either party. The vendor regains his interest in the land; the purchaser recovers his money. But avoidance of an insurance contract normally takes place *after* a loss has occurred and a claim has been made. In such a case, it inevitably results in a loss which may well be overwhelming. The principle of *restitutio in integrum* is satisfied only in the most technical sense. The insured gets back his premium and the insurer is freed from its obligations. But that does not put the parties back into the substantial position they were in at the time of the contract; at that time, the insured had *not* suffered an uninsured loss. In many cases, the insurer's remedy is out of all proportion to the harm caused by the insured's breach of duty. These considerations suggest that a limitation should be placed upon an insurer's right to avoid a contract for a non-disclosure or misrepresentation. The limitation which suggests itself is the substitution of a right to damages for the existing right of avoidance. That would provide an adequate deterrent to misrepresentation and non-disclosure. It would also ensure that insurers were entitled to adequate compensation for loss suffered as a result of breach of the insured's duties. Disproportionate burdens would no longer be placed on the insured"[47]

4.37 The Law Commissions did not however go so far as to adopt this 1982 Australian recommendation: in business insurance for example the rules set out in the 2007 Consultation Paper were proposed as default rules, and at paragraph 5.110 of the Consultation Paper the view was expressed to be that, subject to a requirement to be transparent in concluding business to business insurance, the contracting parties would be free "to agree that the insurer would have specified remedies for misrepresentation, which may apply, even if the proposer was honest and careful in giving information": *a fortiori* such remedies would be available in cases of negligence on the part of the proposer. It cannot of course be known how UK law will ultimately be reformed on this question because the 2009 Report and the *Consumer Insurance (Disclosure and Representation) Bill 2011* do not address business insurance generally. Contracting out of the restrictions on rescission as a stipulated remedy in consumer insurance is not permissible under the 2011 Bill, but it must be likely that the United Kingdom will continue with some level of contracting out/freedom of contract in business insurance generally.

4.38 The issue thus arises as to whether the duty of disclosure should be recast so that a proposer is bound to answer specific questions honestly and carefully and disclose facts that are actually known to him to be either highly relevant to a reasonable insured or facts which, in circumstances, a reasonable insured would know to have a decisive influence on the insurer's decision in acceoting the risk or setting the premium. Meeting such a duty should still require the proposer to comply with the general law of tort: the duty not to misrepresent facts fraudulently or make negligent misstatements will generally provide the misrepresentee with the right to rescind any contract resulting therefrom, and at first blush it is difficult to see why a falsity uttered negligently or fraudulently in relation to an insurance contract aimed at consumers and businesses via mass market sales mechanisms should be treated differently.

4.39 The reasoning of the ALRC – that the consequences are disproportionate – is persuasive, but it can be argued that loss of the right to rescind may itself be disproportionate, seen from the perspective

[47] ALRC Report No. 20, *Insurance Contracts*, para 187.

of the insurer.[48] Furthermore, where the proposer has made a negligent misstatement or negligent misrepresentation, the proposer will in all likelihood have failed to observe his or her duty to answer questions carefully and accurately.

4.40 The view that a proposer who has been negligent should be nevertheless able to enforce the contract, notwithstanding this breach of duty, has been rejected by one of the most distinguished English judges of recent years. In *Highlands Insurance v Continental Insurance*[49] Steyn J was dealing with a fire reinsurance contract that had been struck on the basis that the premises in question were fitted with sprinklers (which was not the case). The insured sought to rely on s.2(2) of the *Misrepresentation Act 1967* (the Irish counterpart to which is s.45(2) of the *Sale of Goods and Supply and Services Act 1980*). Steyn J refused to exercise his discretion to declare the policy to be subsisting and award damages in lieu of rescission. This statutory discretion is a notoriously difficult one to persuade a court to exercise and, in this context, one may be forgiven for thinking that the difficulty of conducting a damages assessment exercise may itself have led Steyn J to decide rescission was the least inappropriate remedy. Steyn J explained that he would not use s.2(2) in this case because:

> "Where a contract of reinsurance has been validly avoided on the grounds of material misrepresentation, it is difficult to conceive of circumstances in which it would be equitable within the reasoning of s.2(2) to grant relief from such avoidance. Avoidance is the appropriate remedy for material misrepresentation in relation to marine and non-marine contracts of insurance. See Arnould, *Law of Marine Insurance and Average,* 16th edition, Vol. 2 p.62. The rules governing material misrepresentation fulfil an important 'policing' junction in ensuring that the brokers make a fair representation to underwriters. If s.2(2) were to be regarded as conferring a discretion to grant relief from avoidance on the grounds of material misrepresentation to the efficacy of those rules will be eroded. This policy consideration must militate against granting relief under s.2(2) from an avoidance on the grounds of material misrepresentation in the case of commercial contracts of insurance."[50]

4.41 The facts of the *Highlands Insurance* case are clearly distinguishable from most other insurance contracts. The reference to commercial insurance is arguably broader than was necessary, this being a case involving business property insurance. The dispute related to a reinsurance contract and included the usual broker to underwriter situation. Notwithstanding these criticisms of the scope of Steyn J's *dictum*, the reference to "avoidance" being "the appropriate remedy for material misrepresentation" for all contracts of insurance is one which suggests that s.2(2) is unlikely to be used

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48 Note that under the PEICL proposals, Article 2:102(3), the insurer may terminate the contract even if the proposer is innocent (*ie* non-fraudulent) if the insurer can show the contract would not have been concluded if the true facts had been known. Reiecke, "Remedies for Misrepresentation Inducing a Long-Term Insurance Contract: The Didcott Principle" (2009) 21 SA Merc LJ 387, provides support for the argument that the right to avoid or cancel should depend on the effects of the proposer's default. Here the argument was put in a South African context that an insurer should only be able to cancel a policy on the grounds of misrepresentation or breach of warranty if it would not have entered the contract. Didcott J in *Pillay v The South African Life Assurance Co. Ltd* (1991) 1 SA 363 (D) argued that if the isurer would have entered into a contract but on different terms those terms should be imposed. Professor Reinecke argues, after citing developments elsewhere (p.395) that "it is to be hoped that the industry will listen to the voice of reason coming from all over the world. If local perceptions on this topic could be brought into line with modern thinking, it would ease the way towards reform through legislation or otherwise. The insurance industry sells security. The adoption of the Didcott principle will boost the public's trust in insurance. Not only will insured persons benefit from the enhanced security provided by their policies, but in the long run this will also lead to an increase in the volumes of insurance business!"

49 [1987] 1 Lloyd's Rep 109.

50 *Ibid* at p.118.

by English judges to any extent, and the Law Commissions in their Consultation Paper comment that there are no cases in which s.2(2) has been applied to an insurance contract.[51]

4.42 Steyn J defended his refusal to apply s.2(2) on the basis that to do so would undermine the 'policing' function inherent in the law of misrepresentation. Clearly there is much force in this where the misrepresentation has been made fraudulently and even negligently. It has no applicability in relation to the innocent misrepresentation made without fault. Nevertheless, there is the possibility of retaining the insurer's right to avoid a policy on the basis that the proposer has made a negligent misstatement or negligent misrepresentation, while at the same time tempering the disproportionate effect of the rescission remedy, by providing that financial adjustments or damages are to be the primary relief following a negligent misstatement or a negligent misrepresentation: rescission would be reserved to extreme 'policing' situations. One possible approach would be to turn to section 45(2) of the *Sale of Goods and Supply of Services Act 1980*, the counterpart to the English statutory provision considered in *Highlands Insurance.* Section 45(2) provides:

> "Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed in any proceedings arising out of the contract that the contract ought to be or has been rescinded, the court may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party."

4.43 The Northern Ireland decision in *Odyssey Cinemas Ltd v Village Theatres Three Ltd*[52] provides a useful illustration of how the court may utilise the discretion. This case concerned a claim by a commercial tenant to rescind the lease of a cinema based upon misrepresentations concerning noise emanating from adjoining licensed premises. The lessor's solicitors who made the misrepresentation were held to have done so negligently but not fraudulently or recklessly. In the Northern Ireland High Court, Deeny J turned the subsection on its head when holding that it would be inequitable not to award damages in lieu of rescission. No bona fide effort was made by the lessee to deal with the noise problem, characterised by Deeny J as "not an inherent and irreparable defect in the premises." The lessor was a mark for damages – indeed the lessor was owed rent by the lessee. Rescission if granted would have disproportionate consequences. In essence the lessee was seeking to use a misrepresentation relating to a minor problem as the basis for resiling from what turned out to be a bad bargain. On appeal, the Northern Ireland Court of Appeal considered rthat Denny J had erred in concluding that damages would be reduced by contributory negligence, as such, under the 1967 Act. Nonetheless, the Court also accepted that this was one of the factors that could be tgaken into account in determining whether rescission or damages was the appropriate remedy. Indeed, the Court considered that this reinforced Denny J's view that damages rather than rescission sould be more suitable; and rtemitted the case to him on this basis.

4.44 It might be possible to build upon section 45(2) by providing the judge or the Ombudsman with a number of indicative factors that could be reference points when the section 45(2) discretion arises in the context of insurance contracts dispute resolution. These factors could include:

- the factual context in which the misrepresentation was made
- the practicality of providing the insurer with an alternative remedy in damages
- the availability of a remedy to the proposer against a third party such as an insurance broker
- the relevant insurance sector and the reaction within it had no misrepresentation been made (ie would the proposal have been declined, loaded etc.)

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51 July 2007, page 25. Indeed, Clause 4, specifically Clause 4(3) of the *Consumer Insurance (Disclosure and Representations)Bill 2011* stipulates that for careless misrepresentations the sole remedies for misrepresentation are found in the schedule to the Bill, apparently making resort to section 2 of the 1967 Act impossible.

52 [2010] NICh 1, [2010] NICA 25.

- the commercial experience of the proposer and his/her familiarity with the relevant insurance sector
- the need to ensure that the remedy given takes account of and is consistent with any proposed reliefs that may be available in relation to any breach by the proposer of the duty of disclosure.

4.45 While this solution is less radical than the Australian approach, it has the merit of taking account of existing Irish statutory provisions that the Oireachtas has already sanctioned in relation to curbing the availability of rescission as a primary remedy for pre-contractual misrepresentation. This approach also leaves it open for the judge or ombudsman to decide, on a case by case basis, that even though the proposer may not have been fraudulent, the degree of negligence demonstrated in the instant situation is one whereby the 'policing' function, and the link between misrepresentation and breach of the duty of disclosure, makes avoidance or rescission an appropriate remedy. The Commission does not anticipate that this decision to continue to afford the insurer the right to rescind for a purely negligent misrepresentation will be made readily or frequently. It may be that cases will arise whereby the alternative financial remedy will be impossible to calculate with any ease, but the judge or ombudsman should be able to resort to rescission as an appropriate remedy in exceptional circumstances.

4.46 *The Commission invites submissions as to whether Part V of the Sale of Goods and Supply of Services Act 1980, which concerns misrepresentation, should be tailored to insurance contracts so as to provide a remedy in damages in place of rescission in respect of pre-contractual misrepresentations made by the proposer and the failure to observe the proposed duty of disclosure in insurance law.*

4.47 The Commission does not however favour the solution initially canvassed by the Joint Consultation Paper by the two British Law Commissions. The Commission has already rejected the dichotomy drawn between misrepresentation in consumer insurance and business insurance. In the view of the Commission the decision to confine the business insurance reforms to situations where the business insured and the insurer have not contracted out is an open invitation to insurers to write around the default rules. As the default rules, as recast, broadly reflect general principles of contract law and tort law the Commission find this approach puzzling and over-elaborate. The Commission favours mandatory rules that operate in a more horizontal manner, giving the parties the kind of outcome that would have resulted had the breach of duty not occurred.

(4) Fraudulent Misrepresentation

4.48 In the leading English case of *Derry v Peek*[53] the House of Lords, particularly Lord Herschell, summarised the elements of actionable fraudulent misrepresentation as requiring any person alleging deceit to show that "a false representation has been made (1) knowingly, or (2) without belief if its truth, or (3) recklessly, careless whether it be true or false".[54] MacGillivray has summarised the position within insurance law thus:

> "In order to constitute an actionable fraudulent misrepresentation the statement of which complaint is made must be:
>
> (1) false,
>
> (2) made dishonestly, and
>
> (3) acted upon by the recipient in the sense that it induced him to make the proposed contract.[55]

4.49 Corrigan and Campbell provide a succinct analysis of fraud in Irish insurance law and practice. Fraud is relevant:

> "at the inception of the policy where material facts have been deliberately withheld or a true state of affairs misrepresented. This has given rise to very few reported cases. Seldom have there been circumstances where the insurer could not simply rely on the defence of innocent

[53] (1889) 14 App Cas 337.

[54] *Ibid*, p.374.

[55] Paragraph 16-001.

> non-disclosure or misrepresentation to defeat a claim successfully, rather than raise the seemingly more complicated issue of fraud. Those cases that to exist have arisen in the claims context and are all of very recent origin. Historically Irish insurers have relied on indirect and unrelated defences to avoid paying what they believed to be a fraudulent claim. With many of these defences no longer available, insurers nofaced by what they believe to be a fraudulent claim are forced to confront head-on the issue of fraud.[56]

4.50 Both Lord Hershell's speech and the extract from MacGillivray were applied in *McAleenan v AIG (Europe) Ltd.*[57] The plaintiff was employed as a solicitor in the practice of Michael Lynn & Co. Mr Lynn was the principal and in preparing an application for professional indemnity cover Mr Lynn stated on the proposal form that the plaintiff was a partner in the firm. After holding that this was both untrue and a material misstatement, Finlay Geoghegan J went on to consider whether the misstatement was fraudulent in the light of two further findings, (1) that the plaintiff did not know of Mr Lynn's misstatement, (2) she signed the form on behalf of the practice, in Mr Lynn's absence from his office. Finlay Geoghegan J continued:

> "Neither of the above findings precluded a finding of fraud in the making of the false statement if the untrue statement was made "recklessly", in the sense that the term was used in *Derry v Peek, ie* careless as to whether the statement be true of false. It is clear that "careless" for this purpose is not the same as when used in relation to the tort of negligence. The carelessness must be something greater, if it is to constitute recklessness for the purposes of fraud. As pointed out by Lord Herschell, in the extract from his speech referred to above, a statement may be considered as made recklessly where the circumstances are such that the Court considers that the maker can have no real belief in the truth of what he states. It appears to require an objective consideration by the Court as to whether the circumstances in which the plaintiff signed the Proposal Form (and, by doing so, made the representations or statements contained therein) were so careless as to whether the statements were true or false that the Court must conclude that she could have had no real belief in the truth of the statements contained in the Proposal Form….On her own evidence, notwithstanding that the Form, when presented to her for signature, had been completed, she did not read the answers given in relation to her status in the practice and was unaware of the type of person by whom the Form was required to be completed and signed, notwithstanding the express statement at the start of the Form and the description immediately under which she signed. As already stated her actions must be considered in the context of the obligations of 'utmost good faith' in relation to the completion of a proposal form for insurance of which she was or ought to have been aware. Considering the matter from the plaintiff's potential belief in the truth of the statements made in the competed Proposal Form, as on her own evidence, she was unaware of what statements she was making by signing the Form, - and was unaware of the person expressly required to sign the Form. It is not possible for me to conclude that she had any belief in the truth of the statements made."[58]

4.51 Irish case-law on fraudulent misrepresentation does not suggest that the law contains any critical problems generally. The question whether fraud raises any particular difficulties in terms of consumer confusion in particular was considered by the Law Commissions in the 2007 Joint Consultation Paper and again in the 2009 Report and Draft Bill. The proposals on avoidance for fraud generally follow common law patterns. Indeed, while the *Consumer Insurance (Disclosure and Representations) Bill 2011*

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56 Corrigan & Campbell, *A Casebook of Irish Insurance Law* (Oak Tree Press 1994) at 322

57 [2010] IEHC 128. See also *Goldsmith Williams v Travellers Insurance* [2010] Lloyd's Law Reports IR 309.

58 [2010] IEHC 128, at paras 123-4. Contrast *Odyssey Cinemas Ltd v Village Theatres Three Ltd* [2010] NICh 1, [2010] NICA 25, above, on the negligence/recklessness boundary. *Furay v Eagle Star and British Dominions Insurance* (1922) 56 ILTR 23, 109.

currently before the UK Parliament, in the definition of "qualifying" misrepresentations, uses "deliberate or reckless" and "careless", rather that fraud or negligence, no changes of substance are evident.[59]

4.52 Similarly, the Australian Law Reform Commission saw no need to review the law relating to fraudulent misrepresentation although the ALRC recommended modification of the avoidance remedy.[60]

4.53 There are however two issues that are of concern within the context of actionable fraudulent misrepresentation. One of them may be classified as being a need "for the avoidance of doubt" declaration in relation to materiality.

4.54 In *Pan Atlantic Insurance Co v Pine Top Insurance Co*[61] Lord Mustill observed that a representation inducing a contract which was fraudulent would "invariably give a right to avoid"[62] without materiality being a necessary element for the insurer to establish. Both MacGillivray and the authors of *Good Faith and Insurance Contracts*[63] are of the view that this argument is wrong.

4.55 The second issue arises out of the deliberations of the Law Commissions in both the Joint Consultation Paper and the December 2009 Report. In cases where fraudulent misrepresentation is alleged by an insurer, against a proposer the onus of proof will be upon the insurer but the Law Commissions suggested that two presumptions might be of assistance to the insurer. These are that the [consumer insured] knew:

> "(1) What someone in their position would normally be expected to know; and
>
> (2) that where the insurer asked a clear question, the issue was relevant to the insurer."[64]

4.56 The Law Commissions point out that these presumptions are rebuttable (eg in the first situation the proposer did not know he had suffered a heart attack). These presumptions have found their way into Clause 5(5) of the *Consumer Insurance and Representations) Bill 2011.*

4.57 On the issue whether the definition of fraud should be put on a legislative basis, the Commission has concluded that the common law should be retained in its present state and does not consider that any change be made on this point.

(5) Misrepresentation – the Insurance Ombudsman of Ireland Decisions

4.58 The decisions of the Insurance Ombudsman in the pre 2005 period indentify many instances where non disclosure involves factual misstatements that, on the bare facts, look like instances of fraudulent misrepresentation because of the specific nature of the questions asked by the insurer. For obvious reasons the Insurance Ombudsman hesitated to reach conclusions on fraud: there are similar judicial decisions where fraud is not in issue.[65]

4.59 The Insurance Ombudsman found misrepresentations were made in the following instances:

- Factually incorrect answers about medical history in life assurance[66]

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59 Joint Consultation Paper, para 12.9. Para 4.50 appears to eschew the common law rules on recklessness. In the 2009 Report the Law Commissions adopt the ABI definition: para 6.27.

60 ALRC Report No. 20, para 196: *Insurance Contracts Act 1984*, s.31 provides a judicial discretion to disallow avoidance where the consequences are disproportionate. The Commission does not favour the introduction of such a discretion as being likely to weaken the deterrent function of the duty to answer specific questions carefully.

61 [1994] All ER 581.

62 *Ibid* at 602.

63 See MacGillivray, para 16-001, footnote 1.

64 2009 Report, paras 6.34-6.39.

65 *Griffin v Royal Liver* (1942) 76 ILTR; *Curran v Norwich Union* [1987] IEHC 5.

66 Case Study 15 of 2000; Case Study 14 of 2003.

- Factually incorrect answers to a question about whether the proposer has any criminal convictions for motoring offences[67]
- Incomplete statement of previous claims history[68]

4.60 However, as in cases of non disclosure, the fact that a misrepresentation has been made does not *per se* allow repudiation or avoidance of the policy. The facts of several of the case studies suggest that the proposer made misrepresentations but the cases were treated as non disclosure cases. Avoidance was declined where a proportionate remedy was possible, especially if there was an innocent misrepresentation offset by poor information gathering by the insurer.[69]

(6) Developments in the United Kingdom on misrepresentation

4.61 Although the *Misrepresentation Act 1967* sought to limit the availability of rescission for a non fraudulent misrepresentation, the Act has had no visible impact upon the law of insurance in the United Kingdom.[70]

4.62 As the Commission has shown, the review of insurance contract law undertaken by the Law Commission of England and Wales between 1979 and 1980 came to nothing in terms of a legislative result. The most recent analysis undertaken by the Law Commissions as a joint project has produced a joint Consultation Paper,[71] a Report[72] and a Bill[73] which was introduced into Parliament on May 16, 2011. The proposals have remained generally consistent, borrowing from the work undertaken in 1979-1980, the Australian 1984 Act and taking account of industry practice and FOS rulings.

4.63 The Law Commissions approached the question of how best to reform the duty of disclosure and misrepresentation by classifying both issues as involving the gathering of pre contractual information from the insured. The Commissions then went on to provide for separate treatment in respect of consumer insureds and business insureds. In essence, the Commissions recommended that where a consumer makes a misrepresentation that induces the insurer to enter into the contract, the remedies available to the insurer should largely depend on the mental state of the proposer.

4.64 In the Consultation Paper it was recommended that an insurer should be entitled to avoid the policy if the consumer has made a deliberate or reckless misrepresentation which the consumer

(i) knows to be untrue (or knows it may be untrue or is made not caring whether or not it is true) and, the consumer

(ii) knows the statement to be relevant to the insurer (or knows it may be relevant and the statement is made not caring whether or not it is relevant).

4.65 The provision in the 2011 Bill on avoidance is in Schedule 1, Part 1, and stipulates that if a qualifying representation was deliberate or reckless the insurer "may avoid the contract and refuse all claims" and need not return premiums save where to do so would be unfair to the consumer. Clauses 5(2)-(5) provides a useful summary of judicial decisions that serve to distinguish cases of fraud from negligence. The use of the phrases "deliberate or reckless" (rather than fraud) and carelessness (rather

67 Case Study 13 of 2001.

68 Case Study 154 of 1992-1998.

69 Cases 41, 68, 76 and 157 of 1992-1998.

70 *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (2007) (Consultation Paper No 182) page 25, footnote 10.

71 *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (2007) (Consultation Paper No 182).

72 *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (2009) (Law Com No 319/Scot Law Com No. 219).

73 *Consumer Insurance (Disclosure and Representations) Bill 2011,* HC Bill 68.

than, for example, negligent misstatement) is, in the view of the Commission, helpful. Clause 5 of the 2011 Bill provides, in part:

> "(2) A qualifying misrepresentation is deliberate or reckless if the consumer -
>
> (a) knew that it was untrue or misleading, or did not care whether or not it was untrue or misleading, and
>
> (b) 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.
>
> (3) A qualifying misrepresentation is careless if it is not deliberate or reckless.
>
> (4) It is for the insurer to show that a qualifying misrepresentation was deliberate or reckless.
>
> (5) But it is to be presumed, unless the contrary is shown –
>
> (a) that the consumer had the knowledge of a reasonable consumer, and
>
> (b) that the consumer know that a matter about which the insurer asked a clear and specific question was relevant to the insurer."

4.66 In the case of an innocent (*ie* non fraudulent) misrepresentation, the recasting of the duty of disclosure to a duty on the consumer to be honest and careful in answering questions or volunteering information, has, as a consequence, that the insurer should not be entitled to refuse to pay the claim, or to avoid the policy on the ground that there was a misrepresentation by the consumer.[74] The Commissions also developed the implications of the duty to act carefully, *ie* reasonably, in relation to factual matters that the consumer might not think would render the statement inaccurate. Furthermore, the type of policy, the way in which it was sold and the normal characteristics of consumers who purchase the policy are to be taken into account, as are the personal characteristics of the actual proposer, insofar as these were known to the insurer. The Commissions also initially recommended that the burden of showing that the consumer acted unreasonably in making the misrepresentation should be on the insurer.

4.67 This approach was the subject of criticism in some of the responses to the Consultation Paper but the Law Commissions', in the 2009 Report indicated that some respondents misunderstood the situation, specifically that insurers only had to show carelessness on the part of a reasonable consumer, not the actual consumer. Nevertheless there is no burden of proof provision for careless misrepresentation. In contrast to clause 5(4) (deliberate or reckless misrepresentation) Clause 3 sets out this "reasonable care" test:

> "(1) Whether or not a consumer has taken reasonable care not to make a misrepresentation is to be determined in the light of all the relevant circumstances.
>
> (2) The following are examples of things which may need to be taken into account in making a determination under subsection (1)–
>
> > (a) the type of consumer insurance contract in question, and its target market,
> >
> > (b) any relevant explanatory material or publicity produced or authorised by the insurer,
> >
> > (c) How clear, and how specific, the insurer's questions were,
> >
> > (d) whether or not an agent was acting for the consumer.
>
> (3) The standard of care required is that of a reasonable consumer: but this is subject to subsections (4) and (5).
>
> (4) If the insurer was, or ought to have been, aware of any particular characteristics or circumstances of the actual consumer, those are to be taken into account.
>
> (5) A misrepresentation made dishonestly is always to be taken as showing lack of reasonable care."

[74] Law Com No. 319/Scot Law Com No. 219 (December 2009) para 6.13.

4.68 While the English and Scottish Law Commissions stopped short of recommending that an insurer should be required to consult databases or the insurers own files, the question whether a consumer acted with insufficient care in failing to give information should, the Commissions said, be viewed by reference to how reasonable it was for an insurer to obtain information for itself (for example, by seeking the consumer's express consent to a request to a third party for disclosure of information held by the third party about the consumer). Clause 3(4) seems relevant to this point but does not give any real guidance to a court.

4.69 In the case of misrepresentations made carelessly, avoidance is not possible but the Commissions recommend a compensatory remedy aimed at putting the insurer in the position it would have been in if the misrepresentation had not occurred. This could result in a claim not being met or adjusted, or the application of a financial adjustment based upon proportionality. In making this recommendation the Commissions departed from the earlier Law Commission Report from 1980 which saw proportionality as an imprecise or often arbitrary mechanism. Even if this be so, the Commissions argued:

> "In any event, in our view it is preferable to allow judges to aim imprecisely at the correct figure than to apply one that is clearly wrong (as where a policy is avoided altogether when there would have been only a small increase in the premium). There are many occasions in which the courts are forced to place arbitrary figures on the level of damages, particularly in personal injury cases. The level of imprecision involved here would appear to fall within acceptable limits."[75]

4.70 The Commission considers the proportionality remedy below in Chapter 10, below. The Schedule to the 2011 UK Bill provides a detailed account of how the remedy will be utilised.

(7) Innocent misrepresentation

4.71 Where a proposer makes an innocent misrepresentation in the sense that the proposer has exercised the necessary amount of care in reading questions put to him or her orally, or in the proposal form, or on an on-line application form, and has answered the question truthfully and with due care and deliberation, the Commisssion sees no basis for the insurer to be able to argue that the contract of insurance should be vitiated or avoided on the ground of innocent misrepresentation.

4.72 *The Commission provisionally recommends that where a proposer has exercised due care and attention in understanding the questions put and has provided the answers to such questions honestly and with due care and deliberation, the insurer should not be able to avoid liability on the policy that has arisen prior to discovery of the innocent misrepresentation.*

4.73 However, in situations where the insurer is able to show that, if the true facts were known at the time when the innocent misrepresentation was made the insurer would not have accepted that risk in any circumstances, the question arises whether the insurer should be entitled to terminate the policy prospectively. The Commission makes a provisional recommendation on the issue of prospective avoidance below in Chapter 10.

[75] Law Com No. 319/Scot Law Com No. 219 (December 2009), para 6.66.

CHAPTER 5 WARRANTIES

A Introduction

5.01 The use of warranties in insurance contracts has been a controversial subject for over 200 years.[1] Insurers defend the practice of securing contractual promises from proposers on the basis that the principle of freedom of contract legitimises the practice, arguing that warranties provide an insurer with effective protection from fraudulent proposers and assist the insurer in fixing or circumscribing the risk. Warranties have been attacked as being traps for proposers (and concealed traps at that)[2] and mechanisms whereby an insurer may extract binding promises from proposers on a wide range of undiscoverable and irrelevant facts which can serve to allow the insurer to avoid paying out on the policy. While insurers acknowledge that warranties are capable of operating harshly where the proposer has acted *bona fide* (in such cases insurers indicate that industry practice is not to invoke a warranty which has no causal link to the loss occasioned)[3] all major common law jurisdictions have either legislated to restrict the operation of contractual warranties or are in the process of doing so.[4]

5.02 In Part B, the Commission examines the law relating to warranties in general and suggests a number of reform proposals. The Commission then examines in Part C the specific issues of causation, the response of the PEICL to promissory warranty provisions and the relationship between promissory warranties and exclusions.

B Warranties in General

5.03 Warranties clearly have draconian effects when the proposer is being required to warrant the truth of all facts provided to the insurer. In such a context the Supreme Court, in *Farrell v South East Lancashire Insurance Co*[5] held that materiality is irrelevant in such a case; Kennedy CJ remarked that this is "undoubtedly a very hard case" but the Supreme Court was unable to lessen the impact of the law on the proposer. However, not all warranties are objectionable or have such oppressive consequences.

5.04 In the 19th Century the Irish judge Palles CB expressed the view that temporal restrictions which can be viewed as promissory warranties are the subject of rules of interpretation that require such

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1 Eg. Hasson, "The Basis of the Contract Clause in Insurance Law" (1971) 34 MLR 29 traces the shift in bargaining power over the centuries; Clarke, "Insurance Warranties: the absolute end?" [2007] LMCLQ 474; Soyer, "Reforming Insurance Warranties – Are we finally moving Forward?" In Soyer, *Reforming Marine and Commercial Insurance Law* (Informa Law 2008).

2 In the 2007 Consultation Paper the Law Commissions observed that "insurers use warranties for a number of purposes: to provide an additional remedy if information given by the proposer was incorrect; as an alternative method of defining the risk; to require the insured to take specified precautions; and to allow the insurer to escape from the contract should there be a change in the risk. This is possible because the wide variety of obligations on the insured can be given warranty status if the contract makes this sufficiently clear."

3 Eg Hasson, "The Basis of the Contract Clause in Insurance Law" (1971) 34 MLR 29; see also the IIF Code of Practice on Non Life Insurance which provides: "Neither the proposal form nor the policy shall contain any general provision converting the statements as to past or present fact in the proposal form into warranties. But insurers may require specific warranties about matters which are material to the risk." But see Buckley; "Self Regultation does not work" [2005] CLP 10.

4 Eg New Zealand, *Insurance Reform Act 1977*; Australia, *Insurance Act 1984.* Canadian law does not have a uniform approach. Warranties are virtually unknown to continental insurance contracts.

5 [1933] IR 297.

terms to be construed by reference to a reasonableness standard,[6] but this is not a universally accepted proposition. Such differences of judicial approach suggest that legislative intervention in Ireland is overdue. The Commission notes that industry practices themselves seek to ameliorate the harsh consequences that follow from a strict application of the law. Insurers may, through contract, place a reasonable limitation on the matters a proposer may be required to warrant. *McAleenan v AIG(Europe)Ltd*[7] demonstrates that a basis of contract clause may within its own terms qualify the insurer's right to avoid the policy. In that case the recorded facts in the proposal form were declared to be "the basis of the policy", but nevertheless the insurers undertook not to avoid the policy for non-disclosure or misrepresentation of facts or untrue statements in the proposal form if the omission or statement was "innocent and free of any fraudulent intent," the onus of proof resting on the insurer. This industry practice practice is to be welcomed, but the Commission do not see this as an acceptable substitute for legislative intervention prohibiting the use of warranties in unacceptable or unjustifiable ways.

(1) Warranties and Representations

5.05 Lord Mansfield characterised a warranty as being a term which is part of a written policy whereas a representation is external to the policy or contract.[8] Furthermore, while compliance with a representation may be judged with a degree of flexibility, a warranty is strictly interpreted. In *De Hahn v Hartley*[9] a policy of insurance was taken out in 1779 in respect of a ships sailing from Liverpool to the West Indies. The ship was warranted to have a complement of 50 hands but on departure from Liverpool only 46 hands were on board. The vessel stopped in Anglesey some hours later and took on six more men. The ship was lost (with all 52 hands) off the coast of Africa when it was seized by brigands. Lord Mansfield observed that:

> "There is a material distinction between a warranty and a representation. A representation may be equitably and substantially answered; but a warranty must be strictly complied with. Suppose a warranty to sail on the 1st of August, and the ship did not sail till the 2nd, the warranty would not be complied with. A warranty in a contract of insurance is a condition or a contingency and unless that be performed, there is no contract. It is perfectly immaterial for what purpose a warranty is introduced; but, being inserted, the contract does not exist unless it be literally complied with". [10]

5.06 It has been observed[11] that the word of "warranty" in insurance law has a similar meaning to that of "condition" in sale of goods law, i.e. it is a term, "the breach of which might give rise to a right to treat the contract as repudiated".[12] While this is the case, should a warranted fact not be accurate at the commencement of the cover, the result is that the insured was never on cover because the breach of warranty, as a breach of a condition precedent, means there is no contract. Breach of warranty entitles the insurer to avoid the contract *ab initio*, there being no requirement to show that the fact warranted was material or that the breach was relevant to the circumstances of the loss, and, subject to contractual provisions to the contrary, this rule is set out in the *Marine Insurance Act 1906.*[13] Such obligations are sometimes described as contingent conditions, rather than promissory conditions, in general commercial law.

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[6] *Gorman v The Hand in Hand Insurance Co* (1877) IR 11 CL 224.

[7] [2010] IEHC 128.

[8] *Pawson v Watson* (1778) 2 Cowp. 785; see also Lord Eldon in *Newcastle Fire Company v Macmorran & Co* (1815) 3 Dow P.C. 255, both followed in *Quin v National Assurance Co* (1839) Jo. & Car. 316.

[9] (1786) 1 TR 343.

[10] (1786) 1 TR 343 at 345.

[11] Law Commission, Report No. 104, paragraph 6.2

[12] *Sale of Goods Act 1893*, s.11(2)

[13] Section 33(3).

(2) Warranties – Matters of substance not form

5.07 In *HIH Casualty and General Insurance Ltd v New Hampshire Insurance Co*[14] Rix LJ said that whether a warranty exists or not:

> "it is a question of construction and the presence or absence of the word "warranty" or "warranted" is not conclusive. One test is whether it is a term which goes to the root of the transaction; the second, whether it is descriptive of or bears materially on the risk of loss; a third whether damages would be an unsatisfactory or inadequate remedy."[15]

5.08 MacGillivray summarises the essential characteristics of a warranty in the following terms:

> "(i) it must be a term of the contract;
>
> (ii) the matter warranted need not be material to the risk;
>
> (iii) it must be exactly complied with; and
>
> (iv) a breach discharges the insurer from liability on the contract notwithstanding that the loss has no connection with the breach or that the breach has been remedied before the time of the loss."[16]

MacGillivray's four qualifying factors will be examined in turn.

(3) The warranty must be a term of contract.

5.09 While no specific form of words are necessary for a stipulation to be held to be a warranty, the current practice is to expressly provide that certain stipulations are to be conditions precedent to the insurers' obligation to pay out on the policy. The Supreme Court, in *Re Application of Butler*[17] held that a covenant in a policy of motor insurance that required the insured to give notice of any accident "as soon as practicable" was a condition precedent, not least because the policy itself expressly so provided. There is no obligation in such instances to show that non compliance has been prejudicial.[18] Should the policy not expressly stipulate that the provision or requirement is a condition precedent to a valid claim, a court will have to consider whether a condition precedent was intended. If insufficiently clear language is used then a warranty or a condition precedent may not be inferred. On matters of this kind differences of judicial perspective are legion, and the cases are incapable of being reconciled.

(4) The matter warranted need not be material to the risk

5.10 Even if the matter warranted is material to the risk, basis of contract clauses have been criticised as being disproportionate in terms of their application and capable of producing considerable hardship for the proposer. The most infamous Irish case in this respect illustrates this point perfectly. In *Keenan v Shield Insurance Co*[19] a house and contents policy was negotiated, the proposal form seeking details of any previous claims. The proposer answered the question in the negative whereas he had made a claim for fire damage to a pump the previous year, the claim being for £53. The declaration recorded that "the particulars and answers are true and complete in every respect". The insurers refused to meet a subsequent claim for fire damage to the property and Blayney J held they were entitled to do so, applying *Pawson v Watson*.[20] Blayney J observed that even if the inaccurate reply to the question "was trivial, that would be no obstacle to the defendant repudiating the policy in view of the accuracy of the answers in the proposal form having been warranted by the plaintiff". Blayney J reached this

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14 [2001] EWCA (Civ) 735.

15 *Ibid*, para 101, followed in *GE Reinsurance Corp v New Hampshire Insurance Co* [2003] EWHC 302 (Comm).

16 Paragraph 10-003.

17 [1970] IR 45; *Patton v Employers Liability* (1887) 20 LR(Ir) 93. Contrast *Weir v Northern Counties of England Insurance Co* (1879) 4 LR (Ir)216 where no express warranty terminology was used in the proposal form.

18 *Gaelcrann Teoranta v Payne* [1985] ILRM 109.

19 [1987] IR 113.

20 (1788) 2 Cowp 785.

conclusion, "with considerable regret" given the hardship caused to the claimant.[21] While the incorrect answer given by Keenan in this case was in relation to a previous trivial claim, the matter to which the question was addressed was at least material. Where the risk is immaterial to the fact or facts that are warranted, it is hardly surprising that there is a torrent of judicial utterances on the impropriety of such warranty practices, even if no English or Irish case-law exists in which overt efforts to counteract warranties have been mounted (e.g. by way of good faith or unconscionability, for example) on a sustained basis. Even though the leading case of *Anderson v Fitzgerald*[22] demonstrates a concern to limit contractual warranties[23] it is as well to bear in mind that Lord St. Leonards' famous dicta[24] represent expressions of judicial impotence, not activism. In this "difficult case"[25] the insurer had drafted a proposal form for life insurance in such a way as to allow the insurer to retain premiums as well as refuse to meet any claim on the grounds of false statements made in response to the questions in the proposal form. There were two incorrect answers made in relation to questions posed which were clearly material to the risk. Lord St. Leonards proposed to read down the offending clause by reading "false" as meaning a "wilful misstatement" rather than "untrue statement". However, while finding that the Company was correct to resist the claim, Lord St. Leonards went on to observe that "I cannot think the Company to be right in so framing a policy".[26] Lord St. Leonards stressed that the law should provide a balance between insurance companies being able to protect themselves from fraudulent practices while affording "a fair security to the person with whom the policy is made, that, upon the ordinary construction of language, he is safe in the policy which he has accepted". Lord St. Leonards went on to observe that if such a warranty could be extracted in circumstances of this kind, he had no doubt:

> "that that very important branch of insurance, life-insurance, will become very distasteful to people, and that no prudent man will effect a policy of insurance with any company without having an attorney at his elbow to tell him what the true construction of the document is. And, indeed, in this case it has been necessary to consult all the Judges in Ireland, and they having decided in one way upon the language of this policy, the Judges of England have been consulted, and they have come to a different opinion [to those of their Irish Brethren]".[27]

(5) It must be exactly complied with

5.11 While the approach taken in respect of a representation is to give the proposer a degree of latitude in respect of trivial misstatements or omissions,[28] the same is not the case where a statement is warranted. Strict and exact compliance is necessary. In response to a question concerning the price paid by the owner of a motor vehicle the reply given was £285 when only £271 had been paid. The breach of a warranty clause allowed the insurer to vitiate the policy when a claim was made: see *Allen v Universal Automobile Insurance*.[29] While efforts are made to ameliorate the consequences of this rule by

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21 A further appeal to the Supreme Court on another point was dismissed at [1988] IR 89.

22 In the Irish Court of Exchequer Chamber see (1852) 1 ICLR 251: House of Lords (1853) 3 ICLR 475 and (1853) 4 HLC 484.

23 Especially in the Irish Court of Exchequer Chamber by way of importing a materiality requirement into the warranty. This position was reversed by the House of Lords.

24 "A policy ought to be so framed that he who runs can read. It ought to be framed with such deliberate care, that no form of expression by which the party assured can be caught on the one hand, or by which the company can be cheated on the other shall be found upon the face of it, and nothing shall be wanting in it the absence of which may lead to such results" (1853) 3 ICLR 475 at 488.

25 See *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co. Ltd* [1994] 3 All ER 581 at 611 (Lord Mustill).

26 (1853) 3 ICLR 475 at 493 – text slightly different to that at 4 HLC (text quoted is from 4 HLC).

27 (1853) 3 ICLR 475 at 491 (text quoted from 4 HLC at p.514).

28 MacGillivray, paragraph 16-024.

29 (1933) 45 Lloyd's Rep.55; *Farrell v SE Lancs Insurance Co* [1933] IR 36.

reference to the plain and ordinary meaning approach to the construction of the warranty[30], or via *contra proferentem* interpretation of the warranty[31], exact compliance remains the proposers primary obligation. The old Irish case of *Quin v National Assurance Company*[32] held that the misdescription of the property and usage of property was by the policy made a matter of warranty, not a representation, and in such a case "the materiality of the misdescription is then out of the question".

(6) A breach discharges the insurer from liability on the contract, even if the loss has no connection with the breach or that the breach has been remedied before the loss

5.12 In the first situation covered by this fourth element, in MacGillivray's summation[33] of the law relating to insurance warranties, the warranty is unaffected by any causation argument. A warranty that a motor vehicle is in a roadworthy condition when it is not will allow the insurer to avoid the policy even if the vehicle is damaged or destroyed by an unrelated event such as a fire in the premises where the vehicle is garaged.[34] A promissory warranty to maintain a fire alarm which is not observed will be likely to allow the insurer to decline to refuse to pay out a claim in respect of flood damage relating to the insured property.[35] The second situation is illustrated by *De Hahn v Hartley,*[36] considered above; many of the cases are marine insurance cases where an unseaworthy vessel is put into a seaworthy state prior to the risk of loss or damage materialising, to no avail to the proposer. Rectification of the factual position constituting the breach of warranty will not avail the insured.

(7) Amelioration of the strict rules relating to warranties

5.13 In relation to the duty of full disclosure, it has been shown that Lord Mansfield's formulation of the duty[37] was tempered by a number of exceptions and that both the duty and the exceptions have been gathered up into statutory form in s.18 of the Marine Insurance Act 1906. While Lord Mansfield did not undertake a similar balancing exercise in relation to warranties, later judges have tried to minimise these rules relating to warranties under the guise of seeking to interpret the contract in such a way as to give effect to the intentions of the parties. Some examples may be instructive.

5.14 Warranties that prescribe a limited remedy or require materiality to be shown will limit the right to avoid the policy. *London Loan and Savings Co of Canada v Union Insurance Co of Canton Ltd*[38] supports the view that, absent a stipulated right to avoid the policy, an insurer may recover only damages or the relief actually set out in the contract. Repudiation of a claim without repudiation of the policy is not possible: *West v National Motor & Accident Insurance Union Ltd.*[39]

5.15 Some judges show a reluctance to view a warranty as a promissory or a continuing warranty. Some courts will favour a warranty as being declaratory of existing facts and as not speaking to future events. *Sweeney & Kennedy's Arbitration*[40] is the leading Irish case in which a question phrased as to

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30 eg *Yorke v Yorkshire Insurance* [1918] 1 KB 662; *Rohan Construction Ltd v Insurance Corporation of Ireland Ltd* [1986] ILRM 419.

31 eg *Weir v Northern Counties of England Insurance Company* (1879) 4 LR (IR) 260; *Sweeney and Kennedy's Arbitration* [1950] IR 85.

32 (1839) Jo & Car 316.

33 Paragraph 10-003.

34 *Dawsons v Bonnin* [1922] 2 AC 413; *Farrell v SE Lancashire Insurance Co* [1933] IR 36; *O'Callaghan v Irish National Insurance Co* (1934) 68 ILTR 248.

35 Law Commissions Consultation Paper (2007) paragraph 1.14.

36 (1786) 1 TR343; *Foley v Tabor* (1861) 2F&F 663

37 In *Carter v Boehm* (1766) 3 Burr.1905.

38 [1925] 4 DLR 676; *Wood v Dwaris* (1856) 11 Exch.493.

39 [1955] 1 All ER 800, This is a controversial decision but the judges view with "distaste" the conduct of the insurer in using an error that could have been an innocent mistake for rejecting a claim (Romer LJ at p.803).

40 [1950] IR 85.

the present was held not to be promissory in nature. *Manor Park Homebuilders*[41] is also in point: a statement as to the current efficacy of an alarm was not read as a promissory warranty to keep the alarm in working order.

5.16 Statements may be held to be suspensory conditions and/or terms descriptive of the risk. A court may interpret a statement as being intended to describe the risk being insured against rather than to constitute a warranty[42]. For example, where a motor policy was taken out in respect of "commercial travelling", the insurer was clearly not liable to meet a claim when the vehicle was being used as a touring vehicle, but the English Court of Appeal observed that liability would resume if the insured use as described was reverted to.[43] A motor insurance policy in respect of a lorry that was described as being used to carry coal was thus held to be on cover when it was in an accident whilst carrying coal, notwithstanding that it had shortly before been used to transport timber. The departure from the usage suspended the cover until the warranted use resumed.[44] This reasoning on suspensory conditions is also to be found in *Brady v Irish National Insurance Co Ltd.*[45] It is evident that this approach is capable of creating a considerable level of uncertainty as to the result that will follow if statements relating to the use to which property is to be put are litigated[46] so even well intentioned judicial efforts to soften the impact of warranties law may exacerbate an already unsatisfactory situation.

5.17 English case-law holds that the insurer may lose any right to rely on a breach of warranty in a variety of ways such as by making an express promise to this effect, through waiver and by estoppel (acceptance of a premium after acquiring knowledge of breach, for example). The *Good Luck*[47] suggests that the principles applicable to election are inappropriate in the context of breaches of a promissory warranty and conditions precedent; because the contract is *void ab initio* there is nothing for an election to operate against. The *Good Luck* raised issues relating to marine insurance and the scope of the *Good Luck* has yet to be considered in Ireland. There are some older Irish cases which hold that waiver of a right to avoid a policy[48] and unconsionability[49] may result in the policy being enforceable.

(8) Statutory Intervention

5.18 The *Insurance Act 1936* sought to protect vulnerable proposers in industrial insurance contracts from the effects of misstating the age of the insured and the consequences of details of the health of the insured life being incorrectly provided by employees of the insurer.[50]

5.19 In the period between the 1936 Act and the next significant piece of legislation addressing contractual issues, the *Insurance Act 1989*, the O'Donoghue Committee[51] delivered a number of reports

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41 *Manor Park Homebuilders Ltd v AIG Europe (Ireland) Ltd* [2009] 1 ILRM 190, following *Hussain v Brown* [1996] 1 Lloyd's Rep. 627.

42 *Farr v Motor Traders Mutual Insurance* [1920] 3 KB 669.

43 *Roberts v Anglo Saxon Insurance Co* (1927) 27 Lloyd's Rep. 313.

44 *Provincial Insurance v Morgan* [1933] AC 240.

45 [1986] ILRM 698 (warranty suspended when pleasure craft laid up for winter).

46 See *Kler Knitwear v Lombard General Insurance Co* [2000] Lloyd's Rep IR 47, discussed in the Law Commission Consultation Paper (2007) paragraphs 2.62 – 2.65. Later cases of interest include *AC Ward & Son Ltd v Catlin (Fire) Ltd* [2010] Lloyd's Rep IR 695 and *Sugarhut Group Ltd v Great Lake Reinsurance (UK) plc* [2011] Lloyd's Rep IR 198.

47 [1992] 1 AC 233; *Kosmar Villa Holidays plc v Trustees of Syndicate 1243* [2008] 2 All ER (Comm) 14; *Lexington Insurance Co v Multinational De Seguros SA* [2009] 1 All ER (Comm) 35; *Walbrook Trustees (Jersey) Ltd v Fattal* [2009] EWCA Civ 297.

48 *Armstrong v Turquand* (1858) 9 ICLR 32; *Car and General Insurance Corporate v Munden* [1936] IR 584.

49 *Tuffnell v O'Donoghue* [1897] 1 IR 360.

50 Sections 61-64. See *O'Callaghan v Irish National Insurance* (1934) 68 ILTR 248 and *Griffen v Royal Liver* (1942) 76 ILTR 82.

51 See the Final Report, Prl. 5330.

on insurance regulation, but the question of controlling the use of warranties did not feature in any of these reports. Notwithstanding the lack of scrutiny by *O'Donoghue*, section 61 of the 1989 Act provided the Minister for Industry and Commerce with a power to, by order "prescribe codes of conduct to be observed by undertakings in their dealings with proposers of policies of insurance and policy holders renewing policies of insurance in respect of duty of disclosure and warranties". No codes of conduct have been prescribed.

(9) Warranties – Incorporation Requirements

5.20 In cases of marine insurance, s.35(2) of the *Marine Insurance Act 1906* states that an express warranty must be contained in the policy either in its own terms or contained in some document incorporated by reference into the policy. This statutory rule is confined to marine insurance, but, by reference to basic contract principles, any express warranty should preferably be set out in some documentary format such as a proposal form if the insurer is to persuade a court that a warranty was made and/or intended. Proposal forms appear to be the most usual means of conveying warranty obligations, but MacGillivray objects to this kind of practice on the ground that it will not be clear to the proposer what his/her obligations are, particularly in the context of continuing obligations[52]. The recent Irish case of *Manor Park Homebuilders Ltd v AIG Europe (Ireland) Ltd*[53] attests to the soundness of MacGillivray's observation. Here, a rudimentary proposal form was used to gather up information on details of premises for fire insurance cover. Statements were made as part of this process but no formal proposal form, policy or indeed any other documentation was issued. McMahon J. held that no warranties had been intended. The learned judge, it is submitted, could also have decided that no warranties had been made because no documents purporting to gather the information together into a contractual form had been created. It is noteworthy that two early Irish cases that appear to hold that statements of fact contained in or incorporated into policy documents may be presumed to be warranties[54] were not discussed. This situation is to be distinguished from *Manor Park Homebuilders* on the ground that no policy documents were executed in *Manor Park Homebuilders* so there was no basis upon which to presume a (verbal) undertaking to be an express warranty. The law thus seems to require the insurer to provide an adequate amount of information to be provided to a proposer at the pre-contractual stage and some evidence (eg documentary, recorded phone call) that a promise or statement was given and a warranty intended, and absent such evidence, a court may be inclined to leave an insurer to rely on whatever remedies for misrepresentation the insurer may invoke.

5.21 While both the *Marine Insurance Act 1906,* s.35(3), and common law principles recognise the concept of implied warranties in general, McGillivrary points out that implied terms of fitness and fitness for purpose are not normally implied into contracts of insurance other than seaworthiness obligations in marine insurance.[55]

5.22 *The Commission provisionally recommends that the entitlement of an insurer to avoid a policy or a claim for breach of warranty should depend on whether the insured was provided at the pre-contractual stage, or contemporaneously with the conclusion of the contract, with the information required by the duty of disclosure (as already defined in this Consultation Paper). The Commission provisionally recommends that, in respect of promissory or continuing warranties that arise after the contract has been agreed, the insurer must provide the proposer with a clear statement prior to the formulation of the contract about the scope of the continuing obligations imposed upon the proposer when he or she becomes the insured. The Commission invites submissions on how this requirement may best be satisfied, particularly when the cover is obtained on-line.*

[52] Paragraph 10-023.

[53] [2009] 1 ILRM 190.

[54] See MacGillivray at 10-031, and discussions in *Sceales v Scanlan* (1843) 6 Ir.L.R.367 and *Quin v National Assurance Company* (1839). Jo & Car 316.

[55] Para 10-032.

(10) Limiting the scope of the warranty

5.23 According to the Privy Council, in *Zeller v British Caymanian Insurance Co plc*[56] a warranty need not contain a reference to a basis of contract clause for an inaccurate warranty of existing facts to justify an insurer's refusal to honour the policy. In many cases the issue will be the scope of the warranty itself. Even if the warranty is qualified by the facts being warranted "to the best of the proposer's knowledge or belief", the qualification will not be enough to excuse all factual inaccuracies and merely guessing whether a given state of affairs existed will not be excused[57] although an honest belief that a property is in good repair, for example, may not be such as to allow an insurer to avoid the contract *ab initio* if investigation of the facts, on an objective basis, reveals that it was not in good repair at the commencement of cover: *Wilkie v Direct Line Insurance*.[58] The cases on health insurance and pre existing conditions suggest that the warranties as to the health of the life in question which are based on a question such as, "are you in good health?" raise questions about whether the insurer is seeking an expression of opinion or a statement of fact. In the leading Irish case of *Keating v New Ireland Assurance Company*[59] the Supreme Court subjected an alleged warranty that answers were "true and complete" to a *contra proferens* interpretation, observing that because the life to be insured was unaware of his true medical condition he had not breached any warranty. The Supreme Court thus appears to have equated "true" as meaning "accurate to the knowledge of the proposer". McCarthy J. observed:

> "If the proposal form were to contain a statement by the proposer that the statements and answers written in the proposal together with the written statements and answers made to the company's medical examiner shall form the basis of the proposed contract "even if they are untrue and incomplete for reasons of which I am totally unaware", would there be any takers for such a policy?"[60]

5.24 *Coleman v New Ireland Assurance Plc*[61] provides the most recent demonstration of the fact that where a declaration that facts disclosed by a proposer are declared to be true "to the best of my knowledge", the declaration will not necessarily provide the insurer with a right of avoidance, "even in the face of the proposer's ignorance or obtuseness". If the circumstances however suggest suppression of facts, i.e. the proposer falsely states he is in good health when he has recently had an epileptic attack, or promises that he has not been treated for a disease, the contract may be void under the warranty.[62]

(11) Basis of Contract Clauses

5.25 An insurer who seeks to persuade a court that a strict warranty was intended, even absent a policy document, will seek to do so by inserting into the pre contractual document a basis of contract clause.[63] A provision that states that all answers given are true and complete, and/or that the answers are the basis of the contract, can fulfil a number of purposes.

(1) the accuracy of the answer is warranted and, as such, it provides a contractual basis for refusing to pay out on the policy rather than leaving the insurer to reply on misrepresentation;

(2) the inaccuracy of the answer may provide an alternative to avoiding the policy on the grounds of non-disclosure;

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56 [2008] UKPC 4.

57 *Unipac (Scotland) Ltd v Aegon Insurance Company UK Ltd* [1999] 1 Lloyd's Rep.502.

58 [2007] CSOH 145.

59 [1990] 2 IR 383; *Fowkes v Manchester and London Assurance* (1863) 3 B&S 917.

60 *Ibid* at 399; *FBD Insurance plc v Financial Services Ombudsman* [2011] IEHC 315

61 [2009] IEHC 273.

62 *Curran v Norwich Union Life Insurance Co* [1987] IEHC5; *Abbot v Howard* (1832) Hayes 381.

63 Hasson (1971) 34 MLR 29; basis of contract clauses can be open to review under the Unfair Contract Terms Regulations (SI No. 27 of 1995) in consumer insurance contracts and there are some regulatory statements about basis of contract clauses but the Scottish case of *Unipac (Scotland) Ltd v Aegon Insurance* [1996] SLT 1197 shows that such clauses are still legally effective.

(3) the basis of contract clause renders issues of materiality and inducement irrelevant whereas these factors remain relevant to non-disclosure and misrepresentation; and
(4) issues of fraudulent intent, negligence and innocence will be irrelevant in the majority of basis of contract situations. For example, if a clause expressly provides that breach will render the contract *void do initio* and no premiums will be returned, the clause will be effective regardless of the degree of culpability shown against the proposer.

5.26 In *Dawsons Ltd v Bonnin,*[64] a motor insurance policy was subject to a basis of contract clause in which the proposer mistakenly warranted that the vehicle was usually parked on business premises when it was not; the claim was brought in respect of loss by fire, something that was immaterial to the question posed. This is also the law in Ireland: *Farrell v South East Lancashire Insurance Co.* [65]

5.27 There are Irish cases where the "basis of contract" clause itself does not appear to operate harshly because of context: the matters misstated were clearly either done fraudulently or related to material factors, or both. Misstatements in health insurance that family members had not died through pulmonary disorders[66] nor that other policies had not been obtained[67] or proposals declined[68] were clearly material matters. Failure to accurately detail a previous household fire claim was arguably material to a domestic all risks application.[69] But the real hardship that warranties cause in the context of incorporation is that most proposers with no specialist knowledge of insurance practice would not understand the draconian effects that such clauses will trigger because "basis of contract" clauses are terms of art. The Law Commission's 2007 Consultation Paper at paragraph 2.112 clearly condemns the fact that

> "An obscure legal device can convert a statement on the proposal form into a warranty. If a policyholder signs the proposal form stating that they warrant the accuracy of all their answers or one stating that their answers "form the basis of the contract" then the answers in the proposal form will be elevated to warranties. This means that the law according to warranties applies and the insurer is entitled to be discharged from liability if any statement is inaccurate."

5.28 That a basis of contract clause can "trump" compliance with the duty of disclosure will exacerbate the position of the proposer is illustrated by several decisions. In *Mackay v London General Insurance Co*[70] the failure by a motorcyclist to reveal that he had been fined in respect of a minor road traffic offence was held not to be a material non disclosure, but because he had signed a basis of contract clause warranting that he had never been convicted the policy was held never to have come into effect. Swift J held the contract was void *ab initio* but said the insured had been very badly treated. The insurers had taken the premium and had not been in the least bit misled by the replies the insured had made to questions posed in the proposal form. In contrast, McCarthy J, in *Keating v New Ireland Assurance Company*[71] approached the basis of contract clause from a different direction, indicating that these clauses hid or obscured the legal consequences for which the insurer contended, the learned judge taking the view that there would be no takers for insurance cover if clauses and their effects in law were clearly set out. Lord Wrenbury observed that reliance on a basis of contract clause or warranty constituted "a mean and contemptible policy [and a]… contemptible defence"[72]. Irish judges in particular

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64 [1922] 2 AC 413.

65 [1933] IR 297.

66 *Anderson v Fitzgerald* (1853) 3 ICLR 475 at p.492.

67 See *Scanlan v Sceals* (1843) 6 Ir LR 367 and *Rose v Star Insurance Co* (1850) 2 Ir Jur 206 for cases involving procedural requirements frustrating these clauses.

68 See Insurance Ombudsman, Digest Case Study 51 (1992-1998).

69 *Keenan v Shield Insurance* [1987] IR113.

70 (1935) 51LI.L.R 201.

71 [1990] 2 I.R. 383. See also *Kelleher v Irish Life Assurance Co* [1993] ILRM 643 where the Supreme Court held that questions in a proposal form could abridge both the duty of disclosure and a declaration that questions had been truthfully answered following *Hair v Prudential Assurance Co Ltd* [1983] 2 LI.L.R 667.

72 *Glicksman v Lancashire & General Assurance Co* [1927] AC 139 at 144-5.

have been forthright in suggesting that the law on warranties tends to favour the commercially sophisticated insurer over the inexperienced proposer[73] and that no account is taken of the degrees of culpability involved[74], but, in general, a well drafted warranty will be given effect. Indeed, even an obscurely worded one will not necessarily be denied effect, even if some of the most distinguished judicial minds of the day differ on the meaning to be attributed to the warranty. *Anderson v Fitzgerald*[75] is of course the best example of this insofar as three judicial proceedings in Ireland on a net point of interpretation were set at nought by a unanimous House of Lords.

5.29 *The Commission provisionally recommends that legislation should provide that statements of fact or opinion shall not be converted into a contractual warranty by anything stated in the contract, so that "basis of the contract" clauses shall be deemed invalid.*

(12) Warranties in Irish Law: the IIF Codes of Practice

5.30 As already noted, section 61 of the *Insurance Act 1989* provides the Minister for Finance with the power to prescribe codes of conduct in respect of "duty of disclosure and warranties" when the Minister considered it necessary in the public interest, after consultation with the insurance industry and consumer representatives, to do so. The Irish Insurance Federation (IIF) responded by producing various Codes of Practice. These Codes of Practice reflected the earlier UK Codes and were clearly conceived to address some of the procedural, formal and substantive objections to warranties.

5.31 The Code of Practice on Non Life Insurance stated:

> "Neither the proposal form nor the policy shall contain any general provision converting the statements as to past or present fact in the proposal form into warranties. But insurers may require specific warranties about matters which are material to the risk."

5.32 The Codes on life assurance and obtaining medical reports stated that the same approach will hold true in those areas but added that such general provisions could be used in "life of another" policies. It is to be noted that "shall" rather than "should" appears in this context. The distinction between general provisions (that may actually have referred to material as well as irrelevant facts) and specific provisions (which must be material) constituted a significant advance on the common law position and section 33(3) of the *Marine Insurance Act 1906.*

5.33 The right to avoid the policy was similarly abridged under the Non-Life Insurance Code of Practice which provided that the right would not be used on the grounds of breach of warranty or condition when the circumstances of the loss are unconnected with the breach unless fraud is involved. In the case of life or life-related policies a more complex provision was in place which essentially provided that a breach of warranty would not invalidate the claim unless the circumstances of the claim are connected with the breach and a specific warranty was created, material to the risk, which was drawn to the proposer's attention before or at time of contracting.

5.34 In relation to the provision of completed proposal forms and policy documents the Code was much weaker, stopping short of imposing a mandatory requirement on the part of insurers to provide copies, other than upon request or in the course of the insurer's normal practices.

5.35 The Codes however also set out a standard in respect of the kinds of question that the insurer should ask, providing that "insurers should avoid asking questions which would require knowledge beyond that which the signatory could reasonably be expected to possess". Warranty disputes do not feature as significant issues in Insurance Ombudsman adjudications.

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[73] *Abbot v Howard* (1832) Hayes 381 at 410-411, per Smith B; *Rose v Star Insurance Co* (1850) 2 Ir.Jur.206 at 209, *per* Richards B; *Anderson v Fitzgerald* (1851) 1 ICLR 271 and see Lord St. Leonards at (1853) 3 ICLR 475 at 488 and 491, cited and followed by McCarthy J, in *Keating v New Ireland* [1990] 2 IR 383 at 399.

[74] On the innocence of the proposer and lack of care taken by companies and their agents see *Griffen v Royal Liver* (1942) 76 ILTR 82.

[75] See (1851) 1 ICLR 27; (1853) 3 ICLR 475.

(13) United Kingdom Developments on Basis of Contract Clauses

5.36 Basis of the contract clauses were examined separately from warranty issues by the Law Commission in the 1980 Report and the views and proposals expressed therein have been revisited by the Law Commissions in 2007 and 2009. In relation to warranties of past or present fact, the Law Commission proposed, in 1980,[76] that where these are created by way of a proposal form, any statement of fact (e.g. a housebuilder warrants that his/her house is constructed of brick and slate) or a declaration that an answer given is true (e.g. proposer is 30 years of age) will be ineffective in creating a warranty.[77] In the event that the insurer wishes to extract specific undertakings, the insurer should only be able to do so by way of terms contained in the policy itself, subject of course to the requirement that written notice of the warranties so incorporated are provided to the proposer as soon as practicable.[78]

5.37 In contrast, the use of basis of the contract clauses in relation to warranties as to the future, or promissory warranties, was not the subject of any specific recommendation because the mischiefs caused by basis of contract clauses relating to warranties of past or present fact were considered to be obvious whereas:

> "the safeguards and precautions which can be created by promissory warranties are clearly necessary for insurers and unobjectionable, and there appears to be no reason to prevent their creation by means of "basis of the contract" clauses as a matter of convenience."[79]

5.38 Insofar as a warranty created via a basis of contract clause related to existing and future conditions (eg the car is roadworthy <u>and</u> will be maintained in a roadworthy condition) the basis of contract clause would only be effective *vis a vis* the statement as to the future. Clearly the Law Commission in 1980 saw the proposed formalities requirements as central to any effective method of dealing with abuse of contractual principles.[80]

5.39 This proposed restriction – basis of contract clauses will not be effective when used in a proposal form in order to create contractual warranties in relation to matters of past or present fact – was accompanied by two proposed substantive law adjustments. The Law Commission recommended that no matter of past or existing fact should be capable of constituting a warranty unless it related to a matter which is material to the risk.[81] The second recommendation was directed at counteracting basis of contract clauses that required the proposer to warrant the absolute accuracy of all or any of the answers given. The Law Commission referred back to the 1957 Law Reform Committee recommendation that, notwithstanding anything containing in a policy, no defence to a claim can arise from a misstatement where the insured can prove the statement was true to the best of his knowledge and belief.[82]

(14) Basis of Contract Clauses – The British 2007 Consultation Paper

5.40 The Law Commissions, in the 2007 Consultation Paper were similarly critical of basis of contract clauses, describing them as "an obscure legal device" allowing insurers to treat themselves as discharged from the contract "if any statement is inaccurate".[83] Basis of Contract clauses were believed to be no longer in use as a result of the Industry Code, *The Statement of General Insurance Practice*, the Statement directing that such clauses should not be used in consumer insurance. The Law Commissions recommended that basis of contract clauses should have no effect in consumer insurance law. In relation to business insurance however, the Law Commissions were more equivocal. While remarking that, save in cases where a business proposer is professionally advised, most proposers will not appreciate the

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[76] Law Com No.104.

[77] Law Com No.104, para. 7.8.

[78] Law Com No.104, para. 10.39.

[79] Law Com No.104, paras. 7.11 and 10.40.

[80] See para. 7.8.

[81] See paras. 6.2 and 7.7.

[82] See paras. 4.61 and 7.7.

[83] See para. 2.112 of the 2007 Consultation Paper.

nature and potentially draconian nature of such clauses, there was no general recommendation to follow the logic of the Australian Act and relegate such clauses to representations, even in business insurance. Rather, the Law Commissions adopted the procedural solution mapped out in 1980, provisionally proposing that a warranty of present or existing fact will only be effective if set out as a specific term of the policy or in an accompanying document. Attempts to convert answers into warranties en bloc, whether in the proposal form or elsewhere, are to be ineffective, the Law Commissions proposed. Because the Law Commissions took the view[84] that in business insurance their proposed rules would only be default rules, the parties in business insurance were to be free to agree either that:

(1) the insurer was to have a stipulated remedy or remedies for misrepresentation, even if the proposer was neither dishonest nor careless in making the representation; or

(2) the insurer could obtain a warranty that statements are correct, affording the insurer a right to refuse claims even if the insured had acted honestly and carefully. Liability for breach of warranty of fact should remain strict unless the warranty is not material to the contract and the warranty cannot be relied upon in relation to a claim for a loss that was in no way connected to the breach of a warranty.

5.41 The Law Commissions however suggested that contracting out of these restrictions is to be possible, that is, the insurer should be free to stipulate that claims in respect of breaches of a non-material warranty will not be entertained and that the insurer is to be entitled to defend a claim for a loss even if it is in no way connected with the breach of warranty.[85]

(15) The 2009 Report and Draft Bill – Basis of Contract Clauses

5.42 On December 15, 2009, the Law Commissions published a joint report, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation.*[86] The core recommendation in the report was that basis of contract clauses should be abolished in consumer insurance contracts, or, more specifically, it should be impossible to use a basis of contract clause so as to convert a misrepresentation into a contractual right to terminate a consumer insurance contract, by stipulating that such a statement is to be a warranty.

(16) Warranties in General – United Kingdom Developments

5.43 The Law Reform Committee, in the 1957 Report, *Conditions and Exceptions in Insurance Policies*[87] was critical of the impact that basis of contract clauses had in elevating all statements, even statements of fact concerning matters that the proposer may have no knowledge of (such as a pre-existing condition), into a binding promise. The Law Reform Committee recommended that:

> "notwithstanding anything contained in or incorporated in a contract of insurance, no defence to a claim should be maintainable by reason of any mis-statement of fact by the insured, where the insured can prove that the statement was true to the best of his knowledge and belief."[88]

5.44 The same hostility was not evident in relation to conditions precedent and subsequent.[89]

5.45 The examination undertaken in 1979 and 1980 by the Law Commission squarely addressed the use of warranties and basis of contract clauses. In relation to warranties the Report drew attention to the important distinction between warranties of past or present fact and promissory or continuing warranties, and warranties of opinion. The Law Commission identified three defects in the existing law on warranties:

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[84] Para. 5.131.

[85] Para. 5.132.

[86] Law Com No.319 / Scot Law Com No.219 (hereafter, 2009 Report).

[87] Cmnd. 62.

[88] Cmnd. 62, para. 14.

[89] Cmnd. 62, para. 9.

(a) "It seems quite wrong that an insurer should be entitled to demand strict compliance with a warranty which is not material to the risk and to repudiate the policy for a breach of it.

(b) Similarly, it seems unjust that an insurer should be entitled to reject a claim for *any* breach of even a material warranty, no matter how irrelevant the breach may be to the loss.

(c) Material warranties are of such importance to the insured that in our view he ought to be able to refer to a written document in which they are contained."[90]

5.46 The Law Commission took the view that there should be a modified system of warranties, but the key recommendation that the Law Commission made related to both warranties and basis of contract clauses and was directed at addressing the defect set out at (c) above. The insurer who extracts warranties from a proposer should be required to furnish the insured with a document containing the warranties by which the insured is bound, at least as soon as practicable after the warranty has been given. This should be done in all cases, even where no proposal form is completed (e.g. when the insurance is concluded over the telephone). Even provisional cover, the Law Commission recommended, should be attended by a written statement of the insured's warranties, by way of a cover note, the certificate of insurance, or by letter. Failure to meet this formal requirement should preclude repudiation of the insurance policy or rejection of a claim.

5.47 Apart from this general obligation to furnish an insured with details of the warranties the insured has agreed to (surprisingly, nothing was said as to a need to disclose the consequences for the insured if the insured was not compliant), the Law Commission went on to suggest other ways in which the existing law relating to warranties could be modified.

5.48 The first modification involved restricting the freedom of the insurer to demand strict compliance with warranties that are not material to the risk. The Law Commission thus suggested the concept of a material warranty that is, a warranty that a prudent insurer would consider material should the insurer contemplate accepting the risk or fixing the terms.[91] To sweeten this particular pill for the industry the Law Commission suggested that when information is sought from a proposer that is considered to be capable of being a warranty at common law, a presumption that the information sought is material should be enacted, the onus resting on the proposer to show that the information sought and obtained would not have influenced the judgement of the prudent insurer.[92] The Law Commission considered that this recommendation addressed the first of the defects that they identified (see paragraph 6.9(a) of the Report) in relation to over-broad rights of repudiation being available to an insurer.

5.49 Perhaps the most important modification suggested by the Law Commission was directed at the power of an insurer to reject a claim, for breach of a material warranty, even if the warranty breached could not have contributed to the loss occurring.[93] The Law Commission had in mind cases where a motor vehicle was warranted to be roadworthy when it was not, the vehicle being lost by theft rather than written off following a road accident. A number of examples of this kind were provided by the Law Commission, the recommendation being that attention should be focused on the type of loss that the question was directed to and to issues of causation. Thus, the Law Commission indicated that as long as the insurer met the formal requirements recommended (i.e. provision of a written statement of warranties as soon as practicable) "the insurer should be *prima face* entitled to reject claims in all cases which occur after the breach". This recommendation was accompanied by two very significant caveats (the nexus test), related to whether the insured can show either:

"(a) that the broken warranty was intended to reduce (or prevent from increasing) the risk that a particular type of loss would occur and the loss which in fact occurs is of a different type; or

90 Law Com 104, para. 6.9 (footnotes omitted).

91 Law Com 104, para 6.12.

92 Law Com 104, para 6.13.

93 Law Com 104, paras 6.19 and 6.22.

(b) that even though the loss was of a type which the broken warranty was intended to make less likely, the insured's breach could not have increased the risk that the loss would occur in the way in which it did in fact occur."[94]

5.50 The effect of the insured being able to make out either or both of these factors would be that the insured should be able to recover on a claim made. The insurer however should still be able to repudiate the policy as to the future because, in the view of the Law Commission, "insurers should not be compelled to continue to cover insureds who have committed breaches of warranty."[95] As a consequence, the Law Commission further recommended that where an insurer exercised a right to repudiate a policy, repudiation would be prospective only and that the effective date of repudiation would be the date when the insurer served a written notice of repudiation. By replacing the idea that a breach of warranty occurs at the time the statement is made with a requirement to serve a notice of repudiation, this recommendation provided a degree of clarity while leaving the insurer on risk until the date of repudiation. A loss arising during the currency of the insurance contract could thus be rejected unless the insured satisfied either of the nexus tests set out above.

5.51 The English Law Commission also recommended that an insurer should also be able to reject a claim for breach of a material warranty without necessarily repudiating the policy *in toto*: "It should in our view be open to insurers to make independent decisions as to whether or not to reject individual claims and as to whether or not to continue on risk for the remainder of the policy period, without having to make these decisions in tandem."[96] The Law Commission believed that this recommendation reflected industry practice.

(17) Warranties in Consumer Contracts in UK Law (the 2007 Consultation Paper)

(a) The First Provisional Recommendation

5.52 The Law Commission in 1980 recommended that warranties should not be effective unless the insurer supplied the proposer with a written statement of the warranty before the statement was made, or as soon as possible thereafter. The Law Commissions in 2007 reaffirmed this requirement, specifying that "writing" would include a printed or electronic form. This proposal was one of the few horizontal proposals in the 2007 Consultation Paper, applying to consumer and business insurance, whether negotiated or made on standard terms.[97] The extent to which the insurer has met this obligation in relation to consumer insurance is the subject of a recommendation that the insurer must take sufficient steps to bring the requirement to the attention of the insurer. Compliance is to be judged by reference to Financial Services Authority Rules or Guidelines.[98]

(b) The Second Provisional Recommendation

5.53 The issue of causal connection in relation to consumer insurances and warranties is addressed by the Law Commissions who favour a causal connection test. In this context, the causal connection test will place the onus on the insured to show, on the balance of probability, that the event or circumstances constituting the breach of warranty did not contribute to the loss[99]. Furthermore, in cases where the breach of warranty was a cause of only part of the loss (the example given is breach of a warranty to maintain fire sprinklers in a factory, only part of the building being damaged by virtue of breach of the warranty), the insurer is not to be permitted to refuse to pay for the loss that is unrelated to the breach.[100] These causal connection rules are recommended as mandatory rules in consumer insurance. The Law

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94 Law Com 104, para 6.22.

95 *Ibid.*

96 Law Com 104, para 6.23.

97 Para 8.11 and 8.12.

98 Para 8.19.

99 Para 8.45.

100 Para 8.48.

Commissions also viewed these rules as being applicable to warranties, *strictu sensu*, that is, exclusions and temporal restrictions were not to be controlled *vis a vis* these warranties provisions.

(18) Warranties in Business Insurance (the 2007 Consultation Paper)

5.54 The first recommendation is that the insurer will have to provide the business insured with a written statement detailing the warranties that are binding upon the business insured, either before the contract is made or as soon as possible thereafter. There is no recommendation as to the amount of detail the insurer should provide, as there is in relation to consumer insurance. The second recommendation is that the parties are to be free to vary the effect of breach of warranty by agreement, but that any such terms must not produce insurance cover that is substantially different from what the insured reasonably expected. A statutory reasonable expectations test is proposed as a business insurance counterpart to the "good faith" standard found in the Unfair Contract Terms Directive, which is of course applicable to consumer insurance only.

(19) The 2009 Report and Draft Bill

5.55 For the moment, the Law Commissions have left warranties reform to one side. The 2009 Report explains the situation in this way:[101]

> "Our consultation paper discussed the problems of warranties, which are terms in insurance contracts that may have particularly draconian consequences. This draft Bill does not reform the law of warranties, except to abolish "basis of the contract" clauses. The main reason is that the need for reform is less pressing. Warranties in the strict legal sense are used only rarely in consumer insurance. And if they are used unfairly, consumers have remedies not only under the Financial Services Authority (FSA) rules but also under the Unfair Terms in Consumer Contracts Regulations 1999. Furthermore, we think that the law on consumer warranties should be consistent with the law on business warranties. We have therefore decided against separate rules on warranties which would apply only in a consumer context." (footnotes omitted)

(20) New Zealand Legislation

5.56 The position in New Zealand is a relatively straightforward one, the legislative response to pre-contractual mis-statements being directed at closing down the right of an insurer to avoid a policy of insurance for any misstatement unless certain conditions are met.[102] Three situations must be distinguished.

i) In respect of general insurance, that, is non life policies, there is no right to avoid a policy only by reason of a statement made in any proposal or other document on the faith of which the contract was entered into, reinstated or renewed, unless the statement

(a) was substantially incorrect; and

(b) material.

ii) In relation to life policies concluded in such circumstances, there is no right to avoid unless the statement

(a) was substantially incorrect; and

(b) was material;

(c) was made fraudulently or within three years of either

(i) the date on which the insurer sought to avoid the policy, or

(ii) the date of the death of the life assured,

[101] Paragraph 1.22 of the 2009 Report.

[102] *Insurance Law Reform Act 1977,* s.5.

whichever is the earlier event.[103]

iii) Where however the misstatement is made prior to a life policy being concluded and the misstatement relates to the age of the life assured, avoidance is not possible and the insurer must vary the contract by substituting a (presumably lesser) sum than that assured, in accordance with a proportionality test.[104]

5.57 The New Zealand Law Commission, in its 1998 Report, *Some Insurance Law Problems*[105] did not revisit these provisions in the 1977 legislation, and the 2004 Report,[106] made minor adjustments in respect of a draft consolidation Bill that are pertinent to warranties insofar as the warranty is regarded as a misstatement. Proposals for further reform of the law relating to non-disclosure and misrepresentation are under consideration in the form of the New Zealand Ministry of Economic Development Report, Review of Financial Products and Providers,[107]

(21) Provisional Recommendations

5.58 The Commission provisionally recommends that breach of a contractual warranty in an insurance contract should no longer lead to the contract being avoided from the date of breach, but that, as in other cases of misrepresentation, the contract should be voidable at the option of the person to whom the misrepresentation was made (and that, to avoid any doubt, it should be provided that section 33(3) of the Marine Insurance Act 1906, which deals with breach of contractual warranty, is confined to MAT insurance).

5.59 The Commission provisionally recommends that, where an insurer is entitled to avoid an insurance policy claim for breach of warranty, the insurer should also be free to reject the claim without repudiating the entire insurance policy.

5.60 The Commission provisionally recommends that the entitlement of an insurer to avoid a policy or a claim for breach of warranty should depend on whether the insured was provided at the pre-contractual stage, or contemporaneously with the conclusion of the contract, with the information required by the duty of disclosure (as already defined in this Consultation Paper). The Commission provisionally recommends that, in respect of promissory or continuing warranties that arise after the contract has been agreed, the insurer must provide the proposer with a clear statement prior to the formulation of the contract about the scope of the continuing obligations imposed upon the proposer when he or she becomes the insured. The Commission invites submissions on how this requirement may best be satisfied, particularly when the cover is obtained on-line.

5.61 The Commission provisionally recommends that legislation should provide that a breach of warranty does not arise in respect of matters of past or present fact where the insured can prove that the statement was true to the best of his or her knowledge or belief.

5.62 The Commission provisionally recommends that legislation should provide that statements of fact or opinion shall not be converted into a contractual warranty by anything stated in the contract, so that "basis of contract" clauses shall be deemed invalid.

C Non-Observance of Warranty after Conclusion of Contract

5.63 In this Part, the Commission considers the problems that may arise after the contract of insurance has been concluded and the insurer invokes non observance of a warranty so as to avoid the contract. In Part B, the Commission focused on warranties of past and existing fact, misrepresentation

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[103] *Insurance Law Reform Act 1977*, s.4.

[104] Insurance Law Reform Act 1977, s.5. Schedule C to NZLCR 87, *Life Assurance* proposed a statutory formula based on the 1984 Australian model.

[105] NZLCR 46, *Life Assurance:* See Campbell, Insurance [1999] NZLR 191.

[106] NZLCR 87.

[107] September 2006 (ISBN 978-0478-30414-5).

and the consequences that follow on from an insurer seeking to acquire broader rights to avoid a policy by way of basis of contract clauses.

5.64 In this Part, the Commission considers three issues that arise generally after the loss has materialised. Firstly, the existing law does not require the insurer to show that a promissory warranty as to the future was either material to the cause or a contributory factor to the loss. The Commission considers whether the law should continue to reflect this position. Secondly, in the event that the law needs to be changed, the Commission considers whether a solution could be provided by Articles 4:102 and 4:103 of the Principles of European Insurance Contract Law (PEICL). Thirdly, the Commission explores the relationship between promissory warranties and exclusions in insurance contract law. In each of these three sections it will be seen that judicial activism has taken some of the sting out of these promissory warranties and exclusions but the Commission puts forward some possible legislative amendments that might make the law clearer and fairer, meeting the reasonable and commercial expectations of Irish insureds.

(1) Warranties and Causation

5.65 An insurer may seek to limit cover to a number of possible contingencies or seek to exclude from cover a range of eventualities by way of exclusion clauses. Restrictions of this kind are understandable and acceptable where the circumstances in question may extend the scope of the risk, as long as the restrictions are transparent and are reflected in the premium charged. However, where the restriction takes the form of a promissory warranty, there is a danger that individual insurers might be tempted to repudiate liability, even when there is no causal link between the loss that has occurred in a given case and the risk referred to in the policy.

5.66 In some cases an insurer will take statistical or actuarial evidence that certain kinds of insureds or activities, or geographical locations, might lead to increases in risk; inexperienced drivers, specific winter sports activities or politically volatile holiday destinations may be the subject of exclusions or restrictions in relevant insurance policies; the use of motor vehicles for business or commercial purposes, as distinct from private use, affords an example. In *Jones v Welsh Insurance Corporation*[108] a motor policy restricted cover to business use of the insured *qua* his trade as a motor mechanic. The insured was also a part-time farmer. An accident occurred when the insured's brother was driving the vehicle and transporting two sheep and two lambs to grazing. The restrictions on cover meant that the loss was not recoverable. In *Kelleher v Cristopherson*[109] the claimant was a labourer who used his car to drive to and from his work at Haulbowline. The claimant kept a few pigs and regularly obtained pig swill from the canteen at his workplace, transporting the swill in his car. An accident occurred whilst transporting the pig swill on the claimant's returning from work. Judge Neylon took the view that the claimant was engaged in pig farming by way of a hobby or amusement, rather than by way of a business, distinguishing the decision in *Jones* on the basis that, in *Jones*, the insured was not driving the vehicle at the time of the accident and the business activity being undertaken was outside the insurance. In the instant case the fact that the insured was transporting swill was irrelevant. Judge Neylon continued:

> I cannot accept the proposition that by carrying swill he thereby converted a journey which was covered by insurance into one which was not so covered. It appears to me that when a person is using his car for a purpose which is apparently covered by his policy of insurance, there is a very heavy onus on the insurance company to discharge before it can establish that such a user has ceased to be insured by reason of some action of the insured. As in this case, it is a fact that the insured was returning home from work and thus is covered by insurance. To deprive him of this benefit it must be proved that he has done something which alters the nature of the journey or user of the car.[110]

108 [1937] 4 All ER 149.

109 (1957) 91 ILTR 191.

110 (1957) 91 ILTR 191, at 195.

5.67 Nevertheless, the law reports are full of cases[111] where common law courts allow an insurer to rely either on an object clause, or an exception, to refuse to honour a policy in circumstances where an event or omission occurred, having no causal link with the accident. The Law Commission of England and Wales and the Law Commissions, have repeatedly cited decisions that dictate that promissory warranties, when breached, give the insurer "the right to repudiate the whole contract from the date of the breach regardless of the materiality of the term, the state of the mind of the insured, or the connection between the breach and the loss."[112] This situation is made even more difficult by virtue of the fact that promissory warranties may be imputed relatively easily if the promise itself speaks to the future and it is clear that the only real purpose that the warranty could have would be to commit the insured to meet the terms of the stipulation on a continuing basis. Although there are some cases where the Irish courts have read a promissory statement as having no such effect,[113] the weight of Irish case-law in relation to conditions precedent as importing future obligations tend to favour the insurer.[114]

5.68 The first meaningful analysis of this situation took place in New Zealand. The Contracts and Commercial Law Reform Committee[115] critically examined two New Zealand decisions that allowed an insurer to avoid liability when promissory warranties were held to have a temporal element (*ie* cover not available whilst certain facts existed).

5.69 This New Zealand case-law concerned accidents involving motor vehicles being driven whilst in an unsafe condition (eg bald tyres).[116] The fact that the vehicle was being driven at a time when the condition itself would not have caused the accident was held in these cases not to disentitle the insurer from repudiating the policy. In *Parsons v Falmers Mutual Insurance Association*[117] an exclusion from cover of a driver "whilst intoxicated" became relevant after the insured was killed outright when the vehicle he was driving struck a bridge. The insured's intoxicated condition was not in issue but there was scant evidence that the degree of impairment contributed to the accident. Nevertheless, the New Zealand Court of Appeal held that the exclusion whilst intoxicated:

> "gave an insurance company a broad means of relieving the company from liability, the underlying consideration being that he who is intoxicated is far more likely to suffer bodily injury by accident than he who is sober. It is clear that the word "whilst" does not import a causative relationship between the state of intoxication and the happening of the event amounting to accident."[118]

5.70 Section 11 of the *Insurance Act 1977* accordingly introduced a mechanism whereby the insured could recover upon proving, on the balance of probability that the loss was not caused or

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111 See MacGillivray, para. 10-040. The causal connection requirement in Civilian systems for precautionary measures is discussed in the 'mixed' South African system by Van Niekerk at (2010) 22 Sa Merc LJ 259, arguing that judicial endorsement of the Civil law approach can be found in earlier Roman-Dutch law decisions and that a modern South African court should act "to put the matter beyond doubt" (p.271).

112 Eg Law Commission Working Paper No. 73, para. 99, citing *inter alia Pawson v Watson* (1778) 2 Comp 785, 587; *De Hahn v Hartley* (1786) 1 T.R. 343.

113 Eg *Gorman v The Hand in Hand Insurance Co* (1877) IR 11 CL 224; *Weir v Northern Counties of England Insurance Co* (1879) 4 LR Ir 689.

114 *Gamble v Accident Assurance Co Ltd* (1869) IR 4 CL; *Patton v Employers' Liability Insurance Corp* (1887) 20 LR Ir 689; *Re the Equitable Insurance Co Ltd* [1970] IR 45. Note that the Supreme Court, in *Capmel Ltd v Lister (No.1)* [1989] IR 319 dismissed an appeal from Costello J holding for an insured on the basis that the onus lay on the insurer to draft a condition precedent in such a way as to have the desired result.

115 Reporting in 1975.

116 *State Insurance General Manager v Harray* [1973] 1 NZLR 276; *Yaxley v New Zealand Insurance Co Ltd* [1973] 2 NZLR 231.

117 [1972] NZLR 966.

118 [1972] NZLR 966 at 976, (MacArthur J), citing *Public Trustee v NIMU Insurance Co* [1967] NZLR 530 and *Abraham v Norwich Union Fire Insurance Society Ltd* [1970] NZLR 968.

contributed to by non observance of the restriction found in the policy.[119] The 1977 reform in New Zealand has been thought to have gone too far in favour of the insured. In *New Zealand Insurance Co Ltd v Harris*[120] the New Zealand Court of Appeal allowed an insured (who had breached a warranty by hiring out a tractor, the tractor being destroyed by fire) to benefit from the provisions of section 11. A strong New Zealand Court of Appeal (Richardson, Bisson and Hardie Boys JJ) observed of section 11 that it was intended to counteract the practice by insurers of putting temporal, not causative exemption clauses into insurance contracts: Richardson J wrote:

> "Section 11 contemplates a two step inquiry where the contract of insurance excludes or limits the insurer's liability on the happening of certain events or the existence of certain circumstances. The first is to determine whether the insurer's liability has been so defined because the happening of the events or the existence of the circumstances was in the view of the insurer likely to increase the risk of occurrence of the loss. That inquiry rests on an assessment of the bona fide view of the insurer in relation to the matter.
>
> Even where the purpose of the limitation is entirely legitimate the insured is not necessarily disentitled to be indemnified. That is for consideration at the second step. The inquiry there is whether the loss in respect or which the insured seeks to be indemnified was caused of contributed to by the happening of the events or the existence of the circumstances was in the view of the insurer likely to increase the risk of occurance of the loss. The onus of proof rests on the insured and the answer turns on the objective assessment of the Court or Arbitrator, not on the subjective views of the insurer. There is then a presumption of a causal link between the relevant events or circumstances and the particular loss."[121]

5.71 The trial judge found the condition in the policy was intended to ensure that insured persons retain control over the vehicle and reflect the appropriate premium to be charged in respect of hiring out. After finding that the contract did not require the tractor to be kept under cover or at a particular location, and that the insured had not breached a separate warranty to take all reasonable steps to safeguard the vehicle, the Court of Appeal upheld the trial judge's decision that breach of the warranty did not cause or contribute to the loss. As there was an accepted practice of leaving tractors in open fields, as occurred here, there was no causal link between the breach of promise and the loss. This decision, and others,[122] was regarded by the New Zealand Law Commission as unfair:

> "The underwriter's art is (theoretically at least) that of determining whether to accept a risk and on what terms, having regard to the likelihood of the loss occurring. The problem with s 11 as it has been interpreted is that it takes no account of the extent to which an exclusion may be framed with that statistical likelihood in mind. It is reasonable, for example, for an insurer to charge different rates of premium for vehicles used commercially and vehicles used privately because of the greater risk of accident (eg. A taxicab is more likely to be involved in an accident than the same vehicle confined to private use.) But s 11 has been interpreted in a way that prevents insurers from declining liability to indemnify for losses to equipment during commercial use when the cover by its terms is confined to private use: *New Zealand Insurance Company Ltd. v Harris* [1990] 1 NZLR 10. It has also been interpreted in a situation where the insured paid a lesser premium in return for motor vehicle cover on the basis that it was confined to a named driver but the insurer was required to indemnify for loss caused when the vehicle was in the control of a different driver: *State Insurance Ltd v Lam* (unreported, 10 October 1996, CA 159/96)."[123]

5.72 The solution identified by the New Zealand Law Commission was to create an amendment to section 11 in the form of a subsection that excludes s 11 operating on certain risk factors that an insurer

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119 See ALRC Report 20, para. 233 for comments on the genesis of the 1977 New Zealand provision.

120 [1990] 1 NZLR 10.

121 *Ibid,* p.15.

122 Report No. 46 *Some Insurance Problems* (May 1998).

123 Report No. 46 *Some Insurance Problems* (May 1998).

may properly consider to be relevant in deciding to underwrite the proposal. Motor insurance and property insurance is often underwritten on the basis of the age, identity, qualifications or experience of a driver, a geographical area within which the loss must, or must not, occur, or the restriction of use to non commercial use. While the proposed amendment to section 11 of the *Insurance Law Reform Act 1977* has not yet been enacted, it suggests (as the Law Commissions themselves said in the 2007 Consultation Paper) a focused and practical answer to a difficult problem of causation.

5.73 The proposed section 11 reads:

> (1) An insured is not bound by an increased risk exclusion if the insured proves on the balance of probability that the loss in respect of which the insured seeks to be indemnified was not caused or contributed to by the happening of an event or the existence of a circumstance referred to in the increased risk exclusion.
>
> (2) For the purposes of this section, an increased risk exclusion is a provision in a contract of insurance that
>
> (a) defines the circumstances in which the insurer is bound to indemnify the insured against loss so as to exclude or limit the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances; and
>
> (b) so defined the liability of the insurer, in the view of the court of arbitrator determining the claim of the insured, because the happening of such events or the existence of such circumstances was in the view of the insurer likely to increase the risk of loss occurring.
>
> (3) A provision is not an increased risk exclusion for the purposes of this section that
>
> (a) defines the age, identity, qualifications or experience of a driver of a vehicle, a pilot of an aircraft, or an operator of a chattel; or
>
> (b) defines the geographical area in which a loss must occur if the insurer is to be liable to indemnify the insured; or
>
> (c) excludes loss that occurs while a vehicle, aircraft, or other chattel is being used for commercial purposes other than those permitted by the contract of insurance.

5.74 The New Zealand Law Commission itself suggested that a broader solution would be possible, via a definition of a contractual provision, which is not an increased risk exclusion, if based on "actuarial or statistical data establishing an increased risk of loss": this option was discounted on the basis that such a provision would "wipe out the original [s.11] reform". Nor did the New Zealand Law Commission favour the adoption of the Australian response, section 54 of the *Insurance Contracts Act 1984.* The New Zealand Law Commission regarded the Australian provision as being, in general, "sweeping and unfocused", out of sympathy with the habits of insurers and insurance law practitioners, likely to provoke litigation and, ultimately, unlikely to prove judge-proof. Even supporters of s.54 – and it is fair to say that Professor Merkin for example found much to praise in that section – regard it as difficult.[124] Even the reforms of The Australian Treasury Review in the form of the *Insurance Contracts Bill 2010* directed at much broader issues than the causation problem in warranties/exemptions as to the future, may not resolve the section 54 problem. It should also be noted that Australian consumer law, unlike Irish consumer law is currently defective in providing specific protection for consumers; in sum, the Commission believe that a section, 54 provision would not be a satisfactory basis upon which to form an Irish legislative solution to the problem at hand.

5.75 The Law Commissions, in their 2007 Consultation Paper, reached much the same kind of conclusion over section 54. While the New Zealand 1977 provision and the proposed amendment would continue to deal with the situations that prompted the reform in the first place, eg an intoxicated driver should be able to recover for damage to the drivers vehicle when struck from behind by another vehicle

[124] Merkin, "Reforming Insurance Law: is there a case for Reverse Transportation?"

whilst stopped at traffic lights,[125] as should the unfortunate driver of a vehicle damaged by a falling tree, the vehicle being in an unroadworthy condition,[126] the Law Commissions felt that there should be limitations on a causal connection test:

> The causal connection test should not apply, for example, where a motor policy specified that drivers must be aged 30 or over, and the vehicle was driven by a 20 year old. The insurer should be entitled to refuse the claim, even if the accident was caused by someone else's fault. Similarly, if a marine insurance contract any loss that took place in the Gulf, even if the location did not cause the loss. The same should apply if a car insured for private use is being used full-time as a taxi. There comes a point where the activity generating the loss is so far removed from the activity covered by the policy that the policy should not apply at all.[127]

5.76 The Law Commissions have since however retreated somewhat from the New Zealand approach, favouring a causal connection test that is confined to warranties. The New Zealand approach was criticised on the basis that the proposed new section 11(3) list was arbitrary, applying to a ship excluding cover whilst in the English Channel but not where an insurer specified that the ship should retain its classification.[128]

5.77 Notwithstanding the force of these points, the Commission sees the New Zealand solution as having considerable attractiveness. The Commission believe that it is relatively easier to understand than the Australian provision, as well as the England and Wales proposed text from 1980, and the proposed causal connection test in the 2007 Joint Consultation Paper. The Commission believe that section 11 strikes a reasonable balance insofar as the insured is required to prove that the event did not cause or contribute to the event (explicable in terms of the New Zealand case-law prior to 1977). On the issue of arbitrariness the Commission recognises that the closed list in the proposed section 11(3) has this disadvantage, but the Commission does not see this as an insuperable obstacle and it represents a considerable imporvement on existing Irish law and the original section 11 solution in the New Zealand 1977 Statute.

5.78 For example, a general "catch-all" provision could be added:[129] a system of delegated legislation could be put in place to narrow or broaden these exceptions, as the case may be. The continued use of conditions precedent in business to business insurance contracts which stand outside the existing 2005 limit on the extended definition of consumer insurance could be effective. Indeed, section 11 of the New Zealand provision, and this suggested amendment, could be a default provision for such business insurance contracts: it has been said by Lord Justice Aitkins that the Law Commissions have not stated that professional insurers and their commercial clients agree that "the law on warranties is out of line with the reasonable expectations of both sides – in insurer and assured – or even those of the assureds alone."[130] Lord Justice Aitkins went on to argue against assimilating the positions of all proposers into one paradigm:

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[125] A New Zealand Contract and Commercial Law Reform Committee (1975) example.

[126] Law Commissions Joint Consultation Paper, para. 8.33.

[127] Joint Consultation Paper, para. 8.35.

[128] Joint Consultation Paper, 8.37. The ALRC made the same comment, noting that the original 1977 provision was aimed at exempting provisions rather than warranties. In South African Law, the *Long-term Insurance Act* (No.52) of 1998, section 59, and the *Short-term Insurance Act* (No.53) of the same year require representations of past and present fact to be material, even if the contract converts such representations into warranties. Promissory warranties on the other hand, as contractual promises as to the future, must be met.

[129] Giving the insured the opportunity to discharge the onus of proof. On balance however the Commission believes it will be better to enact the proposed section 11 New Zealand amendment without further modification.

[130] The Law Commissions' Proposed Reforms of the Law of "Warranties" page 117, in Soyer, *Reforming Marine and Commercial Insurance Law*, at p.117.

"It is easy to sympathise with the consumer assured who has made an innocent error in making a statement about an existing or past fact in a proposal, who then forgets about it all and thinks he is insured and then suffers a loss which is not paid because the fact was not true and it is treated as a "warranty". But I must admit to having less sympathy for the business assured, who, in his own business, may well demand exact compliance with contract terms with its counterparty, whether it be as to description of goods, date of shipment or the documents to be produced to entitle payment on a letter of credit. If business people wish to insure the wherewithal of their businesses, can it not be said that they ought to make themselves as aware of the consequences of their actions (or inactions) as they would do for their own speciality? That was how the rule as to breach of warranties was defended when it was first introduced and one asks whether businesses are, generally speaking, less robust now than they were in 1980."[131]

5.79 *The Commission provisionally recommends that where the insured establishes that there is no causal link between the failure to observe a promissory warranty and the loss the insured should be able to recover on the claim; and the Commission invites submissions as to whether the failure to observe a promissory warranty will only lead to the contract being invalidated where the insured has acted fraudulently (intentionally or recklessly). This provisional recommendation should apply to all insurance contracts within the terms of the Financial Services Ombudsman jurisdiction, even if the dispute comes before the courts. In relation to other insurance contracts the Commission invites submissions on whether a provision of this kind should serve as a default rule in commercial insurance contracts generally.*

(2) Precautionary Measures under the PEICL and Promissory Warranties

5.80 The decision in *Bennett v Axa Insurance Plc*[132] suggests that individual insurers may be prepared to allow a policy to require that promissory conditions should be linked to the events that occasioned the loss. The case also shows that promissory warranties can remain draconian in their consequences. A pizza restaurant covered by an all risks policy was destroyed by fire after closing one evening. The insurer sought to avoid the claim by relying on a "waste clause" whereby the insured warranted that "trade waste" would be removed from the premises at the end of each days trading. Some materials, including cigarette butts and paper napkins, were, the court found, likely to have been left in metal bins and thus created the source of the fire. The insurer did not rely upon a clause requiring the insured to take reasonable precautions to prevent the loss (apparently conceding any defence centring on negligence would fail), and even though the policy behind the waste clause:

"could perhaps be more clearly advertised or enunciated, the waste clause was effective. In a plea *ad misericordiam* in his final reply [the claimant's counsel], suggested that the Claimant had complied with the spirit of the policy, although he was in fact unaware of the existence of the warranty, that the Defendant underwriters were relying upon a technicality and that it was unjust that someone who was as the Claimant was running a tight ship should in such circumstances be denied an indemnity by his underwriters. The plea serves only to demonstrate how uncertain a guide is sentiment in determining a claim of the sort which is before me. Naturally I have great sympathy for the Claimant, an honest businessman who finds himself without insurance cover notwithstanding his evidence as to the measures he took to put into place a proper system designed to ensure the tidiness and cleanliness of the premises was unchallenged. That is no doubt why the insurers did not suggest that the insured had failed to take reasonable precautions to prevent the loss and damage which in fact occurred. Sympathy for a large corporate insurer is less obviously felt, but by inclusion of the waste clause in their policy these insurers made clear that payment of a claim in circumstances such as I have been compelled to find here existed was not the bargain which they made. Warranties in an insurance policy are draconian in their effect … It is not altogether surprising

131 *Ibid* p.118.

132 [2003] EWHC 86 (Comm).

that non-compliance with a warranty as to the existence and content of which both the insured and this staff were in ignorance should lead to failure of a claim."[133]

5.81 In contrast, the precautionary measures provisions in the PEICL, Article 4:102, if applied to this case, would produce a different result. The precautionary measures provisions in the PEICL are heavily influenced by the shape of general European insurance law and practice. The strict and inflexible nature of the promissory warranty is reflected in the *Marine Insurance Act 1906*, section 34 of which defines a promissory warranty as promises by which "the insured undertakes that some particular thing will or will not be done or that some condition will be fulfilled." The Act also provides that a breach of warranty results in the automatic discharge of the insurer from liability of the insurer[134] unless the insurer waives the breach of a promissory warranty, thus creating an estoppel to the extent that the insurer cannot rely upon the breach as having discharged the insurer form liability.[135]

5.82 In contrast, Article 4:102 PEICL provides:

(1) A clause which provides that in the event of non-compliance with a precautionary measure the insurer shall be entitled to terminate the contract, shall be without effect unless the policyholder or the insured has breached its obligation with intent to cause the loss or recklessly and with knowledge that the loss would probably result.

(2) The right to terminate shall be exercised by written notice to the policyholder within one month of the time when the non-compliance with a precautionary measure becomes known or apparent to the insurer. Cover shall come to an end at the time of termination.[136]

Article 4:102 is intended to limit the insurers right to decline to pay out on a claim when the obligation breached is a condition precedent to liability, that is, breach of a promissory warranty,[137] unless the breach occurred "with intent to cause the loss or recklessly and with knowledge that the loss would probably result." Irish law already allows recovery even if the insured acts with carelessness, negligence and improper conduct.[138]

5.83 While this provision would reverse the decision in *Bennett v Axa Insurance Plc,* a hard case, the scope of Article 4:102 to a common lawyer appears at first to be overreaching. Article 4:102 qualifies the bargain and requires an underwriter to meet a claim the underwriter did not undertake to meet; Article 4:102 sets a standard of performance for the policyholder insured that falls short of strict liability; the claim will be successful even if the policyholder/insured was negligent. But codes of practice in Ireland and the United Kingdom direct that claims should not be rejected unreasonably, save where there is evidence of fraud. In cases of breach of warranty or condition, rejection of a claim *per se* is not good insurance practice. Unless the circumstances of the claim are connected to the breach, reliance on breach of a promissory warranty is not industry practice, at least not amongst responsible insurers. The adoption of Article 4:102 would not necessarily deny an insurer the promissory warranty where fraud was suspected, but even in such a case the provisions in Article 4:102(1) seem to accord with the various Ombudsman's

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133 *Ibid* para 22.

134 *Marine Insurance Act 1906,* s.33(3) effective from the date of the breach. This is representative of the entire law of insurance: *The Good Luck* [1992] 1 AC 233; *Global Press Systems Inc v Berhad* [2011] UKSC 5, *per* Lord Mance at para. 56.

135 Section 34(3): see Lord Goff in The Good Luck [1992] 1 AC 233 at 262-3; see also *J Kirkaldy and Sons v Walker* [1999] Lloyds Rep IR 410 and *Kosmar Villa Holidays Plc v Trustees of Syndicate 1243* [2008] Bus L.R. 931.

136 Defined in Article 4:101 as "clause in the insurance contract, whether or not described as a condition precedent to the liability of the insurer, requiring the policyholder or the insured, before the insured event occurs, to perform or not perform certain acts.

137 See Lord Goff in *The Good Luck*[1992] 1 AC 233 at 263.

138 *Jameson v Royal Insurance Company* (1873) IR 7 CL 126.

decisions, and case-law, that prevent an insurer from being judge and jury in relation to allegations on criminal misconduct.[139]

5.84 There may still be room to consider whether Article 4:102 goes further than is necessary or desirable. Promissory warranties may serve important social objectives in the sense that proscriptive rules concerning security measures (for example, in property insurance) might deter burglaries (and even crimes of violence). Should an insurer be able to contract for precautionary measures to be observed, even if the contractual standard is one of reasonable care, rather, than intention, or recklessness, as set by Article 4:102?

(3) The Causation Problem and Promissory Warranties – Article 4:103

5.85 Because the PEICL does not envisage the possibility that breach of a promissory warranty will either automatically entitle the insurer to avoid liability for loss that has arisen, nor terminate the contract, *per se*, any clause that seeks to contractually secure either of these rights will have to satisfy Article 4:102. Article 4:102 does not address the causation problem, while Article 4:103 does. Headed "Discharge of the Insurer's Liability", it follows the same structure as Article 4:102:

> (1) A clause that non-compliance with a precautionary measure totally or partially exempts the insurer from liability, shall only have effect to the extent that the loss was caused by the non-compliance of the policyholder or insured with intent to cause the loss or recklessly and with knowledge that the loss would probably result.
>
> (2) Subject to a clear clause providing for reduction of the insurance money according to the degree of fault, the policyholder or insured, as the case may be, shall be entitled to insurance money in respect of any loss caused by negligent non-compliance with a precautionary measure.

5.86 Article 4:102 deals with the problem outlined by the Law Commissions in their 2007 Consultation Paper (*ie* a fire sprinkler that is out of operation despite a warranty to maintain is the basis upon which a claim for flood damage is rejected). The breach of the promissory warranty to maintain is simply irrelevant. The comments to Article 4:103 show that this provision is intended to go much further:

> "Non-compliance with a requirement of a sprinkler in full operation in a fire policy therefore may have the effect of excluding the insurer's liability for loss caused by fire if the loss would have been avoided by a fully operating sprinkler. In addition, the insurer's liability may be reduced if the loss caused by fire could not have been fully avoided by an operating sprinkler (for example in case of lightning) but has only increased due to the absence of such a sprinkler. In that case the insurer's liability would only be reduced as far as the non-compliance contributed to the extent of the loss. The onus of proving the prerequisites for a discharge of the insurer's liability, including a causal link between non-compliance and loss, is on the insurer."[140]

5.87 The facts of he *Bennett* case, discussed earlier, tease out an interesting aspect of Article 4:103(2). There, the fire was caused by non-compliance with a waste materials clause that essentially involved strict liability. The insured was not alleged to have been negligent in taking reasonable precautions to avoid the loss from occurring (a distinct obligation separate from the waste clause requiring removal of waste materials from the premises). The causation link was thus established by the insurer. But in the case of the fault element, it is likely that a court would not have found the insured to have been negligent. Even careful insureds are to be expected to find that accidents happen. The authors of the PEICL argue that the 'basic' philosophy is that insurance is taken out not just for accidental risks but also for cases or negligent behaviour."[141] The authors of the PEICL go on to state that if a clause is intended to limit the insurer's liability to compensate for a loss that is caused negligently (as

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139 Eg *Gray v Hibernian Insurance* Unreported, H.C. May 27, 1993; Financial Services Ombudsman Decision of July – December 2006, p.8.

140 PEICL, p.176.

141 Irish law contains a similar observation: *Jameson v The Royal Insurance Co* (1873) IR 7 CL 126.

district from purely accidental loss) the transparency provisions in Article 1:203[142] must be met. After speaking to Article 1:203 the authors state that the:

> "additional requirement that it has to be clear indicates that it must be in a very specific language in order to discharge the insurer in cases of negligence. If such a clause is applied in a specific case the discharge of the insurer from liability is limited by the degree of causation (Article 4:103 para. 1) and additionally by the degree of fault. If the fault is very slight there is no discharge, if the degree of fault comes close to recklessness the discharge may be almost complete."[143]

5.88 The problem that the Commission has with the decision in *Bennett* revolves around the fact that the insured seems to have been entirely innocent of any fault, there was no imputation of fraud, the clause was not clearly set out, and it was given a broad application by the Court. If the policy was intended to create a strict duty to remove all waste material from the premises at the end of each trading day, or fire cover would be rendered invalid, perhaps the warranty should have said as much. It is submitted that the general approach to constriction of ambiguous terms in an insurance policy, and a desire to avoid literalism is best summed up in *Pratt v Aigaion Insurance Company SA.*[144] Here, a clause requiring a fishing vessel to be manned "at all times" was not met and the claim initially failed. However, the English Court of Appeal indicated that a court could move some distance from a literal application (eg in cases of emergency on board the vessel in this case) but it could not overturn the bargain. The Court of Appeal however read the clause in a purposive sense and viewed it as being aimed at loss caused by fire whilst tied up in port.

(4) Discussion on unfair terms and the relationship with promissory warranties

5.89 While the Law Commissions appear to be very bullish about the effectiveness of the Unfair Contract Terms Directive in counteracting standard terms that might be unclear in terms of meaning and scope,[145] or may not have been brought to the attention of proposers/insureds, as disclaimers and warranties, the paucity of case-law[146] on the Directive in the context of insurance contracts means that such a perspective is largely untested. As between small business proposers and insurers the Unfair Contract Terms Directive has no application although it is possible that the Financial Services Ombudsman could use the Directive when a business insured's complaint falls within the jurisdiction of he Financial Services Ombudsman. The Commission considers that the Law Commissions arguments are persuasive within the context of consumer insurance and that the emphasis that can and should be placed upon procedural transparency goes some considerable way towards counteracting unfair and abusive contractual practices, as do other measures such as restricting avoidance of the policy as the primary remedy, discussed elsewhere. At this juncture the Commission considers that the Directive, as adjusted by way of Article 2:304 of the PEICL to deal with unfair contract terms in insurance contracts, is a sound and incremental development and the Commission has provisionally concluded that a variation of Article 2:304 should be adopted into Irish law.

5.90 The question of how best to provide protection to business proposers and insureds however is extremely problematical. The Commission has considered the PEICL approach that is, the application of Article 2:304 extending into commercial contracts as well as consumer contracts "because policyholders need protection against insurers, no matter whether they are consumers or not. Insurers commonly draft

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[142] PEICL, p.177.

[143] *Ibid.*

[144] [2009] Lloyd's Rep IR 149. The view that exclusions in liability insurance must be read "in context" (*ie* narrowly) is standard: see *Globan Process Systems Inc v Berhad* [2011] UKSC5; *Selected Seeds Pty Ltd v QBEMM Pty Ltd* [2010] HCA37; *Emo Oil Ltd v Sun Alliance and London Assurance Co* [2009] IESC2; *Allianz Insurance Ltd v RHI Refractories (Africy) Pty* 2008 3 SA 425.

[145] Law Commission, Reforming Insurance Contract Law, Issues Paper 5

[146] *Bankers Insurance Co v South* [2003] EWHC 380 (Comm); *Maple Leaf Macro Volatility Master Fund v Rouvry* [2009] EWHC 257 (Comm).

the terms of the insurance contracts in advance, so that policyholders have no opportunity to negotiate the terms."[147]

5.91 The Commission considers such a proposition to be a rather sweeping generalisation. Large companies seeking insurance cover are not to be equated with consumer proposers. Large companies may often be expected to have specialist departments that will contain the expertise necessary to shop around and secure cost effective insurance. Large companies should be fixed with actual if not constructive knowledge of what terms, exclusions and warranties mean and what legal effects follow therefrom. Large companies may often be expected to engage brokers through whom insurance cover can be obtained. In circumstances of this kind the Commission sees no need to introduce a level of Judicial Review, or a measure that unduly interferes with Freedom of Contract. Abusive clauses that are covertly tucked away in proposal forms or which appear, perhaps belatedly, in policy documents will in any case be the subject of close judicial scrutiny via requirements of good faith and a reasonable expectations standard. It appears that this requirement may be increasingly a standard that will be imposed in commercial insurance contracts.[148] The Commission also considers that the problem of abuse of freedom of contract is one that traverses the entire range of commercial contracts. Irish law, unfortunately, has not sought to address this phenomena in the way that the United Kingdom Parliament has done (eg, see the non-negotiated standard terms provisions in section 3 of the Unfair Contract Terms Act 1977). Other legislative models include the Australian Commonwealth Trade Practices Acts[149] and some specific statutory provisions that may operated on unfair terms;[150] the Commission does not think it is treading on an area of sensitivity when it observes that a broader review of unfair contractual practices in business to business contracts in Ireland is overdue. However, the Commission believes that the problems that arise in commercial insurance do not necessarily require a sweeping legislative measure. The Commission believes that specific legislation, confined to the insurance sector in relation to possible abusive terms in all commercial insurance contracts would be premature.

5.92 However, it is clear that some commercial insurance cover is affected in circumstances where the insurer may seek to avoid honouring a policy on technical and unmeritorious grounds. The facts of *Manor Park Homebuilders Ltd v AIG Europe (Ireland) Ltd*[151] provide such an illustration although McMahon J found for the insured. The decision in the English case *US Trading Ltd v Axa Insurance Co Ltd*[152] also points up a judicial willingness to impose appropriate standards of notice to proposers and insureds. The Commission believes that small business insureds do require some protection from abusive clauses, particularly disclaimers and warranties that have not been individually negotiated. The Commission views two possible responses as being worthy of consideration.

5.93 Because the Commission believes that small business insureds require protection while at the same time considering that all business insureds should not be treated in the same way as consumers, a *via media* in relation to Article 2:304 could be adopted. Under the existing legislation relating to dispute settlement jurisdiction of the Financial Services Ombudsman, business to business insurance contracts (where a corporate insured has a turnover of €3 million or less in the year of the complaint being made) may refer complaints to the Financial Services Ombudsman.[153] The Commission considers it appropriate that the ordinary courts should also be able to apply what is after all a modified example of the EU

147 Principles of European Insurance Contract Law, p.116.

148 Eg *US Trading Ltd v Axa Insurance Co Ltd* [2010] Lloyds Rep IR 505.

149 Specifically the *Trade Practices Act 1974*, s.52 and s.53.

150 Eg the *New Zealand Contractual Remedies Act 1979* (eg s.4 on entire agreement clauses). The 2010 South African Consumer Contracts legislation against unfair terms can also be invoked by small business enterprises.

151 [2009] 1 ILRM 190.

152 [2010] Lloyd's Rep IR 505.

153 S.I. No. 190 of 2005. For unincorporated groups of persons – clubs, charities and trust – there is no effective turnover limit.

consumer acquis, that is, the PEICL Article 2:304, to small business insurance disputes and the Commission provisionally so recommends.

5.94 While the Commission believes that this solution should be generally effective, it may be that there is a discrete problem where insurers rely upon promissory warranties so as to reject claims because of breach of a warranty even if breach had no causal link 'with the loss'. The New Zealand 1977 legislation, section 11 was explained as being concerned with the following kind of situation:

> "a vehicle the driver of which is intoxicated or which is (perhaps unknown to the driver) in an unsafe condition is struck from behind while waiting at traffic lights [and liability to indemnify is avoided] even though the intoxication or the unsafe condition did not contribute to the loss in any way."[154]

5.95 An exclusion from cover, an exemption clause, a condition precedent to liability of the insurer, and a promissory warranty, are all contractual methods of defining the risk and/or limiting the liability of the insurer. In cases where the clause requires the insured or the policyholder to act so as to prevent the risk from materialising, such clauses are generally regarded as promissory warranties.[155] However, the Commission believe that cases which require warranties to be the subject of a rule of reasonable construction, for example, can limit the warranty by reference to suspensory principles. Although not strictly a warranty case, Chief Baron Palles, in *Gorman v The Hand in Hand Insurance Co*[156] limited cover on agricultural equipment to instances where the machinery was in storage in a defined place. Use elsewhere on the farm took the machinery off cover but when return to storage the cover resumed.[157]

5.96 Many of the problems that arise in relation to future warranties, or exceptions that may appear to contain a temporal rather than a causal element, can and will be dealt with under the general scheme found in relation to abusive clauses, considered in the following chapter. The need for clear and transparent drafting of contractual provisions (even provisions which are central or core provisions) as well as a requirement that the clause meet the reasonable expectations of the proposer/insured, are imperatives to be met by insurers *vis a vis* consumers and most businesses.[158] The decisions of the non statutory Insurance Ombudsman of Ireland and the statutory Financial Services Ombudsman contain several instances where temporal restrictions,[159] as well as over-broad definitions and interpretations,[160] were imposed on insureds. Seen in the light of an insurer's legitimate right to either define or limit the risk being accepted by the insurer, there is nothing objectionable about this. The Commission has not found any compelling evidence to suggest that Irish insurers systematically use promissory warranties in an objectionable manner although there will always be room for debate in marginal cases. One decision under the non-statutory Insurance Ombudsman Scheme, and one example taken from the Financial Services Ombudsman's case files illustrate the point.

- a contents policy covering burglary contained a very specific warranty relating to a burglar alarm being installed and maintained to the IS 199 standard. The alarm was disconnected to allow patio work to be undertaken. The new patio door installed was not reconnected, the fitter and

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154 NZLC R 46 *Some Insurance Problems* (1998), page 24-25, citing the NZ Contracts and Commercial Law Reform Committee, *Aspects of Insurance Law* (1975).

155 Contrast notification of claims obligations which can have different purposes: *Aspen Insurance UK Ltd and others v Pectel Ltd* [2009] Lloyd Rep IR 440.

156 (1877) IR 11 CL 224.

157 This approach is also evident in some recent English cases – *Hussain v Brown* [1996] 1 Lloyd's Rep 627; *Pratt v Aigaion Insurance Company SA* [2009] 1 Lloyd's Rep 225; *AC Ward and Son Ltd v Catlin (Five) Ltd and others (No.2)* [2010] Lloyd's Rep IR 695.

158 See the international standard promoted by the International Association of Insurance Supervisors, at www.iaisweb.org.

159 Mostly in relation to claims and time limits. These were often side stepped via waiver reasoning see eg Case 85 of the *Insurance Ombudsman of Ireland 1992-1998*.

160 Financial Services Ombudsman, Case Studies, June 2009 p.20 (meaning of disability).

householder each assuming the other would undertake this job. The householder was admitted to hospital for long term treatment, during which time the patio door was forced open. The insurer had taken no steps to highlight the warranty, nor was an IS 199 standard provided. Nevertheless, the warranty was enforceable.[161]

- less surprising is a decision[162] of the Financial Services Ombudsman who rejected a claim on a motor policy, the insured being required to keep the vehicle "in an efficient and roadworthy condition". The vehicle was damaged when it skidded on icy roads. An independent engineer's report found that two bald tyres on the rear wheels were the proximate cause of the accident.

5.97 It is certainly arguable that whatever the status of the IIF Codes of Practice, good insurers do not appear to use the promissory warranty to reject claims unrelated to the loss. If this is the case, there seems to be no reason why the industry should object to legislation which removes from Irish law an argument that is rooted in the worst excesses of a bygone age.

5.98 *The Commission provisionally recommends that legislation should provide that promissory warranties must be drafted in plain, intelligible language; and that where there is a doubt about the meaning of a promissory warranty, it should be reviewed in terms of whether it is an unfair term within the meaning of the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995*.

161 Case Study 88.

162 Case 19, December 2007.

CHAPTER 6 EXCLUSIONS AND UNFAIR TERMS

A Introduction

6.01 In the previous chapter the Commission considered how best to produce a fairer balance between the legitimate interests of an insurer in identifying and defining the risk to be underwritten and the need to prevent the reasonable expectations of an insured from being disappointed or frustrated. That chapter concerned promissory warranties as to the future and warranties of existing fact. In this chapter the Commission will consider express terms that seek to limit or avoid the insurer's obligations under a policy insofar as the loss has arisen at a time or when prescribed circumstances were or, were not, in being. Contractual exclusions and warranties are often the opposite sides on the same coin. Similar problems of transparency, reasonableness and fairness arise in relation to exclusion clauses. The provisional recommendations in this chapter are based upon existing common law and statutory rules and take account of the recommendations of the authors of the Principles of European Insurance Contract Law, PEICL. The Commission will begin by looking at case-law in relation to the duty of a *proferens* to bring contractual terms to the attention of the other party: the Commission will then suggest two provisions, borrowed from Australian law to put the thinking behind these rules onto a statutory footing in Ireland. The Commission will then examine the statutory rules and the PEICL provisions.

B Rules on Incorporation

6.02 The common law has developed a protective mechanism so as to protect contracting parties from onerous or unusual contractual provisions that one party might tuck away in boilerplate standard terms in the hope or expectation that the provisions in question will prevail. While many of the decisions are old fashioned railway ticket cases involving exemption or limitation clauses, principles of good faith have been invoked by the English and Irish courts to provide a general principle that applies not just to exemption or limitation clauses. Furthermore, the principle applies in business to business transactions,[1] as well as in consumer cases. The leading decision is *Interfoto Picture Library Ltd v Stiletto Visual Programs Ltd.*[2] A standard term that was contained in a delivery note imposed an unusual fee calculation in respect of failure in complying with a duty in returning goods hired out, leading to a substantial charge being due. The English Court of Appeal held that where a particular condition is commonly to be expected in a contract it will suffice if general notice of the condition given. However, as Bingham LJ stated:

> "where the particular condition relied on involves a sort of restriction that is not shown to be usual in that class of contract, a defendant must show that his intention to attach an unusual condition of that particular nature was fairly brought to the attention of the other party"[3]

6.03 Irish case-law has applied the *Interfoto* decision on several occasions. In *Carroll v An Post National Lottery*[4] Costello J. specifically endorsed Bingham LJ's observation, by stating:

> "the tendency of the English authorities has, I think, been to look at the nature of the transaction in question and the character of the parties to it; to consider what notice the party alleged to be bound was given of the particular condition said to bind him; or to resolve

[1] *Kaye v Nu Skin Ltd* (Rev 1)[2011] 1 Lloyds Rep 40; AEG (UK) *Ltd v Logic Resource Ltd* [1995] CLC 265.

[2] [1988] 1 All ER 348. *Contrast Photolibrary Group Ltd v Burdar Senator Verlong* [2008] EWHC 1343 (QB).

[3] [1988] 1 All ER 348 at 357 (Bingham LJ).

[4] [1996] 1 IR 443. See also Charleton J in *McCabe Builders (Dublin) Ltd v Sagamu Developments Ltd* [2007] IEHC 391 and in *James Elliot Construction Ltd v Irish Asphalt Ltd* [2011] IEHC 269.

whether in all the circumstances it is fair to hold him bound by the condition in question. This may yield a result not very different from the civil law principle of good faith, at any rate so far as the formation of the contract is concerned"[5]

6.04 If the condition in question is clearly displayed on a website for example, and the user repeatedly accesses the website, then reasonable notice will have been given: *Ryanair Ltd v Billigfluege.de GmbH*[6]. But an unusual and oppressive term in an employment contract was held not to have passed the *Interfoto* standard by TC Smyth J in *Finnegan v JE Davy.*[7] Even in the absence of *Interfoto*, there are several Irish decisions on incorporation that signify a higher duty to spell out the existence and import of sweeping contractual terms, as distinct from mundane or unobjectionable conditions of contract.[8]

6.05 The general proposition behind the *Interfoto* "good faith" approach to unusual or onerous contractual clauses that have neither been individually negotiated nor specifically drawn to the attention of the proposer/insured has recently been applied to insurance contracts in *US Trading Ltd v AXA Insurance Co Ltd.*[9] The clause in question here was a stipulation that the proposers, a food processing company, would be required to clean the cooker extraction system every three months. Following a fire at the premises, the insurer repudiated the policy on the basis that the stipulation was a warranty and that it had not been complied with. Starting from the position that when a proposer entered into a contract of insurance the proposer did so on the insurer's normal terms, the alleged warranty was not shown to have been a normal term, nor was it individually negotiated: as such the alleged warranty was not part of the contract. The warranty was regarded as particularly onerous and such terms would only be incorporated into a policy if it was brought fairly and reasonably to the attention of the proposer. Simon Brown QC, sitting as a Deputy Judge in the English Queens Bench Division, refused to allow the insurer to rely upon the special clause:

> "Special Condition 4 was a particularly onerous term. An onerous term will only be incorporated into a policy if it is brought fairly and reasonably to a party's attention… There is no evidence that Special Condition 4 was brought to the attention [of the insured]"[10]

(1) Interpretation of the Exclusion

6.06 The cases on this point are legion but a recent English decision gives a flavour of how an exclusion in a policy may be denied effect by giving the words of a clause a plain and ordinary meaning. In *Widefree Ltd v Brit Insurance Ltd*[11] a jeweller in Hatton Garden discovered that a ring from his stock had gone missing when he attempted to show the ring to a particular customer. The jeweller recalled an earlier incident in his shop when two customers had acted suspiciously. After reviewing CCTV footage the jeweller called in the police who agreed that the theft had taken place at the time of the earlier incident. The policy contained an unexplained loss exclusion when the loss was discovered at stocktaking. The High Court held the exclusion did not apply. The CCTV and other evidence identified the time when the loss occurred as being outside the stocktaking exercise – that word "stocktaking" related to a structured organised process taking place at regular intervals. This discovered loss was not within any such framework. Apart from incorporation rules, judges can subject express terms to a process of hostile interpretation. This is particularly the case in relation to exclusions and promissory

5 [1988] 1 All ER 348 at 357. See generally Zimmerman and Whittaker, *Good Faith in European Contract Law* (CUP 2000).

6 [2010] IEHC 18: *Century 21 Canada Limited Partnership v Rogers Communications* [2011] BCSC 1196.

7 [2007] IEHC 18

8 *Western Meats v National ICC and Cold Storage* [1982] ILRM 101; *Sugar Distributors Ltd v Monaghan Cash and Carry Ltd* [1982] ILRM 399.

9 [2010] Lloyd's Rep IR 505.

10 *Ibid*, p 515.

11 [2009] Lloyds Rep IR 440. See also *Reilly v National Insurance and Guarantee Corp Ltd* [2009] Lloyd's Rep. IR 488 (exclusion for failure of machinery: incorrect pressure in a cylinder not failure of machinery).

warranties. A variety of mechanisms are available such as *contra proferens interpretation (e.g. Sweeney and Kennedy's Arbitration)*[12] or arguing a warranty has a suspensory rather than promissory effect[13]. These interpretive techniques are useful palliative measures but they fail to deal with the underlying problem of contractual unfairness and in many instances good contract drafting will make it difficult for a court to operate interpretative techniques e.g. if the clause is not ambiguous the general view is that interpretation *contra proferens* is not possible[14].

(2) General Principles to be added to Irish Law

6.07 The Commission considers that Irish law might usefully articulate two basic principles that would serve to put many of the points made in the above discussion on incorporation and good faith onto a statutory footing. The Commission has relied heavily on principles from the Australian *Insurance Contracts Act 1984.* The first principle revolves around good faith and the inability of either party to rely on a contractual provision where to do so would be to fail to act with the utmost good faith. This is found in section 14 of the Act whuch, as amended, reads:

> "Parties not to rely on provisions except in the utmost good faith
>
> (1) If reliance by a party to a contact of insurance on a provision of the contract would be to fail to act with the utmost good faith, in the light of the circumstances in which the contract of insurance was concluded, the party may not rely on the provision.
>
> (2) Subsection (1) does not limit the operation of the common law duty of utmost good faith.
>
> (3) In deciding whether reliance by an insurer on a provision of the contract of insurance would be to fail to act with the utmost good faith, the court shall have regard to any notification of the provision that was given to the insured, or otherwise."

6.08 *The Commission provisionally recommends that legislation be enacted to provide that an insurance contract should be subject to a good faith requirement, namely that if reliance on a term in an insurance contract would constitute a failure to act with the utmost good faith the party may not rely on that term.*

6.09 The second provision that might usefully be imported into Irish law from Australia on the formation of insurance contracts is contained in section 37 of the 1984 Act. The text of section 14 of the 1984 Act actually contains a reference to section 37 which the Commission considers to be redundant and it has been omitted from our suggested text above. Our modification of section 37 provides for notification of unusual terms.

> An insurer may not rely on a provision included in a contract of insurance of a kind that is not usually included in contracts of insurance that provide similar insurance cover unless, before the contract was entered into the insurer clearly informed the insured in writing of the effect of the provision (whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise). Where appropriate, the document shall include an explanation of technical or legal words or phrases.

6.10 *The Commission provisionally recommends that there should be a statutory duty on an insurer to draw attention to unusual terms*.

(3) 1993 Unfair Contract Terms Directive and PEICL Abusive Clauses Provisions

6.11 The Principles of European Insurance Contract Law recast the 1993 Unfair Contract Terms Directive[15] to address situations where contract clauses may allow an insurer to avoid a policy on what

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[12] [1950] IR 85.

[13] *Ie*. non compliance is operative only insofar and for as long as the warranty is not complied with.

[14] *Danske Bank v McFadden* [2010] IEHC 116, citing Clarke, *The Law of Insurance Contracts* 5th ed at paragraph 15.5. See also *Meritz Fire and Marine Insurance Co Ltd v Jan De Nul NV* [2010] EWHC 3362 (Comm)(a surety case).

[15] Directive 93/13/EC, transposed into Irish Law by SI No 27 of 1995.

may be regarded as technical or unmeritorious grounds. While the Directive clearly applies to insurance contracts and the Insurance Ombudsman of Ireland Scheme features instances where the Directive has been considered in the course of adjudications, there are no United Kingdom or Irish court decisions that fully consider how the Directive may play a part in resolving disputes involving allegations of procedural or substantive unfairness. Indeed, the Law Commissions observe that the UK regulations transposing the Directive, effective since July 1, 1995, "appear to have had surprisingly little impact on the insurance industry"[16].

6.12 The paucity of case-law on how the Unfair Contract Terms Directive has impacted upon insurance contractual practices might suggest that there are relatively few situations in which contract clauses have the potential for creating unfair commercial practices, either on an individual or a systemic basis. An alternative view may be that the Directive has deterred insurers from using clauses that, at the very least, fall foul of the indicative and non-exhaustive "grey" list in the Directive itself. The limited perusal of some 6 property insurance policies undertaken by the Commission, however suggests that several potentially unfair terms continue to be in standard use by insurers in Ireland.

6.13 A more likely explanation for the underwhelming impact that the 1993 Directive has had on UK and Irish contractual drafting lies in both the generic nature of the Directive itself, the lack of clarity that several key provisions in the Directive possess (specifically in an insurance context), as well as uncertainty over the relationship between the procedural and substantive aspects of unfairness.

6.14 Because the Directive applies to consumer contracts generally, Member States were not expected to contextualise the requirements of the Directive in national transposing legislation on a sectoral basis. Both the United Kingdom and Ireland transposed the Directive by way of Statutory Instrument[17] without the benefit of the recitals, useful in this context insofar as the recitals provide guidance on the extent to which the Judicial Review mechanism contained in the Directive is applicable to consumer insurance[18]. While a court would of course resort to the full text of the Directive, it is a common complaint[19] that the bare transposition of a Directive, shorn of the useful interpretive assistance to be gleaned from recitals, is hardly a satisfactory legislative process, especially in consumer protection law.

6.15 The Directive itself provides assistance on interpreting what provisions in an insurance contract are, and are not, likely to be subject to judicial scrutiny under the Directive, recital 19 fleshes out the distinction between (non-reviewable) core terms and reviewable terms under the Directive.

> For the purposes of this Directive, assessment of unfair character shall not be made of terms which describe the main subject matter of the contract nor the quality/price ratio of the goods or services supplied… It follows, inter alia, that in insurance contracts, the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer.

6.16 This recital suggests that terms that relating to the premium to be charged – the price – are exempt from scrutiny on the basis that such a term relates "to the definition of the main subject matter of the contract", to quote from Article 4(2) of the Directive itself. Therefore, it is certainly arguable (and MacGillivray[20] appears to take this position) that exclusions and warranties, provisions which both define and circumscribe a risk, and which will play an important part in determining the premium, are exempt from scrutiny. Certainly, the Law Commissions did not dissent from the view that recital 19 and article

16 Joint Consultation Paper, para. 2.106. The only case referred to is *Bankers Insurance Co v South* [2003] EWHC 380 (Comm), a travel insurance case. There has been one more recent English case, *Direct Line Insurance v Fox* [2010] Lloyd's Rep IR 324.

17 In Ireland see S.I. No. 27 of 1995. In the UK see S.I. 1994/3159, replaced by S.I. 1999/2083.

18 Particularly recital 19.

19 See White, *Commercial Law* (Round Hall 2002) and 'Consumer Sale and Associated Guarantees' (2000) 7 CLP3.

20 11th edition, paras 10-020 and 11-036.

4(2) of the Directive had this result, pointing to both the opinion of text books and *Bankers Insurance Company v South*[21]. A policy of holiday insurance, which contained a term excluding accidents occasioned by "motorised waterborne craft", the insured being responsible for injuring another jet skier, was held to be outside the scope of the Directive. On the other hand, Rühl contrasts the UK position with that found in Germany:

> [t]he provisions that implement the EC Directives, s.305-310 of the Civil Code do apply to contractual provisions that impose obligations on the policyholders. This is because these provisions are not considered to define the subject matter of the insurance contracts in the meaning of s.307(1) of the Civil Code and paragraph 19 of the EC Directive. Instead, they are classified as limitations or modifications of the subject matter which are not excluded from the assessment of fairness. The pool of contractual provisions that actually define the subject matter of the insurance contracts, in contrast, is determined rather narrowly: Only terms that describe the core of the contractual agreement – meaning a brief description of the insured risk as well as the premium to be paid – are deemed exempt from scrutiny under the EC Directive. As a result, contractual obligations of the policyholder are not covered by the exemption of s.307(1) of the Civil Code and – other than in England – are fully subjected to the assessment of fairness[22]

6.17 While there is no clear guidance in the *European Communities (Unfair Terms in Consumer Contracts) Regulations 1995* (which impm,emented the 1993 Directive) Ellis's views on core and non-core provisions in Irish insurance contracts are of considerable interest.

(4) Core and Subsidiary Terms – An Irish View

6.18 Ellis provides a valuable analysis of the scope of the 1995 Regulations and a personal view on when certain terms are likely to be reviewable by an Irish Court. Ellis begins his analysis[23] by commentating that, in the abstract, the operative clause of an insurance policy (that is, the statement about the extent of the cover provided) as well as exclusion clauses" are probably examples of core terms". He stops short of arguing that all operative clauses and exclusions will be core terms. In relation to insurance contracts other than life and personal accident insurance, such policies are contracts of indemnity. The indemnity principle, as well as other attendant implied conditions such as subrogation and contribution are terms which are required to be present on public policy grounds and are thus not reviewable (along with the *uberimae fidei* principle)[24]. Ellis however goes even further by observing that the provisions in the IIF Codes of Practice should also be regarded as mandatory rules, being implied contractual terms. This is a view for which there is no judicial support and, given the uncertainty surrounding the status of the IIF Codes of Practice, post the introduction of the Financial Regulator's Code and the Financial Services Ombudsman's Statutory Adjudication mechanism, it is submitted that the proposition is no longer arguable[25]. For policy reasons it is not desirable to define core obligations too widely, even if some other IIF Code provisions seek to restrict or abridge rights afforded to insurers under the ordinary law on insurance (e.g. on warranties).

6.19 On the question of basis of contract clauses, Ellis is very clear, although again the uncertain status of the IIF Codes of Practice causes some difficulty for his argument that:

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[21] [2003] EWHC 380 (Comm).

[22] (2006) 55 ICLQ 879 at p902-3 (footnotes omitted). On the core term issue generally see Principles of European Insurance Contract Law p.116-117 which appears to suggest that "England" (sic) and Ireland may be isolated in giving the core provision exemption such wide scope.

[23] Ellis, *Modern Irish Commercial and Consumer Law* (Jordan's 2004) Chapter 32.

[24] Schedule 1(e)(i) of the *Unfair Contract Terms Regulations 1995* (S.I. No.27 of 1995). Ellis also cites an insurable interest requirement as being necessary on public policy grounds in every insurance contract. The Commission suggests that this may be too extensive a claim.

[25] Ellis was writing in 2004.

"Basis of contract clauses would be assessable by a court as non-core terms under the 1995 Regulations, had the Codes of Practice not effectively abolished them".

6.20 The express terms that Ellis regards as being reviewable on the basis that they are subsidiary and unlikely to have been individually negotiated he sets out as follows:

(1) duty on insured to notify increases in risk (or change of insured's circumstances);
(2) duty on insured to take reasonable care of property insured;
(3) duty to inform insurer immediately of any alienation or transfer of the insurable interest;
(4) terms under which the policy can be cancelled prematurely by both parties;
(5) arbitration conditions;
(6) claims conditions requiring the insured:
    (a) to give the insurer notice of a possible claim as soon as reasonably possible;
    (b) not to admit liability (in third party insurances) for, or negotiate settlement of, any claim without the insurer's written consent;
(7) imposing a duty on the insured not to act in a fraudulent manner, and making it clear that if any claim is fraudulent, it will not be paid and all cover under the policy will be forfeited;
(8) express conditions modifying the common law doctrine of subrogation and contribution may also be included[26]

6.21 Ellis and Wiltshire in *Regulation of Insurance in the UK, Ireland and the EU*[27] give their view on the boundary between core and non-core insurance terms:

"It is submitted that the following might be considered examples of core insurance contract terms:

- contents of operative clauses describing the events insured;
- exclusions from cover;
- the condition of utmost good faith;
- express conditions requiring an insured to disclose material changes in the risk"[28]

Ellis and Wiltshire also observe that cancellation and arbitration clauses would also seem to be prima facie unfair terms although they note an unreported Circuit court decision on arbitration clauses in a holiday insurance case that stands against this position.[29]. Ellis and Wiltshire also suggest that non core terms "might include"

- "conditions precedent to liability, i.e. claims notification conditions and non-admission of liability conditions
- arbitration conditions (mentioned specifically in s.1(q) of Sch.3);
- cancellation conditions (see s.1(f) of Sch.3);
- possibly express subrogation and contribution conditions but only to the extent that they vary the common law conditions. These conditions of subrogation and contribution implied at common law are so fundamental that they are unlikely to be subject to the tests in Sch.3."[30]

(5) Non Core Terms and Exclusions – The Law Commissions Joint Consultation Paper

6.22 The Law Commissions, in the 2007 Consultation Paper, provide a succinct example of a situation where the same insurance product might fall on either side of the core/noncore term boundary, depending on context:

"take a case where a policy was sold as "insurance for winter sports adventure holidays", but a sub-paragraph of one of the lengthy policy terms excluded off-piste skiing, and no particular

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26 Para 32.8, footnotes omitted.

27 Thomson Reuters (2 Volume Looseleaf).

28 Ellis & Wiltshire, *Regulation of Insurance in the UK, Ireland and the EU* (Thompson Reuters) page E2.37.

29 See E. 2-36.

30 E.2-37. The authors also observe that contractual duties of pre-contractual disclosure may be seen as one of the circumstances that might be considered in assessing the fairness or otherwise of a particular term. This comment seems to be directed at the question whether a proposer has been informed of the nature and consequences of the duty, so some fundamental implied duties are relevant under SI 27 of 1995.

attempt was made to bring this to the proposer's attention. The exclusion of off-piste skiing would not be a core term. However, if the policy were sold explicitly as "suitable for skiing on piste", the same term might be exempt from review, provided it was presented in a plain intelligible way"[31].

6.23 On the more controversial issue of how warranties are treated, if at all, under the Unfair Contract Terms Directive, the Law Commissions conclude that warranties may be core terms that describe the subject matter of a contract, whether the warranty be one of existing fact or future obligation[32]. The Commission agrees with this view. To give an example, there is no substantive difference between a warranty that a burglar alarm meeting an ISO standard is in place to a warranty that such an alarm will be fitted within 1 month of cover commencing. If both provisions make it clear that non compliance renders the policy ineffective then the purpose behind the Community legislation will have been largely achieved. The problem that must frequently arises in relation to warranties is that neither of the procedural requirements required under the Directive – intelligible drafting of the term itself, and the need to satisfy a reasonable expectations test – are always readily met. The Law Commissions argued that the second of these two factors is a powerful counterweight to the formal rules governing warranties in insurance law:

> Consider the legal effect of a breach of the warranty. It will discharge the insurer from liability under the policy automatically, so that there is no liability for any loss even if the matter warranted was immaterial, or the loss was completely unrelated to the breach (for example, flood damage). The insurer is discharged from liability even if the breach of warranty has been cured before the claim arose. As we argued earlier, it is most unlikely that these results accord with the reasonable expectations of any insured, least of all a consumer – unless he or she happens to be an insurance lawyer. Thus for the warranty to be exempt as a "core term", the consequences of a breach of warranty would have to be spelled out in full, in clear and intelligible language and in a way that left the consumer in no doubt about what to expect.[33]

6.24 Substantive unfairness is often relegated to a subsidiary role. However, if the insurer does not overcome these procedural requirements, or if the term is itself incidental or non core, the Directive requires the courts to consider the substantive unfairness of the provision, judged at the time when the contract was made. The Law Commissions argue that this question has two dimensions. Substantive unfairness may undermine warranties that, in isolation, seek to do too much for the insurer:

> The court is required to assess the fairness of the term at the time the contract was made. It is not asked to assess whether the term has been applied fairly in the particular circumstances of the loss. Thus if the term gives the insurer the right to avoid even when the breach of warranty was immaterial, it will be no answer that in the particular facts the loss that has been incurred was caused directly by the breach of warranty. If the warranty as a whole was unfair, the insurer simply cannot reply on it at all.[34]

6.25 The second dimension addresses warranties from the perspective of judicial interpretation of the clause, the Law Commissions arguing that the principle of meeting reasonable consumer expectations will influence this process:

> It might be argued that most warranties are fair on the face. The unfairness arises only because of the way they are applied. However, before assessing the fairness of a term the court must interpret it. Suppose, for example, that an insurer seeks to rely on the lock warranty to reject a claim for flood damage. The court would first have to decide whether the term was a true warranty, and was intended to exclude flood claims in this way. If the court accepts the insurer's case that the term has a wide meaning, then it is likely to hold that the term is unfair.

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31 Para 2.90.

32 The contrary argument, that a warranty does not describe the subject matter of the contract (and is thus non-core) is rejected at para.2.98.

33 Para 2.100.

34 Para 2.101.

> The court may be influenced by the fact that this use of the term [flies in the face of (non binding) codes of practice denying reliance of clauses with no causal link]. As a result, the term would not be binding on the consumer, and the insurer could not rely on it to avoid paying the claim. If the court gives the term a narrow meaning, merely to except burglary claims while the lock is not fitted, then the term is more likely to be considered fair – but it would not assist the insurer to resist liability for flood damage.[35]

(6) The PEICL View on the Boundary Between Core and Non-Core Terms

6.26 The boundary between reviewable and non reviewable terms is elaborated on by the authors of the PEICL. In drafting Article 2:304 Abusive Clauses, the Article itself states that the review powers apply:

> "to terms that restrict or modify cover but it applies neither to
>
> (a) the adequacy in value of the cover and the premium, nor to
> (b) terms that state the essential description of the cover granted or the premium agreed, provided the terms are in plain and intelligible language."

6.27 The authors of the PEICL point out that there is an ambiguity in the Directive in the sense that the English language text implies that every term that defines the risk or the insurer's liability is taken into account in calculating the premium and is thus exempt as a core term. The German version of the Directive however states that the exemption only applies if the term is actually considered in calculating the premium. As a matter of policy, the European Commission regards it as desirable that a narrow view of the exemption should be adopted, and this accords with the approach endorsed by Lord Bingham in particular in the House of Lords. In *Director General of Fair Trading v First National Bank*[36] the Office of Fair Trading challenged the fairness of interest calculation provisions in a credit agreement. Rejecting an argument that the term was not reviewable because the term created a Bank's right to post judgment interest and was thus concerned with the adequacy of the price or remuneration for the banking service, their Lordships characterised the term as a default provision rather than an essential or core feature of the bargain. Lord Steyn described the term as a subsidiary term, remarking that the exemption must be given a restrictive interpretation so as to prevent the Directive from being subverted by endless formalistic[37] arguments as to whether a provision is definitional or an exclusionary provision. All members of their Lordship's House endorsed Lord Bingham's view that the UK transposing regulations and the Directive are intended:

> "to protect consumers against the inclusion of unfair and prejudicial terms in standard-form contracts into which they enter, and that object would plainly be frustrated if regulation 3(2)(b) [of the UK SI] were so broadly interpreted as to cover any terms other than those falling squarely within it."[38]

6.28 The authors of the PEICL give as an example of the boundary between definitional and subsidiary terms the case of a policyholder taking out "professional indemnity insurance": such a description would imply the exclusion of general liability as part of the definition of "the type and subject of insurance". The PEICL authors observe that such an implicit exclusion "would not be subject to review. However, if a term of the policy excludes liability for pure economic loss, such a term would be subject to review".[39]

6.29 In tailoring Article 4(2) of Directive 1993/13/EC to the law of insurance by way of Article 2:304, the PEICL authors have replaced the phrase, "main subject matter of the contract" with, "terms that state the essential description of the cover granted or the premium agreed". This is further elaborated on in a Comment:

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[35] *Ibid*.

[36] [2002] 1 AC 481

[37] [2002]1 AC 481 at 499

[38] [2002]1 AC 481 at 491

[39] PEICL, p.117

the relevant terms are those that give a crucial definition of the type and subject of insurance, the insured risk, the insurer's liability, the insurance benefit, the sum insured, the insured interest or the insurable value. Terms restricting, changing, elaborating or modifying the insurer's obligation to perform are, however, not core terms and therefore subject to review under Article 2:304[40].

6.30 The most important safeguards that European consumers have under the Unfair Contract Terms Directive are arguably, procedural other than substantive. For even a core term to qualify for exemption from scrutiny, that is, the danger that a contractual term will be invalid because:

(1) it is unfair (e.g. as appearing on a grey list)

(2) it was not individually negotiated

(3) contrary to the requirements of good faith and fair dealing, it causes a significant imbalance in the rights and obligations of parties and is detrimental to the interests of the consumer.

The term in question must satisfy the following two key requirements.

6.31 First, the exemption has to be in plain language. Article 4(2) of the Directive mandates that, the exemption from scrutiny applies insofar as these terms are in plain intelligible language. The Law Commissions also reject Professor Malcolm Clarke's view that recital 19 does not insist on such a requirement, pointing out that article 4(2) takes precedence over recital 19 and that, in any case, recital 19 itself requires a core term to "*clearly*" define or circumscribe the insured risk. The scope of this requirement is uncertain. For example, is an average provision one which defines the risk or circumscribes the risk? Even if it is not a core term, does the term have to be explained (e.g. by way of examples on the consequences of under insuring)?

6.32 The second condition is that the reasonable expectations of the consumer. Although the decision of MacMenamin J in *O'Reilly v Irish Life Assurance plc*[41] is somewhat inconclusive on the scope of any duty to provide a bargain which reflects the reasonable expectations of a proposer/insured, the case articulates the view that the process of interpreting an insurance policy seeks to:

> "find the meaning which the document would convey to a reasonable person having all the background knowledge reasonably available to the parties, including anything which would have affected the way a reasonable person would have understood it but excluding previous negotiations or subjective intent."[42]

Even commercial bargains should not be occasions for imposition or "surprise". It is for such reasons that oral contracts are not generally interpreted so as to contain unusual or non-standard provisions that were perhaps tucked away in preliminary documents: *Capes (Hatherton) Ltd v Western Arable Services*.[43] Within the specific context of the Unfair Contract Terms Directive the Law Commissions argue that recital 20 requires not only that the terms of the contract should be drafted in plain, intelligible language, but also the consumer should be given the opportunity to examine all the terms. The Law Commissions have endorsed the view of the Office of Fair Trading that a core term will only be exempt from review as defining the main subject matter of the contract "if it is part of the way consumers perceived the bargain". Tucking terms or disclaimers away into contracts in places where a consumer is unlikely to see it, and even providing terms or disclaimers after the contract has been agreed could well fall foul of such

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40 *Ibid.*

41 [2005] IEHC 449.

42 At para 87. Although noticeably cool on Steyn L.J.'s speech in *First Energy (UK) Ltd v Hungarian International Bank Ltd [1993]* 2 Lloyd's Rep 194 at 196, MacMenamin J's approach is not, it is submitted, very different to Steyn L.J.'s desire to ensure that "the reasonable expectations of honest men must be protected".

43 [2010] 1 Lloyd's Rep.477. See in particular both the English High Court and Court of Appeal decisions in *William McIlroy (Swindon) Ltd v Quinn Insurance* [2011] EWCA Civ 825.

"consumer's reasonable expectations" standards[44]. It may be that even if the term is subject to the fairness test it would pass muster[45], but the need for clear and transparent drafting and accessibility to contractual terms in a timely fashion seem a reasonable precondition to set for the validity of core provisions and other essential terms. The Directive generally appears to be concerned with situations where the court concludes that there was such a lack of openness, fair dealing or good faith so as to render a contractual provision unfair.[46]

6.33 Clauses that may be found in insurance contracts that are referred to in the Annex to the 1993 Directive and in Schedule 3 of the *European Communities (Unfair Terms in Consumer Contracts) Regfulatinos 1995* (which implemented the 1993 Directive in Ireland) are grouped under the following 6 headings by the authors of the PEICL:

1. *Hidden Terms:* These include terms that are not fully disclosed or intelligible to the consumer, terms which cross refer to legal provisions not disclosed in the contract "small print" provisions and entire agreement clauses.

2. *Exculpatory Provisions:* Terms excluding or limiting liability for non-performance or defective performance, one sided performance obligations.

3. *Terms imposing Barriers to Redress:* These clauses include evidentiary obstacles, onerous rules on maintaining and proving a claim, arbitration clauses, clauses that otherwise enable slow payment of a claim.

4. *Cancellation Clauses:* Insurers having unilateral rights to cancel, particularly when this can be done without the insured being able to arrange cover or recover the premium.

5. *Unilateral Variation of Cover*. For example, an insurer, who, without good cause, can unilaterally vary either the cover or the premium, or assign the policy, may have to defend such a clause.

6. *Penalty provisions.* A term that imposes a disproportionate penalty for breach by the consumer will be reviewable. Seen in context, the 1993 Directive affords a significant range of remedies to the consumer. For example, it is arguable that an innocent misrepresentation by a proposer, which affords an insurer a right of avoidance is itself a disproportionate penalty under category 6 above, even if the Marine Insurance Act 1906 provides a legislative endorsement of this common law rule.

(7) The 1995 Regulations and Insurance Adjudications in Ireland

6.34 The Financial Services Ombudsman has not specifically referred to the 1995 Regulations in any of the Case Studies released on the Ombudsman's website. However, general standards of "fairness", "reasonableness", and a desire to avoid inequitable results permeate the Ombudsman's decisions. Two examples from 2009[47] illustrate this point:

- An elderly man died of cardiac arrest following a fall. Death benefit was refused on the basis that the cause of death was a heart attack and the insured event, as stipulated in the policy, related to a death, the "sole" cause of which was bodily injury. The Ombudsman held the policy was too strict and narrow, directing the company to review the wording to "reduce the risk of unfairness to policyholders".
- While the Ombudsman upheld the right of a health insurance company to change the terms of a policy at renewal and adjust the premiums upwards, the introduction of a new

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44 Joint Consultation Paper 2007: Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured, at para 2.94.

45 *R&B Customs Brokers Co Ltd* [1988] 1 WLR 321; *Smith v Eric S Bush* [1990] 1 AC 381*; Watford Electronics Ltd v Sanderson* [2001] 1 All ER (Comm) 696.

46 *Bryen & Langley Ltd v Boston* [2005] EWCA Civ 973, applied in *Maple Leaf Macro Volatility Master Fund v Rouvroy* [2009] EWHC 257 (Comm).

47 See Case Studies at www.financialombudsman.ie.

waiting period under a policy said to be an "upgrade" of a previous policy was not permitted. Compensation of €2,000 to the complainant was also awarded.

6.35 The decisions of the non-statutory Insurance Ombudsman of Ireland contain overt references to the 1995 Regulations.

6.36 In Case Study 95[48], the Insurance Ombudsman of Ireland took a cautious approach on the issue of jurisdiction. The case involved an issue of interpretation relating to a holiday insurance exclusion. While the Insurance Ombudsman noted that the insurer was relying on the exclusion in Recital 19, the clause was upheld on the basis that:

- It was a common exclusion and not unusual
- It was not unfair as it limited cover
- The policy itself was clear on what was and was not covered.

6.37 The Insurance Ombudsman also ruled that the question whether an exclusion clause should be deleted from a policy was an underwriting decision outside the jurisdiction set by the IIF's terms of reference for the Scheme. Nevertheless, several of the early adjudications by the Insurance Ombudsman reflect a fair and reasonable terms approach. For example,

- Imposition of penal compound interest rates on premium arrears and failure to notify the insured[49] was overturned.
- Insisting on strict contractual requirements of proof, as in the case of a theft on holiday abroad, when adequate evidence of loss was available from other sources[50] was held not to be fair and reasonable.

6.38 Ambiguous terms[51], or reliance upon an unreasonable interpretation of a term, expression, or an exclusion[52], were also successfully contested under the non statutory Ombudsman scheme between 1992 and 1998.

(8) The PEICL Recommendation

6.39 Article 2:304 of the PEICL is modelled on the 1993 Unfair Contract Terms Directive, 93/13/EC. The Article has been crafted in order to respond to the specific context of mass marketed consumer insurance products. Article 2:304 provides:

Abusive Clauses

(1) A term which has not been individually negotiated shall not be binding on the policyholder, the insured or the beneficiary if, contrary to the requirements of good faith and fair dealing, it causes a significant imbalance in his rights and obligations arising under the contract to his detriment, taking into account the nature of the insurance contract, all the other terms of the contract and the circumstances at the time the contract was concluded.

(2) The contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term. If not, the unfair term shall be substituted by a term which reasonable parties would have agreed upon had they known the unfairness of the term.

(3) This Article applies to terms that restrict or modify cover but it applies neither to
(a) the adequacy in value of the cover and the premium, nor to
(b) terms that state the essential description of the cover granted or the premium agreed, provided the terms are in plain and intelligible language.

(4) A term shall always be regarded as not individually negotiated when it has been drafted in advance and the policy holder has therefore not been able to influence the substance

[48] Digest of Cases 1992-1998.

[49] Case Study 119.

[50] Case Study 84.

[51] Case Studies 3, 83 and 131, for example.

[52] Case Studies 24, 94, 128 and 134, for example.

> of the term, particularly in the context of a pre-formulated standard contract. The fact that certain aspects of a term or one specific term have been individually negotiated shall not exclude the application of this Article to the rest of a contract if an overall assessment of the contract indicates that it is nevertheless a pre-formulated standard contract. When an insurer claims that a standard term has been individually negotiated, the burden of proof in this respect shall be incumbent on the insurer.

(9) Discussion on the Adoption of Article 2:304

6.40 Irish law does not have any statutory provisions that can effectively counteract contractual provisions that have been included in negotiations or contract documents in an unfair way. While the common law and the judiciary may strive to protect contracting parties by way of imposing good faith requirements during the negotiation process, particularly through the rules on incorporation of terms, there is less room for judicial manoeuvre in cases of substantive unfairness. While clauses may be subject to hostile interpretation and ambiguities read against an insurer, careful drafting will provide an insurer with a means of avoiding a claim in some instances. Even though Irish law has a strong tradition in relation to unconscionable or improvident transactions being overturned, the jurisdiction has not been employed in the insurance sector. In any event, such equitable doctrines are not appropriate here because the weaker party will in most cases be seeking to enforce the contract, shorn of the objectionable provision. Courts of equity do not re-shape unconscionable or improvident transactions, as a rule.

6.41 The statutory protections available in the *Consumer Protection Act 2007* have yet to be tested in Ireland. It may be that the 2007 legislation, which clearly applies to insurance, may be suitable, but one cannot be sanguine about this: the Commission considers that an appropriate and tailored response is necessary. The Óireachtas has already recognised that unfair contractual practices in the insurance sector exist and that both the Financial Regulator and the Financial Services Ombudsman have important and distinct roles to play in protecting consumers and small businesses. The Commission believes that this can be further developed by making the provisions of Directive 93/13/EC fit more appropriately into Irish commercial law and the Commission believes that the PEICL recommendations provide a very helpful precedent, one that should be built upon in Ireland.

6.42 It is the view of the Commission, looking at the IIF Codes of Practice, as well as the decisions of the statutory and non statutory dispute resolution bodies that have effectively provided the legal and regulatory standards that operate in Irish insurance consumer law, that problems of substantive unfairness are not commonly found. The Commission believes that most problems arise out of difficulties, misunderstandings and isolated instances of bad insurance practice. The onus should rest on the industry to improve training, enhance information gathering and ensure that customers are better informed about the product they are considering purchasing. By the same token, insureds should read and make strenuous efforts to understand the cover being provided. Unfair terms legislation, in the Commission's view, is more concerned with ensuring that products are adequately described and that the insured should obtain the product that is best suited to their requirements. Unfair terms legislation has an important part to play in matching the buyer with an appropriate product.

6.43 The Commission notes that the Draft Consumer Rights Directive, which was intended to replace Directive 1993/13/EC, contained a reformulated recital, which in the view of the Commission, provides greater clarity on what the Judicial Review provisions intend to achieve. Recital 49 of the Draft:

> For the purpose of this Directive, neither the fairness of terms which describe the main subject matter of the contract, nor the quality/price ratio of the goods or services supplied should be assessed unless these terms did not meet transparency requirements. The main subject matter of the contract and the price/quality ratio should nevertheless be taken into account in assessing the fairness of other terms. For example, in insurance contacts, the terms which clearly define or circumscribe the insured risk and the insurer's liability should not be subject to such an assessment since these restrictions are taken into account in calculating the premium paid by the consumer.

The "transparency requirements" mentioned in the draft Directive are found in Article 31[53], and the general principles[54] outlined in article 32 of the draft Directive are not to apply "to the assessment of the main subject matter of the contract provided the trader fully complies with Article 31"[55].

6.44 This reformulation helpfully states that core provisions are immune from review if transparency requirements are met. To purchase immunity the insurer must meet both the reasonable expectations of the purchaser and communicate the essential features of the policy to the purchaser. The Commission does not think this is too onerous and the Commission believes that this is in accordance with good insurance practice, as well as the Ombudsman jurisprudence since 1992 to date. The adoption of Article 2:304 would, in the Commission's view, be an important step and the Commission would so provisionally recommend.

6.45 However, the Commission suggest that the refinements should be adopted. First of all, the Commission would favour the approach taken in Germany and elsewhere, which narrows down the scope of the exclusion to terms which describe the insured risk and the premium paid. In other words, a description of a policy as a "guaranteed income protection policy", or a "domestic fire insurance policy", as well as the premium to be charged, would be immune from scrutiny. The Commission does not think this will have a significant impact[56] but views on this from the industry are invited. Secondly, the Commission would welcome an adjustment to Article 2:304(3) (b) so as to add that the terms "have been clearly communicated to the policyholder". This is implicit as a result of the fourth indent to Schedule 2, Guidelines for the Application of the Test of Good Faith[57], but in the Commission's view this requirement should be overtly stated, for the avoidance of doubt.

6.46 *The Commission provisionally recommends that Regulation 4 of the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995 (which deals with specific circumstances in which a contract term shall not of itself be considered to be unfair) should be clarified in the context of insurance contracts so that it is provided, to avoid any doubt, that: (a) a term in an insurance contract shall not in itself be regard as unfair where the subject matter of the term has actually been considered by the insurer in the calculation of the premium (price); (b) that this has been drawn to the attention of the proposer; and (c) that this clarification to Regulation 4 should apply to consumers as defined for the purposes of the jurisdiction of the Financial Service Ombudsman, namely natural persons and businesses with an annual turnover not exceeding €3 million.*

(10) Enforcement

6.47 The most important feature of Directive 93/13/EC is the fact that it is not merely a private law mechanism. The role that national consumer regulators play in having terms declared unfair is a critical part of effective enforcement. A declaration that a particular term is unfair has an effect that goes beyond the ambit of individual private law adjudication[58]. As the Commission recommend that Article 2:304 should be available to small businesses, this raises the question about which State agency should be able to utilise enforcement powers if, as the Commission believe, the same enforcement mechanism be available to consumer insureds under the Directive. The Commission provisionally recommend that the

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53 Draft Article 32(1) is the good faith/significant imbalance provision currently found in S.I. 27/1995.

54 Draft Article 32(2) sets out the assessment process for the competent national authority, currently found in SI 27/1995.

55 Draft Article 32(3). Unfortunately for our purposes these provisions were deleted from the Consumer Rights Directive (Directive 2011/83/EU, 25 October 2011)

56 Article 2:304(3)(b)arguably already does this.

57 "The extent to which the seller or supplier has dealt fairly or equitably with the consumer whose legitimate interests he has to take into account". See also Schedule 3(j) (hidden terms) the list of unfair terms which are presumptively unfair: SI 27 of 1995.

58 See Bright, "Winning the Battle against Unfair Terms" (2000) 20 LS 331; See the High Court Order in relation to the Building industry of December 5, 2001, discussed by Dorgan [2002] Law Society Gazette 12, and the NI Case of *Kindlance v Murphy* (1997) discussed by Bright, *op cit.*.

National Consumer Agency would be the most obvious agency but as the re-organisation is under review, the Commission merely wishes to flag this issue as one that needs to be considered.

CHAPTER 7 FORMALITIES

A Introduction.

7.01 Irish law does not provide a coherent set of rules requiring an insurance contract to be negotiated or concluded in tandem with the creation of a written or electronic record of the transaction. A fragmented body of EU legislation has built up in relation to consumer insurance but the absence of any general requirement on pre-contractual information being furnished to a proposer, or the recording of essential terms of the agreement, as well as any requirement to actually furnish the insured with a copy of the policy (or key terms such as promissory warranties) are shortcomings in the law that need to be addressed. The Commission is aware of the need to allow flexible contractual practices to operate and the desirability of keeping transaction costs to a minimum, but these objectives should not be purchased at the cost of lack of clarity and procedural or substantive fairness.

B Legislation, Case Law and Codes of Practice

7.02 Isolated examples of legislative provisions which seek to promote greater clarity of purpose and legal certainty between a proposer and an insurer do exist. The *Insurance Act 1936* in relation to industrial assurance[1] provides exceptions that prove the rule. While the *Insurance Act 1989* contained an enabling provision[2] that would have had a significant impact on pre-contractual negotiations and notice requirements in respect of the duty of disclosure and warranties, this power was never exercised.

(1) Limited legislative provisions

7.03 The Road Traffic Acts make it necessary for vehicle insurers who issue approved policies on insurance to issue certificates of insurance in the prescribed form,[3] an understandable provision in relation to compulsory insurance. Some isolated examples of formal requirements have been identified in industrial assurances relating to endowment policies, eg funeral expenses, but not only have such instances been repealed.[4] It appears that in historical terms the interest of Parliament and the Óireachtas in ensuring that contracts of insurance are evidenced in writing owe much to a desire to create appropriate targets for stamp duties and levies.[5] Section 22 of the *Marine Insurance Act 1906* requires every contract for marine insurance to be expressed in a policy, the policy being capable of being executed or issued either at the time of the contract or otherwise. Non-compliance renders the contract of marine insurance inadmissible in evidence. As was shown in Chapter 2, in relation to the insurable interest requirement, the *Life Assurance Act 1774*, as extended into Ireland, requires policies of life insurance to be in writing with the name of the beneficiary on it. This is not however a "consumer protection" measure – quite the reverse. Lack of clarity and certainty is also not provided via section 2 of the *Statute of Frauds, 1695.* The provision in section 2 of the Statute of Frauds, which directs that a memorandum is necessary in respect of an agreement that is not to be performed within one year from the making of the agreement has been held to be fully performed on one side by the payment of the

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1 Eg. s.61 (contents of proposals to contain some specific terms) and 63 (ministerial power to delete or amend proposal terms)

2 s.61.

3 *Road Traffic Act 1961* s.66, and SI 14 of 1962, as amended.

4 Eg *Assurance Companies Act 1909*, repealed by section 7(2) of the *Insurance Act 1936.*

5 Existing revenue practice is to raise the levy against premiums: see for example section 26 of the *Finance Act 2009.*

premium, thus taking the contract outside the Statute, even in long term insurance contracts.[6] As indemnity insurance is normally an annual contract at most, so the question should not arise in any case. In the case of contracts of indemnity insurance the provision in the Statute that requires a memorandum in relation to a special promise to answer for the debt, default or miscarriage of another person[7] is also not relevant[8] because an insurer does not answer for the default of another – the insurer is directly liable and there is a strong line of Canadian law, for example holding that oral contracts of insurance are enforceable because of the existence of direct liability.[9]

7.04 Some sections of the Irish insurance market have however been identified as ripe for a process of prescriptive regulation vis-à-vis contractual practices but again, the record of the Oireachtas has been disappointing. The *Health Insurance Act 1994*,[10] and the *Health Insurance (Miscellaneous Provisions) Act 2009*[11] make provision for prescribing information that should accompany the health insurance contract, and health insurance advertising, but no regulations have been made under either Act.

(2) Case law

7.05 Judicial protection of proposers and insureds has been available on an *ad hoc* basis. In cases where an insurer does not make use of a "proposal form with its presumably relevant questions"[12] the duty of disclosure will often be abridged or the duty to make full disclosure waived. In *Manor Park Homebuilders Ltd v AIG Europe Ireland Ltd*[13] the failure of the insurer to make reasonable inquiries, issue appropriate documentation at the pre-contract stage were held to fall short of the good faith obligations resting upon the reasonably prudent insurer and "in breach of its duty of *uberrimae fidei* in failing to adequately inform itself of the facts and in failing, for improper reasons, to deal fairly with the insured or consider his interests".[14] In the context of this more proactive view of what the insurer must do in order to keep up the insurer's end of the utmost good faith principle, the transfer of information is not asymmetrical at all. It follows that, if an insurer's right to avoid a policy for misrepresentation or non-disclosure can be lost because of shoddy infomation gathering practices, the insurer has as much to lose by breaching this good faith principle as does the proposer. In this context, legal rules to regulate information transfers and secure compliance with requirements of form should be mutually beneficial to proposer and insurer.

(3) Self Regulation and Formalities

7.06 The insurance industry recognises the importance of good information gathering practices and using documents to communicate with consumers. Both the IIF Code of Practice on Life Assurance–Duty of Disclosure, and the Code of Practice on Non Life Insurance set out a limited number of obligations that are relevant. These include a requirement to advise proposers of the consequences of failure to disclose all material circumstances, to be included in the declaration or prominently displayed elsewhere. Also, matters which insurers have commonly found to be material should, insofar as practicable, be the subject of clear questions in proposal forms. These Codes do not however provide any guidance on the

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6 *Miles v New Zealand Alford Estate Co.* (1886) 32 Ch. 266

7 On contracts of surety and indemnity see Corbin, "Contracts of Indemnity and the Statute of Frauds" 41 Harv. L.R. 689 (1941). There is a conceptual difficulty raised by contracts of guarantee – see *ICB plc v Insurance Corporation of Ireland* [1991] ILRM 726.

8 Section 2 of the Statute of Frauds Ireland 1695 remains in respect of contracts not to be performed within one year and contracts of guarantee – for land contracts see now section 51 of the *Land and Conveyancing Law Reform Act 2009* and Schedule 2 thereof.

9 *Hochbaum v Pioneer Insurance Co* [1933] 1 WWR 403; *Gayditch v Mutual Benefit Health and Accident Insurance* [1940] 4 DLR 236; *Gillies v Brown* (1961) 53 SCR 557.

10 Section 13.

11 Section 11.

12 *Per* McCarthy J. in *Aro Road & Land Vehicle v ICI* [1986] IR 403.

13 [2008] 2 ILRM 190.

14 *Per* McMahon J, at p.216.

provision of policy documents as a mandatory requirement. The Code of Practice on Life Insurance Duty of Disclosure, for example states:

7.07 The proposal form or a supporting document should include:

i) a statement that a copy of the completed proposal form is available on written request by or on behalf of the proposer within 3 months from date of proposal;

ii) a statement that a copy of the completed proposal form will be supplied to the proposer as part of the insurer's normal practice.

7.08 The Codes of Practice also suffer from the fact that these provisions involve the aspirational "should" rather than "will" or "shall", as found in other parts of the Code.

7.09 The Financial Regulator's *Consumer Protection Code 2012* contains a number of documentation requirements in the Common Rules for all Regulated Entities. For example, Terms of Business detailing information about the insurer's business must be drawn up and provided to the consumer prior to the first provision of a service to the consumer: information provided must be "clear and comprehensible, and that key items are brought to the attention of the consumer".

7.10 The experiences of the Office of the Insurance Ombudsman of Ireland also attest to the importance of efficient pre-contract information gathering on both sides and the usefulness of contractual formalities. Even in cases where an insurer had grounds for treating the contract as void *ab initio* or voidable for non-disclosure or misrepresentation, the failure of the insurer to record the usefulness of the contract itself or document the information requested or provided by the proposer could lead to the contract being enforceable or the subject of a proportional payment or *ex gratia* award.[15]

7.11 In the context of the statutory jurisdiction of the Financial Services Ombudsman, there are instances where the Ombudsman has intervened to protect consumers in cases of misselling and lack of understanding of a policy, even where the appropriate documentation and a cooling off period have been provided.[16] Where the documentation provided was said to have been so complex that "one would have had to have a considerable amount of financial literacy to follow the terms and conditions within it and the case had a strong element of misselling, the Financial Services Ombudsman decided upon making a pro rata allocation of liability.[17] *A fortiori*, where incorrect statements of cover, at odds with the policy itself have been made in correspondence, the Financial Services Ombudsman has made decisions favouring compensatory awards to insureds.[18]

7.12 This question of how to develop best practice standards in relation to "fixing" the actual contract involves also verbal agreements.

7.13 In one important complaint a consumer was sold an insurance policy which was described by sales personnel as a personal accident policy. Three weeks later the insured suffered fractures to both his arms as a result of a workplace accident. The policy in question only covered permanent disability or death. The policy was sold over the telephone as a result of a "cold call" made by the insurer's sales staff to the consumer who had obtained the consumer's contact details via a credit card issued by the insurer, a bank. The policy documents were issued 10 months after the contract was concluded. Recordings of the telephone conversation were not available. The Financial Services Ombudsman said the case was one in which the policy was mis-described and that it was unacceptable that no record was available as to what had transpired at the time of sale:

> "The Ombudsman is conscious that many contracts and indeed other issues are carried out on line and over the 'phone. In those circumstances he pointed out to all Financial Service Providers that where he is dealing with a complaint that hinges on contractual commitments entered into over the 'phone, he would be disposed to find in favour of a Complainant where

15 Eg Digest Case Studies 8, 12, 31, 43, 45, 49 and 69 in the period 1992 to 1998.

16 July 2009 Complaints, pages 13-14. 'Company ordered to purchase back investment'.

17 *June 2008 Complaints,* pages 10-11.

18 *June 2006 Complaints*, page 7.

the Provider could not provide the necessary evidence to rebut the claim being made. It would therefore be in the interests of the Providers to consider retaining appropriate records – including, where necessary, 'phone recordings relating to such contractual commitments – for the period within which a person can complain to the Ombudsman i.e. six years."[19]

(4) EU law and Formalities

7.14 The First Council Directive of 24 July 1973 on Direct Insurance other than Life Assurance (Directive 1973/239/EEC) as amended,[20] and Directive 2002/83/EC concerning Life Assurance,[21] provide the main regulatory provisions that have an impact on how insurance companies are to meet Community transparency standards generally. However, while Directive 2001/83/EC provided detailed provisions in Chapter 4 (Contract Law and Conditions of Assurance) on cancellation rights and information to be provided to policy holders in relation to life assurance, it is only the Distance Marketing of Consumer Financial Services Directive[22] that provides a horizontal set of information disclosure requirements and a cancellation right for consumers in respect of financial services; the Directive specifically defines a financial service to include an insurance business and insurance is defined so as to include life assurance. As a basic rule the information to be provided must:

- have a commercial purpose which is made clear;
- be provided in a clear and comprehensible manner appropriate to the means of distance communication used;
- with due regard, in particular, to the principles of good faith in commercial transactions;
- satisfy principles governing the protection of persons unable to give their consent, such as minors.[23]

7.15 The Directive has been transposed into Irish law by the *European Communities (Distance Marketing of Consumer Financial Services) Regulations 2004* (S.I. No. 853 of 2004) and Schedule 1 of the 1994 Regulations provides that the supplier must provide a consumer with the following information prior to entry into a distance contract:

(a) identity, main business and address of the supplier;

(b) if the consumer resides in another Member State, name and address of the supplier's representative in that State;

(c) name and address(es) of the advisor or agent with whom the consumer may be dealing and a statement of capacity;

(d) the supplier's registered company details, if applicable;

(e) details of any relevant supervisory authority under any applicable authorisation scheme;

(f) details of any membership of a professional body regulated by law;

(g) VAT registration details;

(h) a description of the main characteristics of the financial service;

(i) total price payable including fees;

(j) a relevant notice about risks and performance fluctuations;

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19 Case 5, December 2007. See also Case 9 of June 2007.

20 See the Consolidation of 2007- 01- 01 on EUR – LEX.

21 OJL 345, 19.12.2002, building on Directives 1979/267/EEC, 1009/619/EEC and 92/96/EEC. The principal regulations transposing the life assurance directives are SI 360 of 1994.

22 2002/65/EC, OJL 271, 9.10.2002.

23 Directive, Article 2(2).

(k) possible additional taxes and costs;

(l) limitations on the accuracy of information provided;

(m) arrangements for payment and performance;

(n) additional charges for use of a means of distance communication;

(o) availability of cancellation rights and details relating thereto;

(p) minimum length of the service where it is of a recurring nature;

(q) early or unilateral termination details and charges;

(r) instructions on exercise of the right to cancel the contract;

(s) details of the applicable law selected by the supplier on the issue of establishing relations with the consumer;

(t) any term in the contract on applicable law/jurisdiction;

(u) language(s) in which contract details will be given;

(v) language(s) in which supplier will communicate with the consumer during currency of the contract;

(w) availability of access to out of court redress mechanisms for the consumer;

(x) details on guarantee funds or other compensation agreements.

7.16 In addition, Schedule 2 to the 2004 Regulations sets out a number of information requirements to be met before entering into a distance marketing contract by telephone. There are five categories of information relating to the identity of the supplier or any intermediary in contact with the customer, a description of the main characteristics of the service, total price and taxes, or a means of calculating price, details of taxes or charges, and details of any available cancellation right.

7.17 Apart from these provisions, another set of information requirements must be met when electronic commerce rules are applicable. Most Irish consumers will have some familiarity with data protection rules that prohibit email spamming and unsolicited SMS messages to promote goods and services, but there are other rules of a Community origin.

7.18 In accordance with the Electronic Commerce Directive, the *European Communities (Directive 2000/31/EC) Regulations 2003*[24] contain obligations which a service provider using an electronic means to communicate with consumers, must observe if the service provider is to lawfully engage in ecommerce activities. These obligations will apply to insurance companies that respond to requests for information from individuals and individual proposers and the overlap with the distance marketing of consumer financial services is significant. In fact, the European Communities (Distance Marketing of Consumer Financial Services) Regulations 2004[25] expressly provide that a distance contract for the supply of a financial service is subject to regulations 13 and 14 of the Electronic Commerce Regulations as well as the Distance Contracts Regulations.

7.19 Regulation 13 of the Electronic Commerce Regulations provide that where a contract is to be concluded by electronic means, the relevant service provider shall "clearly, comprehensively and unambiguously and prior to the order being placed" provide information on the necessary technical steps needed to conclude the contract, whether the contract will be filed and whether it will be accessible, the technical means whereby input errors may be identified and corrected prior to the order being placed, and the language or languages in which the contract may be concluded. The service provider must provide the recipient of the service with terms and general conditions prior to contract in a way that allows the recipient to store and reproduce them, and information on any applicable code of conduct must also be made available prior to an order being placed or as soon as practicable thereafter. While there are

[24] SI No. 68 of 2003.

[25] SI No. 853 of 2004.

exceptions to these requirements in respect of business to business and individual electronic negotiations, these regulations do add a significant layer of additional regulation for service providers.

7.20 To similar effect, regulation 14 stipulates that where an order is placed by the recipient through electronic means:

> "the relevant service provider shall acknowledge the receipt of the order of the recipient without undue delay and by electronic means"

and further, information on correcting input errors must also be provided. There are again exceptions in respect of business to business and individualised electronic negotiations.

7.21 What is particularly significant about articles 13 and 14 is the fact that non-compliance may result in criminal liability, with the National Consumer Agency having powers to prosecute non-compliant service providers. Non-compliance with these requirements does not have any negative impact on the enforceability of any contract concluded in breach of these provisions.

7.22 It is not clear what plans the European Commission have in relation to the Distance Selling of Financial Services Directive which is *not* supplanted by the recently agreed Consumer Rights Directive, Directive 2011/83/EU.

(5) EU Law – Cancellation Rights in relation to Life Assurance Contracts concluded by a Distance Contract

7.23 With effect from 9 October 2004 any life assurance policies issued on or after that date are the subject of a 30 day cancellation right which is vested in the policyholder.[26] Prior to that date, the cancellation right was limited to 15 days.[27]

7.24 In the case of other distance contracts for the supply of financial services, the cancellation right ends 14 days after the beginning of the cancellation period.[28] The right of cancellation does not apply to certain insurance contracts, specifically if the service is or relates to a travel or baggage insurance policy or an insurance policy under which cover is provided for less than a month.[29]

(6) Pre-Contractual Information and Formalities in incentivising Best Practice Standards

7.25 Insurers do not have any general requirement to satisfy any common law rules on the accurate recording of negotiations and reducing contracts into documentary form: statute law, outside of a number of EU directives is also less than prescriptive. However, there are good commercial and ethical reasons why sound documentary practices should be devised and adhered to. MacGillivray cautions:

> "There is nothing to prevent a valid contract of fire, accident or burglary insurance being constituted by informal writing or correspondence or even by mere oral communications. In practice, however, it is difficult to satisfy a court that there is an oral contract when one party disputes its existence, and attempts to set up such an agreement are not to be undertaken lightly. The small trouble involved in recording contracts in writing is amply justified to avoid later evidentiary difficulties. When an informal contract is recorded in writing, the written terms are not necessarily a conclusive statement of the contract in law, because oral evidence is admissible to prove other terms of the contract, if it is established that the document was not intended to be a complete record of it."[30]

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[26] SI No. 543 of 2004, giving effect to Directive 2002/65/EC, article 6, supplanted by Regulation 11(5) of SI No. 853 of 2004.

[27] SI No. 360 of 1994, giving effect to Directive 90/619/EC, article 15.

[28] Regulation 11(4) of SI No. 853 of 2004. The recently agreed Consumer Rights Directive 2011/83/EC (25th October 2011) does not apply to financial services contracts and will not affect the existing law.

[29] Regulation 12(1)(b) of SI No. 853 of 2004.

[30] Para. 3-002 (footnotes omitted). See para 7.13 above.

7.26 One may also add that considerations of good faith may also be breached by negligent or unsatisfactory business practices that attend the negotiation and recording of insurance contracts and policy documents.

(7) A General Duty to Provide Pre-Contractual Information in PEICL

7.27 The European Union *acquis* imposes significant information requirements on the suppliers of goods and services, particularly when the good or the service is provided via distance marketing or away from business premises. These requirements only apply to consumers however, and, apart from the information and cancellation rights in respect of life assurance, any insurance contract which is not concluded within the distance contracts regulations, are not attended by information disclosure rules or a legal duty to provide copies of completed documentation or any policy documents, save in respect of some applicable law provisions and dispute resolution mechanisms under Article 31 of Directive 1992/49/EEC.[31]

7.28 In the interests of greater clarity and transparency, the Commission takes the view that there should be a general duty to provide proposers with pre-contractual information, and, in the event that a contract is concluded, copies of any completed documentation and policy documents. This general duty should arise in relation to all consumer and business insurance contracts that are the subject matter of this Consultation Paper. A number of exceptions to this general duty will be necessary for when such requirements are inappropriate or would have a disproportionate impact upon the insurer or insurance sector concerned. The general duty and related matters, as well as the exceptions hereto, are based upon the recommendations contained in the Principles of European Insurance Contract Law, to which the Commission will now turn.

7.29 The authors of the PEICL distinguish between information duties that arise before the contract is concluded (Article 2:201) and a separate duty to issue an insurance policy after the insurance contract has been concluded (Article 2:501).

7.30 Article 2:201 is also tailored to aspects of the specific insurance contract such as the sum insured and the amount of the premium. While the Article begins by referring to a copy of the proposed contract terms as well as a document containing the following information, if relevant, the proposed contract terms requirement is to be satisfied if the document is in writing, is readable by both sides. Article 2:201 reads:

> (i) The insurer shall provide the applicant with a copy of the proposed contract terms as well as a document which includes the following information if relevant:
>
> (a) the name and address of the contracting parties;
>
> (b) the name and address of the insured and of the beneficiary;
>
> (c) the name and address of the insurance agent;
>
> (d) the subject matter of the insurance and the risks covered;
>
> (e) the sum insured and any deductibles;
>
> (f) the amount of the premium or the method of calculating it;
>
> (g) when the premium falls due as well as the place and mode of payment;
>
> (h) the contract period and the liability period;
>
> (i) the right to revoke the application or avoid the contract in accordance with Article 2:303;
>
> (j) the law applicable to the contract or, if a choice of law is permitted, the law proposed by the insurer;
>
> (k) the existence of an out-of-court complaint and redress mechanism for the applicant and the methods for having access to it;

[31] See the Consolidation of the Directives (21.03.2008) on EUR-LEX.

(l) the existence of guarantee funds or other compensation arrangements.

(ii) If possible, this information shall be provided in sufficient time to enable the applicant to consider whether or not to conclude the contract.

(iii) When the applicant applies for insurance cover on the basis of an application form and/or a questionnaire provided by the insurer, the insurer shall supply the applicant with a copy of the completed documents.

7.31 It should be noted that Article 2:201 sets out some generic provisions and that the requirement is imposed only "if relevant". While some of this information will need to be tailored to meet the requirements of each proposed contract (e.g. risks and exclusion, premiums, details of the insured and beneficiary) Commission sees no reason why most of these information requirements could not be met via basic provisions on a website followed by way of an SMS message/email, as long as the text is retrievable and/or printable.

7.32 Article 2:201(2) raises the question of what consequences will follow if the information provision is not met when it would have been possible for the insurer to have done so had the insurer acted in a professional and timely manner. This issue arose in the context of the transposition of the Distance Marketing of Consumer Financial Services Directive. The 2004 Regulations, S.I. No. 853 of 2004 originally provided that non-compliance with the information requirements and contract terms provisions made the contract unenforceable against the consumer. S.I. No. 63 of 2005 gave a court of competent jurisdiction a power to dispense with the obligation where non-compliance was not deliberate or prejudicial to the consumer, the court having the ability to make the contract subject to such conditions as the court sees fit to impose. This seems to be a more appropriate response and it is arguable that the Financial Services Ombudsman's jurisdiction should be extended to allow such matters to be within the remit of the Office rather than requiring an application to a court of competent jurisdiction.

7.33 Article 2:201(3), as the authors of the PEICL concede, is not based upon the Community *acquis* but is rooted in a number of national law provisions[32] that requires such details that have been provided by the proposer to be furnished, in documentary form, not later than the time when the contract has been concluded.

7.34 Clearly, the authors of the PEICL are correct when they point out that any application form or questionnaire will be "of decisive evidential value for *ex post* determination of the contents of the concluded insurance contract or a possible breach of the applicant's pre-contractual information duty".[33] However, while the duty must be observed whenever possible, there must be some question about whether it is practicable to require this information to be furnished prior to the conclusion of the contract.

C Recommendations

7.35 While the Community *acquis* in relation to consumer insurance in particular contains a number of information requirements, there is no basic rule that provides that a contract must be concluded, or evidenced, in writing. As the authors of the PEICL point out, the core issue is whether the parties have reached an agreement. Also, "it is important and socially desirable that insurance cover can be put in place as quickly as possible after the decision of the applicant to apply for insurance and the agreement of the parties. Observance of formalities will cause delay."[34]

(1) No written requirements

7.36 The fact that no requirements as to form exist *a fortiori* precludes specific rules as to the means whereby a contract is concluded. In such a context, the ordinary rules of offer and acceptance, for an identifiable consideration, will apply. In *Kennedy v. London Express Newspapers*[35] an advertisement in a

32 See PEICL, pages 95-6 for details.

33 PEICL, page 93.

34 PEICL, page 104.

35 [1931] IR 532: see also *London v Accident Insurance Co* (1904) 43 ILTR 271.

newspaper giving readers the benefits of insurance cover was held to have led to a concluded contract when the reader completed a document providing the *Daily Express* with details of registration by way of a letter posted in Dublin. No actual registration mechanism formed a part of the means of concluding the contract.

7.37 A similar degree of flexibility is expected of the judiciary when doubts arise about the terms upon which the contract has been concluded. An offer to take out standard insurance from a specific insurer will impliedly constitute a willingness to contract on the insurer's usual terms of cover: *Sanderson v. Cunningham*.[36] Where performance of the contractual obligations in respect of which insurance cover is sought has begun, the fact that no contract documentation has been issued is irrelevant.[37] As long as any subsequent documentation is in accordance with any verbal assurances and the usual terms, the formal documents will be operative. It may of course not be possible to adduce parol evidence to add to, vary or contradict the usual terms of cover.[38] Any contract documentation that seeks to delay the commencement of a contract until a stated event such as the payment of the first premium[39] or the delivery of the policy[40] may however negative a contract on the basis that until delivery of the premium or the policy, as the case may be, there is no *animus contrahendi* and the event will be viewed as condition precedent to the existence of the contract.

7.38 Where an insurance contract is concluded on the basis of a mistake, the question whether the mistake is operative is determined by the standard rules of common law and equity,[41] including those applicable to the remedy of rectification.[42]

7.39 These factors persuade the Commission that there is no need to introduce a formalities requirement into Irish law. For the sake of greater clarity on this question, the position of the authors of the PEICL on this point, should be adopted. Article 2:301 provides, under the heading, "manner of conclusion":

> "An insurance contract shall not be required to be concluded or evidenced in writing nor subject to any other requirement as to form. The contract may be proved by any means, including oral testimony."

7.40 *The Commission provisionally recommends that legislation should provide that it is not a necessary pre-condition to the validity of an insurance contract that it be in writing. The contract may be proved by any means, including oral testimony.*

(2) The Provision of a Policy Document

7.41 While the Commission does not see any need for rules requiring a contract to be concluded or evidenced in writing, a general requirement that the policy itself should be provided to the insured, along with the contractual details that must be furnished prior to the conclusion of the contract, seems to be unobjectionable as a general principle. The authors of the PEICL provide in Article 2:501 that the policy, and the twelve items listed in Article 2:301 (insofar as they are not included in the policy) should be issued to the proposer "when concluding the insurance contract".

7.42 On the assumption that the insurer has provided the pre-contractual information in a timely manner, the question that arises is whether the obligation to issue the policy document should be contemporaneous with the conclusion of the contract, as the PEICL envisages. This is, in the view of the Commission, a rather onerous obligation, particularly in sectors where preliminary cover is sought or documents need to be prepared or reviewed. For this reason, the Commission would suggest that the

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36 [1919] 2 IR 234.

37 *Slattery v CIE* (1972) 106 ILTR 71.

38 *S.E. Lancs Insurance Co. v. Croisdale* (1981) 40 Lloyd's Rep. 22.

39 *Canning v Farquhar* (1886) 16 QBD 727.

40 See MacGillivray, para. 2-048.

41 *Stapleton v Prudential Assurance* (1928) 62 Ll LR 56: *Kyle Bay Ltd v Underwriters* [2007] EWCA Civ 57.

42 Eg *Irish Life Assurance Co v Dublin Land Securities* [1989] IR 253.

policy should be issued within fifteen working days of the contract being concluded. This requirement will be important when seen in the light of the cooling off period, considered below.

7.43 The Commission provisionally recommends that, subject to a cooling-off period (if any), the insurer should transmit the insurance policy document to the insured within fifteen working days of the contract being agreed.

(3) A Right of Withdrawal or Cooling Off Period

7.44 The Distance Marketing of Financial Services Regulations[43] currently provides a cooling off period of 14 days for financial services, save in respect of life assurance which is set at 30 days. Cooling off periods are a feature of the broader Community contract *acquis* and the 2011 Consumer Rights Directive[44] seeks to harmonise the right of withdrawal to a standard period of 14 days. The Distance Marketing of Financial Services Regulations however contain a provision postponing the commencement of the cancellation right until the pre-contract requirements for financial services are complied with: Regulation 11(6).

7.45 The authors of the PEICL suggest that a right of withdrawal or cooling off period should apply generally, and the proposed text is found in Article 2.303.

> "(1) The policyholder shall be entitled to avoid the contract by giving written notice within two weeks after receipt of acceptance or delivery of the documents referred to in Article 2:501, whichever is the later.
>
> (2) The policyholder shall not be entitled to avoid the contract when
>
> (a) the duration of the contract is less than one month;
>
> (b) the contract is prolonged under Article 2:602;
>
> (c) it is a case of preliminary insurance, liability insurance or group insurance."

7.46 The authors of the PEICL acknowledge that the Distance Marketing of Financial Products Directive is the source of this obligation, although the right to avoid the contract under that Directive is only displaced by short term insurance policies of less than one month.[45] The other exceptions contained in Article 2.303(2)(b) and (c) of PEICL are specifically required so as to provide that a new policy or in cases where preliminary cover (e.g. on foot of a cover note) or the policy is effected in order to protect third parties by way of liability insurance and group insurance.

7.47 The Commission recognises that the extension of a right of withdrawal from the specific circumstances provided for in the Community *acquis* is a radical step that might have a significant impact upon all sectors of the Irish insurance market. Such a universal right of withdrawal might not be in the best interests of the insured, particularly when the insured has been provided with detailed information on the essential nature of the contract prior to conclusion of the contract, as well as a copy of the actual policy, *post hoc*. However, it is possible to argue that a right of withdrawal is the logical conclusion to be drawn from those pre-existing rights to information and policy documentation. The vast majority of insureds will not exercise a right of withdrawal.

(4) The PEICL and Notices to be provided by and to the Insurer

7.48 The PEICL however is quite prescriptive in relation to notices, most of which are specifically required to be in writing. For example, written notice of an intention to vary or terminate a contract for breach by the applicant of the duty to inform the insurer of circumstances must be given within one month of the breach being known.[46] Notice of avoidance for the fraud of a policyholder must also be given in

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[43] SI No. 853 of 2004.

[44] The Consumer Rights Directive does not have any application to the Distance Marketing of Financial Services Directive.

[45] See Article 6(2)(b) – "travel and baggage insurance policies or similar short term insurance policies of less than one month's duration".

[46] PEICL, Article 2:102(1).

writing within 2 months of the fraud becoming known to the insurer.[47] Protection against unilaterally imposed changes in respect of an application for cover and the policy document are also provided via a requirement that differences in the policy should be both highlighted in the policy and by notice in bold print of the right to object to changes.[48] A general duty to provide a policyholder with information, without undue delay, of all matters relevant to the performance of the contract requires that the policyholder's request, and the information in question, must be in writing.[49] Termination rights for non-compliance with precautionary measures must also be effected via a written notice to the policyholder within one month of non-compliance becoming known to the insured[50] and termination for non payment of premiums also contain invoicing and documentation rights under PEICL, Article 5, and notice of an insured event occurring also envisage notice within a stated and reasonable period of time, not being shorter than 5 days.[51]

7.49 The Commission considers that these extremely detailed rules are too prescriptive and would not favour their adoption other than in the form of best practice guidelines. The Commission would favour less prescriptive rules and takes note of the existing consumer protection legislation, in particular, the *European Communities (Distance Marketing of Consumer Financial Services) Regulations 2004*[52]*.* Schedule 1 and 2 of the 2004 Regulations provide comprehensive lists of what information and notices must be given to a consumer before entering into a distance contract for the supply of financial services. While it may be necessary to tailor these regulations to address specific issues that arise in relation to insurance contracts, they do provide useful and clear guidance for any proposed legislation governing insurance contracts.

7.50 The Commission provisionally recommends that legislation should provide that insurance contracts be subject to prescribed requirements of notices, notification and forms that are comparable to those already found in existing consumer protection legislation, such as the European Communities (Distance Marketing of Consumer Financial Services) Regulations 2004. The Commission also provisionally recommends that legislation should include a statutory duty on insurers to provide a proposer with the prescribed requirements of notices, notification and forms. The Commission invites submissions on the precise nature and content of such prescribed requirements.

(5) How Information is to be provided

7.51 Irish law is also not very clear in relation to prescriptive rules on the presentation of information, as distinct from detailing what must be disclosed.[53] The Financial Regulator's Consumer Code does have a number of provisions requiring, for example, information to consumers to be "of a print size that is clearly legible.[54] The Code requires that insurance warranties and endorsements set out in quotation documents "must not be detailed in smaller print than other information provided in the documents".

7.52 The Commission considers that the question of how consumers are informed about the policy under negotiation is of critical importance. In this regard, the work of the Australian Law Reform Commission, undertaken nearly 30 years ago, remains important. While the ALRC ultimately decided against prescribing binding rules on print size, legibility, and plain English in the draft Insurance Act, the ALRC did suggest that a standard of legibility "should be prescribed by regulation".[55] The Report also

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[47] PEICL, Article 2:104.

[48] PEICL, Article 2:502(1).

[49] PEICL, Article 2:702(2).

[50] PEICL, Article 2:102(2).

[51] PEICL, Article 2:101(1). This does not involve documentary notice but the "stated" element suggests some contractual agreement on such a key point.

[52] SI No. 853 of 2004

[53] *Insurance Act 1936*, s.61: *Sale of Goods and Supply of Services Act 1980*, s.52(1).

[54] Whether illegibility can vitiate a policy term was considered in *Koskas v Standard Marine Insurance Co* (1926) 25 U.L. Rep. 363. The case is inconclusive on the point.

[55] Report No. 20, *Insurance Contracts* para. 38.

contains interesting and helpful advice on comprehensibility.[56] The Commission has noted that a considerable amount of work has gone into the broader question of how electronic media can be used in order to meet the needs of contracting parties, both in general commercial transactions and within the insurance sector. Legislation in the insurance sector is already in the process of being enacted in Australia and some Canadian Provinces. The Commission consider that an Irish initiative on this important topic would be timely for customers and commercially valuable to the Irish insurance industry.

(6) Information on Renewal: Information upon refusal of a proposal?

7.53 There are specific provisions in Irish statute law that require an insurer to provide information upon renewal of a policy which are intended to allow the insured to "shop around" for cover.[57] While there are no express statutory obligations requiring an insurer to explain the grounds upon which a decision to decline a proposal or to renew a policy exists, this situation is one that causes considerable difficulties for a proposer. It may be, for example, that a proposal has been declined or a renewal refused for organisational or underwriting considerations that are unrelated to the risk in question. Yet if the proposer fails to disclose that a proposal has been declined or the proposer gives an incorrect answer, even if the proposer genuinely and in good faith believes that such an event is of no significance, there may be grounds upon which a subsequent claim can be avoided for non-disclosure or misrepresentation. One way to avoid such circumstances can be provided by imosing or implying a duty to provide the proposer with a general statement explaining the decision to decline a proposal. In the absence of some express undertaking, Irish law does not impose upon insurers a general duty to explain why a proposal has been declined or an expiring policy will not be renewed. In *Carna Foods Ltd v Eagle Star Insurance Co*[58] the Supreme Court refused to imply a business efficacy implied term into a contract of insurance when the insurer decided not to renew a policy on the basis that the contract did not need such a term for it to function adequately. Clearly the Supreme Court was concerned about how the scope of such a term could be framed and enforced.

7.54 Efforts have also been made to take the implied term a step further by arguing that the Medical Defence Union has a duty to afford professional indemnity insurance and these too have failed.[59]

7.55 The disgruntled applicant might be able to resort to making a data protection request but in the light of English case-law it is by no means clear that such a request will be successful. In *Johnson v Medical Defence Union*[60] a majority of the Court of Appeal, via a highly artificial process of reasoning indicated that no processing of personal data had taken place so no relevant fair processing principle had been breached. It is clear that the Data Protection principles were not intended for the kind of use to which Dr Johnson sought to employ them, and it is clear that Dr Johnson at least was given an explanation about why his professional indemnity insurance was being withdrawn. Other applicants are not so fortunate and it is the generality of proposers that the Commission is concerned with.

7.56 This question appears to be a controversial one in Ireland at the present time. The Commisssion do acknowledge the arguments against any requirement to provide information in cases where the reasons for declining to renew cover are based upon confidential information or sensitive data that it would not be appropriate for the insured to have access to; however, the Commission would like to open up a debate on whether there are situations in which reasons for refusal are provided by insurers under existing best practice standards and the Commission invites submissions on this matter.

56 See also Case Studies 22 and 65 of *The Insurance Ombudsman, 1992-1998.*

57 Non-Life Insurance (Provision of Information)(Renewal of Policy of Insurance) Regulations 2007 (SI No. 74 of 2007): 15 day notice of renewal of a policy and the terms of renewal and a no claims bonus certificate for motor insurance.

58 [1997] 2 ILRM 499; *Sweeney v Duggan* [1997] 2 ILRM 211.

59 *Medical Defence Union v Department fo Trade* [1980] 3 IR 621; *Barry v Medical Defence Union* [2005] IESC 41.

60 [2007] EWCA Civ 262.

CHAPTER 8 THE DUTY OF UTMOST GOOD FAITH - POST CONTRACTUAL ASPECTS

A Introduction[1]

Section 17 of the *Marine Insurance Act 1906* states: “A contract of Marine Insurance is a contract based upon the utmost good faith, and, if the utmost good faith is not observed by either party, the contract may be avoided by the other.”

8.01 This proposition is regarded widely as expressing a principle that is applicable to marine and non marine insurance contracts. Within the context of pre-contractual non-disclosure dispute in regard to property insurance, the Supreme Court has affirmed that the:

> “contract of insurance requires the highest standard of accuracy, good faith, candour and disclosure by the insured when making a proposal for insurance…[a]ny misstatement in the answers given, when they relate to a material matter affecting the insurance, entitles the insurance company to avoid the policy and repudiate liability if the event insured against happens.”[2]

8.02 The Supreme Court has also mentioned with approval[3] Lord Mansfield’s *Carter v Boehm* explanation of the duty of good faith as extending into the area of non disclosure as well as misrepresentation. Lord Mansfield explained that the

> “Reason for the Rule which obliges parties to disclose, is to prevent fraud and to encourage good faith. It is adopted to *such* facts as vary the nature of the contract; which one privately knows, and the other is ignorant of and has no reason to suspect.”[4]

8.03 In this Consultation Paper the Commission has decided not to examine the law of marine insurance, nor related areas of insurance relating to aviation and transport insurance which are commonly placed on a marine insurance basis. This Consultation Paper does not examine the difficult question of what differences exist *vis-à-vis* the section 17 duty of utmost good faith and the duty of good faith at common law. The Commission notes that the Englsh and Scottish Law Commissions have considered this question[5] and do not consider that there is any significant difference in terms of the substantive content of either duty. The Law Commissions’ view is in accordance with that expressed by McCarthy J

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1 Ahern, “The Formation of Insurance Contracts and the Duty of Insurers” [2009] CLP 84; Bennett, “Mapping the Doctrine of Utmost Good Faith” [1999] LMCLQ 165; Davey, “Unpicking the Fraudulent Claims Jurisdiction in Insurance Law” [2006] LMCLQ 42; Merkin and George, “The Continuing Duty of Utmost Good Faith” (1998) 10 SA Mercantile LJ 135; Merkin and Lowry, “Good Faith and Breach of Warranty” [2004] LMCLQ 158; Longmore, “An Insurance Contracts Act for the New Century?” [2001] LMCLQ 356; Lowry and Rawlings, “Insurers, Claims and the Boundaries of Good Faith” (2005) 68 MLR 82; Campbell, “The Nature of an Insurer’s obligation” [2000] LMCLQ 42; Rose, “Information Asymmetry and the Myth of Good Faith” [2007] LMCLQ 181; Ryan, “Moral Hazard and the duty of disclosure” [2007] CLP78; Soyer, “Continuing Duty of Utmost Good Faith in Insurance Contracts” [2003] LMCLQ45; Tarr, “Fraudulent Insurance Claims” [2008] JBL 139; Thomas, “Fraudulent Insurance Claims” [2006] LMCLQ 485.

2 Kenny J in *Chariot Inns Ltd v Assicurazione Generali Spa* [1981] IR 199 at 225.

3 *Aro Road and Land Vehicles Ltd v Insurance Corporation of Ireland* [1986] IR 403. See Lord Hobhouse in *The Star Sea* [2001] UKHL 1, [2003] 1 AC 469, at para 49.

4 (1766) 3 Burr 1905 at 1911.

5 *Reforming Insurance Contract Law: Issues Paper 7: The Insured’s Post-Contract Duty of Good Faith* p.1 (2010).

in the *Aro Road* case who wrote that "good faith is not raised in its standard by being described as the utmost good faith; good faith requires candour and disclosure, not, I think, accuracy in itself."[6] The Law Commissions have suggested that any statutory formation should drop the reference to "utmost", a position already taken in the PEICL Article 1:104 with particular regard to be "had to the need to promote good faith and fair dealing in the insurance sector, certainty in contractual relationships, uniformity of application and the adequate protection of policyholders."

8.04 It is arguable that the references in Article 1:104 of the PEICL provide additional guidance on how contract rules should be interpreted and applied, over and above the need for good faith.

B Rationale for the duty of utmost good faith

8.05 The Law Commissions observe that it is right that the law should provide safeguards against the moral hazards of insurance particularly the possibility that policyholders may lie, or insurers may delay in processing a claim. Insurance is:

> "a bargain in which one party pays money to another not in return for goods or services but for a promise to pay should a particular event occur. The insurer has to be confident that the policyholder has provided a fair presentation of the risk, and has acted honestly in making a claim. Policyholders have to be confident that their claims will be considered in a fair an unbiased way. Mutual duties of good faith reinforce the parties' contractual arrangements."[7]

8.06 While the duty of good faith is most readily identified with a proposer's duty to make full disclosure, the duty is a mutual duty that can be invoked by the proposer. Lord Mansfield said as much in *Carter v Boehm*, and Eggers, Picken and Foss give a number of instances where a misrepresentation made by an insurer could give rise to liability.[8] However, in relation to non disclosure by an insurer to an insured, the leading English case[9] holds that liability in contract, tort and the *Misrepresentation Act 1967* cannot be established *vis-a-*vis damages: the sole remedy that is available following on from breach of the mutual duty of good faith is limited to avoidance. Damages are not available for breach of the mutual duty, which, in a post contractual setting is wholly one sided as a remedy, of value to the insurer only, and affording the insurer a disproportionate benefit by allowing the insurer to retrospectively avoid the liability to indemnify the insured.

8.07 It should be highlighted at the outset that there are no Irish cases that support a general duty of post contractual good faith. It is also evident that there is scant authority in other countries, other than where statute mandates such a proposition.[10] Eggers, Picken and Foss[11] challenge recent assertions that there is no such post contractual duty, relying essentially upon one case to support the existence of such a duty.[12] Hirst J formed the view that there was a post-contractual duty of good faith on the basis of *dicta* in cases concerning held covered clauses[13] orders for ship's papers[14] and fraudulent claims.[15] On this

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6 [1986] IR 403 at 413.

7 Issues Paper 7 p.1.

8 Eggers, Picken & Foss, *Good Faith and Insurance Contracts,* 3rd ed (ISBS 2010) at 201-2; see *Duffell v Wilson* (1808) 1 Camp. 401 for an early example.

9 *Banque Financiere de la Cite v Westgate Insurance Co* [1990] 2 All ER 947.

10 Eg Australia, *Insurance Contracts Act 1984*, sections 13 and 14.

11 Eggers, Picken & Foss, *Good Faith and Insurance Contracts,* 3rd ed (ISBS 2010) at 243. See Morison J in *Bonner v Cox* [2004] EWHC 2963 (Comm), following *The Star Sea*: "post contract the source of the obligations must be found in the contract; there is no concept of a free standing duty of good faith after the contract has been concluded… no general duty of "fair dealing" or disclosure."

12 *The Litsion Pride* [1985] 1 Lloyd's Rep 437 at 509-512.

13 *Overseas Commodities Ltd v Style* [1958] 1 Lloyd's Rep 546: *Liberian Ins Agency v Mosse* [1977] 2 Lloyd's Rep 560.

and other points, *The Litsion Pride* was overruled in *The Star Sea.*[16] In Canada it has been held that the concept of utmost good faith "plays no part when it comes to an allegation of fraud in the proof of loss": *Tumbles Video Ltd v INA Insurance Co of Canada.*[17] It is certainly arguable that enthusiasts for a general post contractual duty require section 17 of the *Marine Insurance Act 1906* to carry more weight than it can realistically sustain.

8.08 Critics of a post contractual duty of good faith point to not only the inherent vagueness of the duty and the fact that the remedy of avoidance found in section 17 is inappropriate. Lord Hobhouse, in *The Star Sea* said that, apart from some reinsurance situations "it is hard to think of circumstances where an assured will stand to benefit from the avoidance of the policy for something that has occurred after the contract has been entered into."[18]

8.09 There are good policy reasons why the duty of pre-contractual good faith on both sides – *ie* the duty to make disclosure and not to misrepresent matters of fact – should be supported. It is generally cheaper and easier for proposers to disclose what they already know, or may be able to readily discover (be the most effective source of information in other words) than for an insurer to have to investigate circumstances and phycical and other conditions, perhaps at some remote place. Nevertheless, there are equally valid reasons why it may be appropriate for the insurer to separately evaluate "the risk", (eg examine a site or locality for the purposes of property insurance), failure to do so constituting a waiver of the duty of disclosure. The insurer will be in the best position to assess risk when the proposer has no special knowledge or no appreciation of the risk. The Commission believe that the provisional recommendations made on recasting the duty of disclosure to a redacted duty that genuinely depends on disparity of information will more appropriately reflect the spirit of Lord Mansfield's views in *Carter v Boehm.* Rose provides three interesting explanations for the exceptional nature of the utmost good faith obligation in insurance law, isolated as it generally is in the common law:

> "The first is formal. Simply, the pre-contractual duty of disclosure is established by judicial and statutory authority so cannot be overcome without legislative intervention, until which time it remains as a base for potential expansion. A second possibility is psychological. The duty of disclosure is commonly articulated superlatively within a more grandly expressed idea – utmost good faith – and it is also expressed in terms of an ancient and dignified language (*uberrima fides* or *uberrimae fidei*) – as indeed is the best known emanation of the contrary general principle (*caveat emptor*). This both enhances its apparent authority and seems to have encouraged an indiscriminate and symbiotic association between different expressions of good faith and duties to disclose. Thirdly, there has been habitual conditioning…judiciary seems to have accepted that constant reference to post-contractual duties of good faith and disclosure – often unaccompanied, indeed perhaps because unaccompanied, by specific illustrations of their practical application – has given them some form of validity which may now need to be removed rather than simply denied. The law has been allowed to appear more complicated than it really is, and to be given support for becoming so."[19]

8.10 The concept of *uberrimae fides* or *uberrimae fidei* itself has not been universally acclaimed as an essential part of insurance law. In South Africa the Court of Appeal, in *Mutual and Federal Insurance Co Ltd v Oudtshoorn*[20] saw no real role for utmost good faith in Roman Dutch Law.

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14 *Leon v Casey* [1932] 2 KB 576 and *China Traders Ins Co Ltd v Royal Enchange Assurance Corp* [1898] 2 QB 187; *Boulton v Holder Bros & Co* [1904] 1 KB 784; *Harding v Bussell* [1905] 2 KB 83.

15 *Britton v Royal Ins Co* (1866) 4 F&F 905, 909.

16 [2001] UKHL 1, [2003] 1 AC 469.

17 [1992] 2 WWR 66: *Saskachewan Crop Insurance Crop v Deck* [2008] 8 WWR 501.

18 [2001] UKHL 1, [2003] 1 AC 469, at para. 57.

19 [2007] LMCLQ 181, at 195.

20 1985 1 SA 419; Joubert JA said that utmost good faith was unknown to Roman law. For a discussion on PEICL and the duty of disclosure in Dutch law see *Delfos-Roy* (2011) 19 ERPL 71.

8.11 The most visible demonstration of utmost good faith is the duty on insureds not to submit fraudulent claims. The way in which this aspect of the post contractual duty of utmost good faith has been supported by some judges – whether it is seen as related to s.17 of the 1906 Act, or is an implied term in an insurance contract itself – has no real impact on the rationale that stands behind the requirement that an insured must not submit a fraudulent claim.

> "The logic is simple. The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain: if it is unsuccessful, I will lose nothing."[21]

8.12 In *Aviva Insurance Ltd v Brown*[22] the insured made a claim for subsidence damage to his home. The claim was a valid one but in putting forward his claim in respect of alternative accommodation he indicated that a named property was available to rent and it was owned by someone other than himself. The insured owned the property and it was not in fact on the rental market. Holding that the misrepresentation was not "insubstantial", "insignificant" or "immaterial", Eder J held that £176,951.78, paid for repairs due was to be repaid as the claim was tainted by fraud,

> "this conclusion might seem harsh but it seems to me that it is the inevitable results of the conclusions I have reached on the facts and the well-established policy of the law, set out, in the authorities I have already cited."[23]

8.13 There are some post contractual situations that have been regarded as involving good faith issues. Longmore LJ, in the *Mercandian Continent*[24] suggested that post contractual duties of good faith may arise when the insured or the insurer seeks to vary the contractual risk. As these situations are regarded as analogous to negotiating a new contract, a misrepresentation will avoid the term as to variation.[25] The same position holds in respect of misrepresentations made at renewal of a contract.[26] In both these instances the earlier contract is not rendered void *ab initio* and thus add little or no support to the existence of a general good faith doctrine. The Commission consider that these duty of disclosure cases do not strengthen any argument that a post contractual duty of good faith exists, at common law, by analogy with section 17 of the *Marine Insurance Act 1906*; the Commission believe that those cases reflect the essentially *ad hoc* nature of the duty.

8.14 Nevertheless, there are instances where the contract of insurance may contain express or implied terms requiring the insured to provide information to the insurer. These situations were examined by the Law Commissions in Issues Paper No.7, largely in the context of Articles 4:201 and 4:202 of the PEICL which impose obligations on the parties to notify each other of changes in circumstances which either aggravate the risk or effect a material reduction of the risk.[27] This mechanism was also found in the ill fated proposed Insurance Directive from the late 1970s and it is an essential part of the European Insurance scene because insurance contracts tend to run for long periods (as distinct from the UK and Irish models which are short term or revolve around annual renewals).

8.15 The Commission see no need for specific provisions about change in circumstances. Insurers themselves are well able to identify and seek to insist on circumstances being communicated as a matter of contractual obligation, and insurers use conditions, exemptions and temporal restrictions to protect their interests. Adding a generalised duty of this kind would cause uncertainty and would in the Commission's view be unnecessary. The Commission agree with the Law Commissions that notification

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21 Lord Hobhouse in *The Star Sea* [2001] UKHL 1, [2003] 1 AC 469 at para. 62.

22 [2011] EWHC 362 (QB).

23 *Ibid,* para 122, citing *The Star Sea* [2001] UKHL 1, [2003] 1 AC 469; *Britton v Royal Insurance Co* (1866) 4 F & F 905; *Galloway v Guardian Royal Enchange (UK)* [1999] 2 Lloyd's Rep IR 209.

24 [2001] EWCA Civ 1275.

25 Eggers, Picken and Foss, *Good Faith and Insurance Contracts,* 3rd ed (ISBS 2010) at para. 16.50 – 16.54.

26 Eggers, Picken and Foss, *Good Faith and Insurance Contracts,* 3rd ed (ISBS 2010) at para. 10.38 – 10.40.

27 Issues Paper 7, para. 6.29 – 6.47. See also Smith, The Effect of subsequent increases of risk on Contracts of Insurance [2009] LMCLQ 366.

clauses have no obvious "good faith" characteristics inherent in them and that satisfactory control of these clauses can be left to the judiciary who can and do interpret them restrictively.

C Post contractual duty of good faith – the duty not to make a fraudulent claim

8.16 English case-law in recent times has been generally emphatic in holding that an insured is under a duty not to make a fraudulent claim. The basis of the duty however is a matter upon which the judges have differed. For our purposes the statutory basis, section 17 of the *Marine Insurance Act 1906* can be left to one side: although the *Litsion Pride*[28] provides support for affording an "utmost good faith" basis for this duty, *Manifest Shipping Co. Ltd v Uni-Polaris Shipping Co. Ltd (The Star Sea)* effectively overruled *The Litsion Pride.* In that case Hirst J had ruled that the duty extended to the giving of information on the voyage being undertaken. The House of Lords criticised the view that, absent a breach of contract, avoidance of the policy could be available outside the framework of the 1906 Act. Lord Hobhouse indicated that forfeiture, as a common law remedy that prevented a fraudulent claim form being met, was both the correct and most desirable remedy. Alternative views on the correct judicial basis of the duty not to make fraudulent claims that were canvassed prior to *The Star Sea* have focused on an implied contractual term, but these judgments[29] are now incompatible with *The Star Sea*. Eggers[30] *et al* are prepared to argue that, conceptually, the duty not to make a fraudulent claim can be accommodated under the duty of utmost good faith and that both the weight of authority,[31] and the information imbalance that is at the core of the duty, favour this approach. While the House of Lords in *The Star Sea* were concerned to limit both the scope of post contractual duties of good faith and the avoidance of the contract remedy, Eggers argues that the law requires a rule which will deter insurance fraud while at the same time averting the prospect that avoidance, as an inflexible remedy, can be a possible source of injustice. The Commission agrees with this perspective and would support the view that Irish law should attempt to provide a flexible response to the fraudulent claims problem, whilst eschewing difficult questions of definition eg "forfeiture" of claims as distinct from contractual rescission, "avoidance", whether retrospective or prospective. The Commission will examine this issue in Chapter 10, Remedies.

8.17 The Law Commissions have examined post *The Star Sea* case-law and have apparently not endorsed the analysis of Longmore LJ in *The Mercandian Continent*[32] in which an attempt was made to align pre and post contractual good faith by requiring the non disclosure or misrepresentation to be material and to have induced the contract. The Law Commission notes that MacGillivray comments that this is not an onerous standard for the insurer to meet – "in most cases, the fraud is material and would be sufficient to allow the insurer to repudiate" under section 17.[33] A bolder attempt to clarify the law was made by Mance LJ in *Axa General Insurance Ltd v Gottlieb:*[34]

> "there is no basis or reason for giving the common law rule relating to fraudulent claims a retrospective effect on prior separate claims which have already been settled under the same policy before any fraud occurs. It is unnecessary to reach any conclusion on this case on the

[28] [1985] 1 Lloyd's Rep 437.

[29] Eg *Orakpo v Barclays Insurance Services* [1995] LRLR 443 *per* Hoffmann LJ, outlining a theory of repudiatory breach by way of the making of a fraudulent claim, fraud going to the root of the contract (p.451).

[30] Eggers, "Utmost Good Faith and the Handling of Claims" in Soyer, *Reforming Marine and Commercial Insurance Law*, at 243.

[31] *Britton v Royal Insurance Co* (1866) 4 F & F 905; *Lek v Mathews* (1927) 29 Ll.L. Rep. 141; *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 209.

[32] [2001] EWCA Civ 1275.

[33] Issues Paper 7, para. 2.19. See also Eggers, "Utmost Good Faith and the Handling of Claims" in Soyer, *Reforming Marine and Commercial Insurance Law at*.247.

[34] [2005] EWCA Civ 112.

common law position relating to separate claims which are still unpaid at the time of the fraud…"[35]

8.18 In *Agapitos v Agnew (No 1)*[36] a warranty in a policy against port risks required a certificate from the London Salvage Association prior to "hot work" being carried out. After commencement of the litigation of a claim for a loss caused by fire the assured disclosed statements of hot works occurring before the fire. The insurers applied to amend its defence to plead that the insured had a post-contractual duty of good faith and was in breach of it, so as to entitle them to avoid the policy. However, the Court of Appeal held that the rule whereby fraud in attempting to enforce a claim operated to defeat the claim was not part of a post-contractual duty of good faith derived from the *Marine Insurance Act 1906*, s 17; in any event, as in *The Star Sea*, once litigation had begun the matter was governed by procedural rules of litigation.

D Non payment of a fraudulent claim, not avoidance of the policy

8.19 It is now clear that the principle denying recovery on a claim made by a person who has fraudulently exaggerated the loss, the claim itself being otherwise valid, is a special rule of insurance law.[37] Efforts to extend this rule into personal injury claims[38] outside the insurance contract have been rejected, whether the dishonesty seeks to benefit that individual[39] or a third party.[40] The fact that this rule is specific to insurance and that it pre-dates the 1906 Act – *Britton v Royal Insurance Co*, is a fire insurance case after all – suggests that there is much to be said for Mance LJ's view that the common law principle governing fraudulent claims has a separate origin and existence to any principle that exists under, or by analogy with, section 17 of the *Marine Insurance Act 1906*.[41] After noting that counsel for the insurer was pressing for an interpretation of the forfeiture principle in relation to fraudulent claims that would have had a similar effect to avoidance *ab initio*, Mance LJ decided that the effect of the forfeiture rule does not to enable the insurer to recoup payments made earlier during the life of the policy when those claims were valid and untainted by fraud.

8.20 To summarise, English case-law seems to be setting down around the proposition that the forfeiture of fraudulent claims provisions can be based upon the express terms in the contract, but that even if there are no such express terms, a fraudulent claim will be forfeit as a matter of common law. The forfeiture operates on the claim and is not a facet of any common law duty of utmost good faith or section 17 of the *Marine Insurance Act 1906.*

8.21 However, it would be desirable to legislate to carify what the appropriate penalty should be in the context of a fraudulent claim. Unlike pre contractual fraud, whereby the common law declared the contract to avoid *ab initio*, there is no doubt that post contractual fraud disentitles the claimant from recovering on it but that a valid contract subsists. The Law Commissions[42] cite the Scottish case of *Fargnoli v GA Bonus Plc*[43] as clarifying this point. It would be helpful if a declaratory statement were made in forthcoming legislation making it clear that the forfeiture of claims fraudulently made rested upon public policy considerations rather than any common law or statutory (ie section 17 of the 1906 Act) duty

35 [2005] EWCA Civ 112 at para. 22

36 [2002] EWCA Civ 247.

37 *The Star Sea* [2001] UKHL 1, [2003] AC 469; *Agopitos v Agnew* [2002] EWCA Civ 247; *Axa General Insurance v Gotlieb* [2005] EWCA Civ 112.

38 *Molloy v Shell UK* [2001] EWCA Civ 1271 *per* Laws LJ.

39 *Churchill Car Insurance v Kelly* [2006] EWHC 18 (QB).

40 *Shah v Ul-Hag* [2009] EWCA Civ 542.

41 *Axa General Insurance Ltd v Gottlieb* [2005] EWCA Civ 112.

42 Issues Paper 7, para 2.26.

43 [1997] CLC 653.

of good faith. This declaratory provision should also make it clear that the policy is not avoided by reason of the making of the fraudulent claim but that any claim made on the basis of the fraud is forfeited.

8.22 Support for this position is found in the PEICL, in the Australian Act and in Issues Papers 6 and 7 produced by the Law Commissions in 2010. Article 6:102 PEICL operates in the context of a duty placed upon an insured to respond to an insurer's reasonable requests for information and the supply of documentary evidence and information generally. Implicit in this is an honesty and accuracy requirement. As an article that is labelled as a claims cooperation provision, the article distinguishes cases of breach *simpliciter* from breach with intent to cause prejudice or breaches made recklessly and with knowledge that predjudice would result. For breach *simpliciter* a proportionality remedy *vis-a-vis* the insurance money is the remedy. In the breach with intent context, "the insurer shall not be obliged to pay the insurance money."

8.23 The Australian *Insurance Contracts Act 1984*, relating to fraudulent claims provides at section 56(1):

> "Where a claim under a contract of insurance, or a claim under this Act against an insurer by a person who is not the insured under a contract of insurance is made fraudulently, the insurer may not avoid the contract but may refuse payment of the claim."

8.24 This part of section 56 has not proved controversial. The rest of the section however has been the subject of much adverse comment, as will be shown.

8.25 In the specific context of section 17 and the *Marine Insurance Act 1906* (it should be recalled that most of the influential recent cases on the forfeiture for fraudulent claims have not been marine insurance): the Law Commissions reached the "tentative conclusion" that the section 56(1) Australian approach should be followed, a solution that the Law Commissions said was "well established and accepted."[44] The Commission will return to this question in Chapter 10, Remedies.

E Other (contractual) remedies

8.26 One question that arises is the scope of the duty of good faith and whether, by contract, remedies other than forfeiture will be available. Lord Hobhouse, in *The Star Sea* was extremely hostile to both an expansive view on the nature of the duty of good faith and the development of any post contractual duty of good faith. Any support for the idea that good faith was a continuing duty, post contract formation, was scant. Even accepting that the duty could be broken when an insured submitted a fraudulent claim, the weight of authority indicated that submission of such a claim did not give the insurer the right to treat the contract as void *ab initio*, but rather, the claim was forfeit by virtue of the fraud. Lord Hobhouse closed his analysis of the authorities by remarking that they "show that suitable caution should be exercised in making any extensions to the law of non disclosure and that the courts should be on their guard against the use of the principle of good faith to achieve results which are only questionably capable of being reconciled with the mutual obligation to observe good faith." Eggers *et al* speculate that should the parties to an insurance contract expressly provide for an insured to be under a duty not to submit a fraudulent claim, or a court be prepared to imply a term into a contract having such an effect, the applicable remedy would not be self evident, as the law stands. Clearly if the obligation is an express term the contract will be dispositive, but resort to implied terms as a source of the obligation will hardly provide a coherent basis for the remedy. Eggers cautions against expanding the law in an unbalanced and uncertain manner.[45]

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[44] Issues Paper 7, para. 4.81.

[45] Eggers, 'Utmost Good Faith and the Presentation and Handling of Claims' in Soyer, *Reforming Marine and Commercial Insurance Law,* p.229 at 235-6.

F Effects of fraud

8.27 Once the fraudulent claim is discovered, the courts hold that the entire claim is forfeit. In *Galloway v Guardian Royal Exchange (UK) Ltd*[46] the victim of a burglary submitted a claim for £18,000, including in the claim an item which did not exist which was estimated at £2,000. The entire claim was rejected. There is a *de minimis* rule which is uncertain in its application. Some judges take the view that if the fraud is an unsubstantial element in a large claim it will not necessarily taint the claim eg a loss of 0.3% of the claim in *Tonkin v UK Insurance.*[47] Eggers is critical of the *Tonkin* approach[48] but the Law Commissions appear to side with the *Tonkin* decision:

> "The courts are clearly right to reject the idea that policyholders are allowed some margin of fraud, so as to increase claims by 10%, 5% or even 1%. On the other hand, the issue of whether the fraudulent element of the claim is more than minimal must be looked at in the context of the claim itself. We think it would be wrong to state that the courts should never consider the amount of the fraud as a proportion of the claim. A misrepresentation which appears substantial in the context of a £20,000 claim may be viewed differently in the context of a £2 million claim.[49]

8.28 However, it is only the claim that is made fraudulently that is forfeit, as English[50] and Scottish[51] cases in recent years have made clear.

8.29 Generally, while the definition of fraud follows the tried and tested patterns laid down in cases such as *Derry v Peek*[52] there are some refinements. Because of the wording of some general clauses against "fraudulent devices" and "fraudulent instruments" the judicial analysis takes account of these express terms. MacGillivray explains:

> "If the assured makes a claim where he has suffered no loss or claims for a loss which he has himself caused, insurers do not need to rely on any condition relating to fraudulent claims; but in practice, where the circumstances are suspicious, it may be much easier to show that the assured has made a fraudulent statement in the advancement of his claim than it is to show that he wilfully destroyed his own property. The clause thus enables the assurers to assume a lesser burden and still defeat the claim. This approach had the full support of, at any rate, Willes J in his summing-up to the jury in *Britton v Royal Insurance Co:*
>
> "Of course, if the assured set fire to his house, he could not recover. That is clear. But it is not less clear that, even supposing it were not wilful, yet as it is a contract of indemnity only, that is, a contract to recoup the insured the value of the property insured by fire, if the claim is fraudulent, it is defeated altogether. That is, suppose the insured made a claim for twice the amount insured and lost, thus seeking to put the office off its guard, and in the result to recover more than he is entitled to, that would be a wilful fraud, and the consequence is that he could not recover anything. This is a defence quite different form that of wilful arson. It gives the go-by to the origin of the fire, and it amounts to this – that the assured took advantage of the fire to make a fraudulent claim."[53]

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46 [1999] Lloyd's Rep IR 209; *Micro Design Group Ltd v Norwich Union Insurance Ltd* [2005] EWHC 3093 (TCC); *Aviva Insurance Co v Brown* [2011] EWHC 362 (QB) shows that where the fraud is discovered before all payments have been made, it will not matter what percentage of the claim is tainted as long as it is not *de minimis*.

47 [2006] EWHC 1120 (TCC).

48 In Soyer, *Reforming Marine and Commercial Insurance Law*, p.239.

49 Issues Paper 7, para. 326, citing *Tonkin* at para 3.27.

50 *Agapitos v Agnew* [2002] EWCA Civ 247; *Axa General Insurance Ltd v Gottlieb* [2005] EWCA Civ 112.

51 *Fargnoli v GA Bonus Plc* [1997] CLC 653.

52 (1889) 14 AC 337 at 374 *per* Lord Herschell.

53 Para 19-057, citing *Britton*, reported at (1866) 4 F & F 905 at 909.

8.30 Some exaggeration of a claim is permissible when it is clear that the insured is about to commence to bargain with the insurer and the inflated nature of the claim is clear to the insurer. Some cases suggest that a deliberately inflated claim may however be proof of fraudulent intent and loss, especially when supported by a fraudulent device.[54] In the most recent English case, *Aviva Insurance v Brown,*[55] a letter written to support a claim for rental costs for a vacant house that the insured actually owned was a fraudulent device.

8.31 The leading Irish case is *Fagan v General Accident Fire and Life Assurance Corp Plc.*[56] A domestic fire insurance policy was effected by the plaintiff. A fire occurred shortly thereafter. A claim was "supported" by a list of over 20 pages of false or grossly exaggerated claims. Applying *Lek v Matthews*, Murphy J said that the facts and figures submitted were "deliberately overstated". Had the case not been one of deliberate and insupportable claims, putting an "extremely optimistic" valuation would not justify the insurer in repudiating the policy, but these facts did not fall into such a category. The *Fagan* case was mentioned by the Insurance Ombudsman of Ireland in a later adjudication.[57] *Fagan* was distinguished on the basis that while the motor vehicle insured and later stolen and burnt out had been over-valued in the proposal form a claim for the true value was only made. Surprising perhaps, a separate item, a radio that appears to have been claimed for fraudulently, did not taint the entire claim in *Fagan*.

8.32 The Commission does not seek to provide a definition of fraud in this, or indeed, any other context. However, because the policy that stands behind the forfeiture claims can lead to harsh but morally and economically defensible results, efforts have been made to soften the impact of the law. In particular Lord Justice Mance in *Agapitos v Agnew*[58] observed that while the fraudsters own appreciation of the value of the lie will suffice, there should be some objective element: Mance LJ proposed that the insurer or judge should objectively determine that the fraudulent device or means should yield a not insignificant improvement in the insured's prospects of gaining a settlement, or an enhanced settlement, or succeeding at any trial.[59]

8.33 Later English cases have developed these tests so as to deny forfeiture in respect of *de minimis* or irrelevant lies.

G Co-insurance and moral hazard

8.34 The law of agency[60] views certain kinds of insurance contract, whereby two or more persons seek to effect insurance in respect of joint property, as indivisible moral hazard situations. In accordance with the need to deter the insured from causing the loss, certain kinds of joint insurance treat all the policyholders as subject to the rule that an improper claim affects all the policyholders, regardless of knowledge or fault.

8.35 The law draws a distinction between composite insurance and joint insurance. In a composite insurance policy each policyholder has a right to enforce the policy in his or her own name and any claim made will generally not be affected by any fraud perpetrated by another policyholder. In a case of joint insurance all policyholders are linked together and a wrongful or fraudulent act by any one of them, post contract, will allow the insurer to avoid the policy against all policyholders. Whether a policy is composite or joint insurance is a matter of construction.

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54 See the cases collected by MacGillivray at paras 19-058 and 19-059.

55 [2011] EWHC 362 (QB). Evidence given in the witness box by a claimant will also taint the claim: *Yeganah v Zurich plc* [2011] Lloyd's Rep. IR 75.

56 HC Unreported February 19, 1993. For townland-wide insurance fraud, see Kavanagh, *The Green Fool* (Penguin Books, 1971) pages 125-6.

57 Digest of Cases 1992-1998 Case Study 80.

58 [2002] WECA Civ 247 at para 38.

59 *Ibid*. See the application of this approach in the fraudulent invoices cases in business interruption insurance, *Sharon's Bakery (Europe) Ltd v Axa Insurance UK Plc* [2011] EWHC 210 (Comm) being the latest example.

60 *Bowstead on Agency* p.145-6 (2010) contains a discussion on agency and married persons that is of interest.

8.36 In the case of composite insurance the obligations are several and one co-insured will not be prejudiced by the fraud of another. In *McAleenan v AIG (Europe) Ltd*[61] the plaintiff was a solicitor employed within the law firm Michael Lynn & Co. A pre contractual misrepresentation was made by Michael Lynn that the plaintiff was a partner in the firm. The plaintiff sought to claim on the professional indemnity policy obtained via the misrepresentation. One issue for Finlay Geoghegan J to decide was whether the policy was joint or several. The learned judge approved the following discussion from *Colinvaux's Law of Insurance:*

> "Joint and composite policies. Where two or more persons are insured under a single policy, it is important to determine whether the policy is joint or composite, in that the former is regarded as a single contract whereas the latter is a bundle of contracts. The distinction is based on the nature of the interests of the assureds, if the assureds share a common interest in the insured subject matter, eg where they are joint owners of a property or partners, the policy is joint. By contrast, if the parties have different interests, as in the case of a landlord and tenant or a mortgagor and mortgagee, the policy is composite."[62]

8.37 The effect of fraud on a policy of composite insurance was succinctly stated by Rix J in *Arab Bank Plc v Zurich Insurance Co,*[63] a case on a professional indemnity policy effected in this case in favour of the company and directors operating a surveying and valuation business. It is, Rix J said, "implicit in the nature of a composite policy that one assured is not prejudiced by the dishonesty of another, provided that the other is not a joint assured."[64] After holding that the policy was to be viewed as a composite policy, Finlay Geoghegan J ruled that Ms McAleenan could not be prejudiced by Mr Lynn's misrepresentation from relying on the policy. However, a gloss was added to the proposition that fraud by one co-insured will not preclude another co-insured from relying on the separate rights afforded under the insurance contract. Finlay Geoghegan J advanced two caveats:

> "The first caveat is if the policy of insurance in its express terms provides that the policy and that the insurer is entitled to repudiate against all co-insureds upon dishonest misrepresentation in the proposal by any one co-insured. The Policy herein cannot, in my view, be so construed. The second caveat…is that the relationship between the insured guilty of the dishonest non-disclosure and the innocent co-insured is such that the knowledge of the former is attributed to the latter for the purposes of the proposal form. That issue was expressly addressed by Rix J in *Arab Bank Plc* and he found at p.283 that the knowledge of the managing director was not to be attributed either to the company or the innocent directors. On the facts found herein, Mr Lynn was the employer of the plaintiff and it does not appear to me that there are either any facts or principles which permit attribution of his knowledge of the true state of affairs to her, as an employee."

8.38 In the case of fraud in respect of a policy of joint insurance the effect of fraud by one insured will taint the claim,[65] preventing another insured from recovering at all[66] unless some independent basis for a claim can be put forward.[67] In cases of joint insurance by married couples the effect of the law is

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61 [2010] IEHC 128.

62 Colinvaux, *The Law of Insurance,* 8th ed (Sweet & Maxwell 2006) para 14-03. See also *HLB Kidsons (AFirm) v Lloyd's Underwriters* [2008] Lloyd's Rep IR 237.

63 [1999] 1 Lloyd's Rep 262.

64 *Ibid* at p 272, citing *Samuel & Co Ltd v Dumas*, [1924] AC 431, *General Accident Fire and Life Assurance Corporation Ltc v Midland Bank Ltd*, [1940] 2 KB 388, *State of the Netherlands v Youell*, [1997] 2 Lloyd's Rep 440.

65 *Samuel & Co Ltd v Dumas* [1924] AC 431; *New Hampshire Insurance Co v MGN* [1997] LRLR 24.

66 On assignment see *The Litsion Pride* [1985] 1 Lloyd's Rep 437.

67 *General Accident v Midland Bank* [1940] 2 KB 388. See also where there is a compromise of a claim – *Direct Line Insurance Plc v Fox* [2009] EWHC 386 (QB).

extremely harsh. In *Direct Line Insurance Plc v Khan*[68] a claim on a policy of domestic fire insurance was inflated by adding a claim to rental accommodation for a property which Mr Khan owned. Mrs Khan was not a party to the fraud, nor did she know of her husband's misconduct. Mrs Khan's innocence did not provide any basis for relief, nor, given that the duty not to make a fraudulent claim is a rule of law, could the Unfair Contract Terms Regulations be invoked on her behalf.

8.39 English law is even stricter in relation to the possibility of repentance once the claim has been submitted. Mance LJ in *Agapitos v Agnew*[69] and again in the Privy Council in *Stemson v AMP General Insurance NZ Ltd*[70] seem to have regarded repentence as irrelevant, and certainly in *Direct Line Insurance v Fox*[71] this was the view taken of the law by Judge Richard Seymour QC.

8.40 This position has been criticised and other jurisdictions have moved some way from operating a blanket forfeiture mechanism. In cases where the fraudulent act may have some even darker purpose – one spouse sets fire to the family home seeking to murder the other spouse for example – the idea that the wholly innocent victim should be prevented from recovering on the policy because of either a ludicrous application of agency law, or an inappropriate rule of public policy that operates as a windfall to an insurance company, cannot, in the opinion of the Commission, be correct. The Law Commissions, in Issues Paper 7 note that case-law from the United States, Canada, Australia and New Zealand has introduced a "modern approach" to this question. In essence, the automatic forfeiture of all claims brought on a joint policy where one insured acts fraudulently in promoting the claim is no more. It has been replaced by the view that an innocent insured should not be punished for the wrongdoing of another. However, when a claim is brought by the innocent insured the court or indeed the insurer, as a matter of public policy, should seek to prevent the wrongdoer from benefiting from the policy. The Supreme Court of Canada in *Scott v Wawanesa Mutual Insurance Co*[72] divided by 4 justices to 3 on the interpretation of an exception clause barring recovery for deliberate fire damage caused, *inter alia* by a minor child of the householder. La Forest J, dissenting, suggested that the court should strive to give effect to the intention of the parties as of the time of entry into the contract, viewed from the perspective of an "ordinary person" entering the contract. This approach requires the court to subject the argument that all obligations in a joint policy are intertwined to an intention of the parties test, for the purpose of the contractual analysis. This approach replicates that found in the Ontario case of *Higgins v Orion Insurance Co,*[73] cited by the Law Commissions. The British Columbia case of *Riordan v Lombard Insurance Co,*[74] involved a fire insurance claim brought by members of a family, the cause of the domestic fire being an act of arson by a 13 year old foster child. While the British Columbia Court of Appeal disallowed the claim, via contractual interpretation, it has been influential in sponsoring a legislative change in British Columbia[75] which, as a matter of law, is intended to open up a route to recovery for innocent persons. These amendments provide:

> (1) [I]f a contract contains a term of condition excluding coverage for loss or damage to property caused by a criminal or intentional act or omission of an insured or any other person, the exclusion applies only to the claim of a person
>
> (a) whose act or omission caused the loss or damage,
>
> (b) who abetted or colluded in the act or omission, [or]
>
> (c) who

68 [2002] Lloyd's Rep IR 364.

69 [2002] EWCA Civ 247.

70 [2006] UKPC 30.

71 [2009] EWHC 386 (QB).

72 [1989] 1 SCR 1445

73 (1985) 17 DLR (4^{th}) 90

74 [2003] BCCA 267

75 Insurance Amendment Act 2009, s 28.6 (Innocent Co-Insured)

(i) consented to the act or omission, and

(ii) knew or ought to have known that the act or omission would cause the loss or damage

8.41 The clause goes on to require the courts to award at most, that persons proportionate interest. While this provision is intended to benefit vulnerable insureds, the section would allow that interest to be further reduced if there was any prospect that the wrongdoer could benefit, directly or indirectly, form the recovery of the insurance monies awarded to that innocent party.

> (2) Nothing in subsection (1) allows a person whose property is insured under the contract to recover more than their *proportionate interest* in the lost or damaged property.

8.42 The amendment was enacted as section 28.6 of the *Insurance Act 2009.* It is modelled on similar legislation enacted in the Provice of Alberta. The British Columbia Ministry of Finance published a February 2010 Discussion Paper which proposed to phase in the reform, requiring further legislative refinement by delegated legislation. In order to give effect to a legislative desire to protect innocent persons who are "in abusive relationships", corporate entities will not be able to mount a claim. So as to meet reservations about this reform from the insurance industry, it was propsed that a claimant under section 28.6 should submit to an examination under oath on the request of the insurer. Submissions were also sought on the broader question of whether, in the words of the Consulation Paper:

> "the regulation should also specifically require that the claimant co-operate with the insurer in its investigation of the loss and provide all relevant information and documents in addition to those required by the contract. Since these duties may apply to other insurance claims as well, setting them out here could raise the implication that they apply only in these circumstances. As well, there are concerns that concepts like "cooperate" might be too general and vague to be effectively, and fairly, administered."

8.43 Section 28.6 along with new regulations which addressed the concerns raised in the Consultation Paper was brought into force on June 16th, 2011[76]. These regulations require a claimant to co-operate with the insurer in respect of the investigation of the loss. Such co-operation includes, but is not limited to, submitting to an examination under oath and producing documents specified by the insurer that relate to the loss.The Commission consider that a procedure such as that enacted in British Columbia provides a more flexible mechanism than that found in the current English and Irish approach while not being as market insensitive as that of South Africa where the common law is seen as penal in nature. The British Columbia reforms suggest a direct and speedy mechanism which is preferable to requiring the applicant seeking to recover on the policy to show duress, undue influence or *non est factum* in litigation against the insurer.

8.44 In the Law Commission's Issues Paper 6, the "modern approach", as found in the various common law jurisdictions identified therein, is criticised as being result oriented rather than proceeding on the basis of what the contract means, as viewed at the formation of the contract: the "modern approach works backwards. The courts decide what result they wish to reach in the circumstances, and then they characterise the policy as joint or composite accordingly."[77]

8.45 This observation does not seem to be entirely fair or accurate. The same can be said of the blanket application of the forfeiture rule of law. Judges have in a joint policies context developed a forfeiture solution to a public policy question – moral hazard – that operates mechanically against innocent insureds. The Commission believes that a more flexible solution is necessary.

8.46 The Commission does agree that in relation to misrepresentations made at formation of the contract that a fraudulent misrepresentation made by one co-insured on a joint policy should be binding on all other co-insureds. The Law Commissions take this position in their Issues Paper 7. The Commission also agrees with the Law Commissions that a distinction is to be drawn between wrongful acts at formation and wrongful acts after the contract has been formed:

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76 BC Reg 115/2011

77 Issues Paper 7, para 5.46.

> "The problem is that two people may act together in taking out insurance, but may act separately at the time of the deliberate destructive act or fraudulent claim. If, for example, a wife asks her husband to take out insurance on their home we think it is fair to hold her responsible for the husband's lie on the application form. It would be unfair, however, to hold her responsible for her husband's arson or wilful fire-raising several months later, especially where this constituted an attempt on her life."[78]

8.47 The limited reform that the Law Commissions put forward on this question is as follows: a presumption should be enacted which provides that, when insurance is secured by two or more persons to insure their joint interests, any fraud committed by one party should be regarded as having been done by all parties. Should a joint policyholder prove the act or omission was not done on their behalf or with their knowledge the innocent policyholder's share of the claim should be paid.[79] On the scope of the recovery remedy the Law Commissions ask:

> "Should the legislation provide that the recovery will be limited to the innocent insured's own interest, and will only be payable if the guilty insured would not benefit from any recovery?[80]

8.48 The Commission has reached the conclusion that, on the forfeiture rule of law for post contract formation fraud, the law, as it has generally developed, rightly seeks to encourage honesty and good faith dealings in the presentation and authentication of claims.[81] The Commission agrees that the approach taken in the courts in England and Scotland in isolating section 17 of the *Marine Insurance Act 1906* from this duty is a sensible one. The remedy that would be available if section 17 (or indeed the duty of good faith at common law were to govern this situation) that is, retrospective avoidance, would be unacceptable and disproportionate in its effects.

8.49 However, the Commission also considers it odd that in the co-insurance situation the law draws a distinction between joint insurance and composite insurance for the purpose of the forfeiture provision insofar as an innocent party under a composite policy could recover even if payment on the composite policy would benefit the wrongdoer. The Commission notes that Rix J, in *State of Netherlands v Youell and Hayward*[82] suggested that even under a composite policy forfeiture may apply if in effect the wrongdoer benefits from the innocent parties' claim. The Commission thinks that any formulation of the forfeiture rule in Irish law should require the courts to "police" the innocent claim, regardless of the nature of the policy. To this extent the British Columbia proposals appear to be soundly based. On the substantive question of whether a move towards the "modern approach" should be adopted, the Commission would favour giving the British Columbia and Alberta position a detailed examination and have formed the preliminary view that this kind of legislative development would be preferable to the existing position and a more structured alternative to a broad judicial discretion along the lines of the Australian 1984 Act, section 31.

8.50 *The Commission provisionally recommends that the law should continue to provide that an insured should be prohibited from recovering on a claim by submitting a fraudulent claim or fraudulent evidence to support a claim; but that it should also provide that an innocent co-insured or beneficiary may recover on a proportionate basis; provided that the fraudulent insured cannot benefit from the policy.*

H Is there a duty in claims processing?

8.51 The two most important observations on the duty of utmost good faith that may be owed by an insurer to an insured given by the English and Scottish courts suggest a strong difference of opinion. In

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78 Issues Paper, para 5.48.

79 Issues Paper 7, paras 5.49 and 7.46.

80 Issues Paper 7, paras 5.49 and 7.46, endorsing *Higgins v Orion Insurance Co Ltd* (1985) 17 DLR (4th) 90, discussed at para. 5.28 of the Issues Paper.

81 In Chapter 10 the Commission will discuss whether a broader power to allow linked claims as part of a judicial discretion should be introduced.

82 [1997] LRLR 94.

Insurance Corporation of the Channel Islands v McHugh[83] Mance J advanced the view, within the context a counterclaim by an insured alleging unreasonableness in rejecting an insurance claim, that any fraud would breach this aspect of the duty of utmost good faith. In contrast, in *Fargnoli V GA Bonus plc*[84] Lord Penrose expressed the view, *obiter:*

> "Of course it follows from the mutuality of the obligation of utmost good faith that an insurer has similarly rigorous duties in dealing with claims. It mist be open to question whether an insurer would be in good faith in delaying an admission of liability, or in advancing spurious defences to a claim, or to put the insured to proof of what the insurer knows is true, or in delaying settlement of claims which he would, objectively, be obliged to admit before a court to be valid."[85]

8.52 In other words, fraud is a requirement in English law while the Scottish position is not so restrictive. There is however a recent Irish High Court decision[86] which appears to side with the position taken by Lord Penrose but there is no clear Irish judicial decision on this in a claims context. One could of course extrapolate from McCarthy J's speeches in *Aro Road* and *Kelleher v Irish Life* that honesty is required and that, in this context, honesty has a broader meaning than not acting fraudulently: recall the Financial Regulator's 2012 Code of Practice which requires a regulated entity in all its dealings with its customers to act "honestly, fairly and professionally in the best interests of its customers and the integrity of the market".

8.53 Despite the asserted mutuality of the principle of good faith in the *Marine Insurance Act 1906*, s 17, judicial examination of the application of the principle, not surprisingly, normally focuses on the behaviour of the proposer/insured. It is therefore useful to consider some recent examples of circumstances in which it may be argued that insurers have failed to exercise good faith.

8.54 First, it has notoriously been held, in *Sprung v Royal Insurance (UK) Ltd*[87] — paradoxically, given that insurance is presumably meant to provide the insured with protection in the event of a loss— that there is no effective sanction against an insurer who procrastinates in discharging his liability to pay an indemnity: court interest will be due but not damages for consequential loss.

8.55 Secondly, in *Drake Insurance Plc v Provident Insurance Plc*[88] an insured failed to disclose a speeding conviction which, if it had been disclosed when the contract was negotiated, would not have affected the insurer. Nonetheless, the insurer purported to avoid the policy. In the circumstances, the English Court of Appeal held that the insurer had not shown that he been induced by the non-disclosure and so was not entitled to avoid the policy. That rendered necessarily *obiter* the Court's speculation that an insurer might be disentitled to rescind for lack of good faith, in failing to ascertain whether the circumstances were in fact such that it would not have been induced by the non-disclosure. However, despite raising the possibility, the Court of Appeal generally registered a reluctance to go so far.[89]

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83 (1997) 6 Reinsurance Law Reports 374.

84 [1997] CLC 653

85 *Ibid at 376.*

86 See the unreported account in the *Irish Times* for May 13, 2009, "€30,000 awarded to solicitor or over fraud accusation against him."

87 [1999] Lloyd's Rep IR 111 (CA). See J Lowry and P Rawlings, "Insurers, Claims and the Boundaries of Good Faith" (2005) 68 MLR 82.

88 [2003] EWCA Civ 1834.

89 [2004] QB 601, 626–630, 642–643, 646–650 (per Rix, Clarke and Pill LJJ respectively) and the cases there cited, in particular *Brotherton v Asegurodora Colseguros SA (No. 2)*; [2003] Lloyd's Rep IR 746; noted R Gay [2004] LMCLQ 1 (rejecting Colman J's view in *Strive Shipping Corp v Provident Ins Plc (The Grecia Express)*; [2002] 2 Lloyd's Rep 88) that the insurer's right to avoid is dependent upon the insurer's good faith or good conscience)..

8.56 Thirdly, in *Diab v Regent Insurance Co Ltd (Belize)*[90] the insured argued that the insurer's entitlement to rely on a term was subject to a duty of good faith to warn the insured that he had to act promptly in making his claim. The Privy Council stated *obiter* that good faith obligations might have been in point had the insured asked for an extension of time in providing the requisite particulars and the insurer had refused.

8.57 Fourthly, in *Goshawk Dedicated Ltd v Tyser & Co Ltd*[91] it was held by the Court of Appeal that there was in insurance contracts made in the Lloyd's market an implied term that placing and claims documents which have previously been shown to underwriters, and premium accounting documents which are necessary for the operation of the contract, where retained by the insureds' Lloyd's brokers, should be available to the underwriters in cases of reasonable necessity. Rix LJ, effectively delivering the judgment of the Court of Appeal held that "the implication is to be made on the traditional basis that it is necessary for business efficacy".[92] Rix LJ added that the duty of good faith extends to other classes of documents as well: "An example of such an implication, made for the purposes of business efficacy but informed by the insurance context of good faith, can be found in *Phoenix General Insurance Co of Greece SA v Halvanon Insurance Co Ltd*,[93] where Hobhouse J accepted an implied term which extended to the obligation to keep proper accounting records and to make them reasonably available to reinsurers as being something which 'would probably be imported anyway by the duty of good faith'."[94] In both *Goshawk* and *Phoenix* the court's decision was, in the absence of a governing rule expressed by law or contract, focused on and correctly arrived at by the traditional process of implication of a term for business efficacy. In both cases, there are *obiter dicta* that the decision is supported by "the duty of good faith". But in neither case was consideration given to the implications of recasting the duty as one of good faith.

8.58 In summary, a duty of good faith on the insurer has been conceded by Lord Mansfield in *Carter v Boehm*, and supported by the principle of mutuality in the *Marine Insurance Act 1906*, s 17 and by implication in recent judicial *dicta*; but it has yet to find expression in binding authority. On one view, authoritative recognition of such a duty is only a matter of time, for, as the cases indicate, there are a number of situations in which insurers could be expected to behave better towards insureds.[95] However, a fundamental difference between the circumstances in which the insured's and the insurer's possible duties might arise indicates that an insured is unlikely to have a remedy of avoidance for the insurer's lack of good faith: for, whereas the duty lying on the insured arises, primarily at least, pre-contractually, the situations in which an insurer might be expected to behave with good faith are mainly post-contractual (in relation to the processing of claims) and therefore more likely to be recognised, if at all, as the subject of implied contractual terms, consequently with different remedies for breach. Even so, a shift in the perception of the nature of an insurance contract is likely to be necessary before greater duties on the insurer are established. An insured's pre-contractual duty of disclosure is an understandable concomitant of a contract of which the main concern is the risk to the subject-matter of the insurance. A more bilateral interpretation—balancing the risk of a casualty's occurring against the risk of the insurer's unsatisfactorily processing of the claim — needs to be more clearly recognised in order for good faith duties resting on the shoulders of the insurer to be sanctioned by judicial decision.

8.59 Apart from asserting that the law does not allow the award of damages to compensate insureds for the insurers failure to handle a claim within reasonable time, Eggers puts forward a number of arguments suggesting that such a development would be undesirable:

> "As a matter of policy, absent fraud on the part of the insurer, there are several reasons why the insurer should not be answerable for consequential losses. First, insurance cover serves

90 [2006] UKPC 29.

91 [2006] 1 Lloyd's Rep 566.

92 *Ibid*, p.576; Mills, Duty of Good Faith (2006) 80 ALJ 397.

93 [1988] QB 216.

94 *Ibid*, p.241.

95 Eggers in Soyer, *Reforming Marine and Commercial Insurance Law* (Informa Law 2008) at 251.

not only an economic purpose, but also a social purpose. It facilitates commercial enterprise and provides protection to those who suffer harm. By increasing the possible exposure on the part of the insurers may well render risk management and reserving policies problematic and make the cost of insurance inordinately high.

Secondly, the insurer is not in fact guilty of a breach of duty or a wrongdoing in causing the insured loss; it has merely agreed to bear the risk of that loss. It would be inappropriate to treat the insurer's "breach" in the same way as a party guilty of a breach of duty. Thirdly, the consequential losses are not those which the insurer has agreed to bear under the policy. For example, if a property insurer agrees to indemnify the assured for physical loss of a factory, the financial losses associated with the assured being deprived of the use of that factory does not fall within the insurer's remit. Indeed, such losses are specifically insurable. Fourthly, it is unlikely that such consequential losses will satisfy the rules of remoteness, as the additional losses likely to be borne by the assured are based on the latter's impecuniosity, which in many cases might not be reasonably foreseeable or in the contemplation of the parties when the contact of insurance is concluded."[96]

8.60 The first argument ignores the causal link between late payment of the claim and subsequent damage to the "commercial enterprise", or individual policyholder, as being a *sine qua non* to recovery of damages, while insurance costs will only increase if insurers process claims inefficiently – these increased costs can be avoided by effective claims handling. The second objection, in Ireland, is beside the point because the law will change to impose a duty upon the insurer as a result of the Commission's provisional recommendations. Eggers' third objection has some merit but it is the existence of the duty to process claims with all reasonable speed, and the insurer's breach of it, that triggers this head of loss. The fourth objection, that damages might not in fact be awarded, the Commission consider to be an argument in favour of making this rather modest adjustment to the law.

8.61 Eggers puts forward a number of arguments that support the view that an insurer, absent fraud, should not be liable for consequential losses. While these are persuasive in some respects it should be noted that Eggers favours a limited duty on the insurer in respect of claims handling because he believes that the duty of good faith is, or should be, the basis of an insured's duty not to make fraudulent claims. Indeed, Eggers takes the view that an insurer will be liable if the insurer makes a knowing misrepresentation of fact, and probably of law, in their handling of a claim; this will be a breach of the duty of utmost good faith. Eggers is no doubt correct in making the argument that a fraudulent misrepresentation of this kind is actionable, but it is difficult to see why this forms part of the law on utmost good faith in insurance law, as distinct from actionable misrepresentation in tort.

8.62 In any event, the question of whether consequential losses should be recoverable and the basis of liability are distinct issues. Certainly, if the action is established via fraudulent misrepresentation then all consequential losses will be recoverable as the existing rules on remoteness of damage in deceit now stand. In the case of an insured being able to establish that the claim was not processed by reference to a duty to take all reasonable steps to settle a claim promptly, for example,[97] then such a duty, if cast as contractual, will attract first limb *Hadley v Baxendale* damages which can of course involve an element of lost profits in any case, and it would require communication of special circumstances for the damages to engage "second limb" *Hadley v Baxendale* damages. The Commission think that the exposure of insurers to claims for consequential loss, or indeed any kind of loss, is of itself a reason not to retain the existing law if it is unsatisfactory.

I Has an insurer a right to damages against the insured?

8.63 Oblique authority for the view that an admission of liability given by an insured, to the prejudice of the insurer, can give rise to liability in damages, can be found in *Car and General Insurance*

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96 *Ibid*

97 Eg *Hotel Services Ltd v Hilton International Hotels (UK) Ltd* [2000] EWCA Civ 290; *GB Gas Holdings v Accenture UK Ltd* [2010] EWCA Civ 912

Corporation,[98] but "good faith" obligations that are breached by an insured have not attracted damages awards in the English or Irish courts. The same is not true in Canada. Damages awards have been given in favour of insurance companies for an insured's breach of the mutual duty of good faith by the Canadian courts. Indeed, these awards cover both compensatory damages and punitive damages. In A*ndruswi v Aetna Life Insurance Co of Canada*[99] a policyholder was ordered to repay $260,000 in disability payments. Because the conduct of the insured constituted a marked departure from the ordinary standards of decent behaviour expected of an insured, censure in the form of punitive damages of $20,000 was regarded as appropriate.

J Claims handling: An Alternative Approach?

8.64 The PEICL in Chapter Six, Insured Event, contains a balanced set of recommendations on the mutual duties that should perhaps attach to both the insurer and the insured in respect of claims made following the materialisation of risk.

Article 6:101

Notice of insured event

(1) The occurrence of an insured event shall be notified to the insurer by the policyholder, the insured or the beneficiary, as appropriate, provided that the person obliged to give notice was or should have been aware of the existence of the insurance cover and of the occurrence of the insured event. Notice by another person shall be effective.

(2) Such notice shall be given without undue delay. It shall be effective on dispatch. If the contract requires notice to be to be given within a stated period of time, such time shall be reasonable and in any event no shorter than five days.

(3) The insurance money payable shall be reduced to the extent that the insurer proves that it has been prejudiced by undue delay.

Article 6:102

Claims Cooperation

(1) The policyholder, insured or beneficiary, as appropriate, shall cooperate with the insurer in the investigation of the insured event by responding to reasonable requests, in particular for

- information about the causes and effects of the insured event;
- documentary or other evidence of the insured event;
- access to premises related thereto.

(2) In the event of any breach of para. 1 and subject to para. 3, the insurance money payable shall be reduced to the extent that the insurer proves that it has been prejudiced by the breach.

(3) In the event of any breach of para. 1 committed with intent to cause prejudice or recklessly and with knowledge that such prejudice would provably result, the insurer shall not be obliged to pay the insurance money.

Article 6:103

Acceptance of Claims

(1) The insurer shall take all reasonable steps to settle a claim promptly.

(2) Unless the insurer rejects a claim or defers acceptance of a claim by written notice giving reasons for its decision within one month after receipt of the relevant documents and other information, the claim shall be deemed to have been accepted.

[98] [1936] IR 584

[99] (2001) 33 CCLI (3d) 238 (Alta. QB)

Article 6:104

Time of Performance

(1) When a claim has been accepted the insurer shall pay or provide the services promised, as the case may be, without undue delay.

(2) Even if the total value of a claim cannot yet be quantified but the claimant is entitled to at least a part of it, this part shall be paid or provided with undue delay.

(3) Payment of insurance money, whether under para. 1 or para. 2, shall be made no later than one week after the acceptance and quantification of the claim or pat of it, as the case may be.

Article 6:105

Late Performance[100]

(1) If insurance money is not paid in accordance with Article 6:104, the claimant shall be entitled to interest on that sum from the time when payment was due t the time of payment and at the rate applied by the European Central Bank to its most recent main refinancing operation carried out before the first calendar day of the half-year in question, plus seven percentage points.

(2) The claimant shall be entitled to recover damages for any additional loss caused by late payment of the insurance money.

K Recommendation on the duty of utmost good faith

8.65 It is arguable that the universal duty of utmost good faith, if it exists at all, has outlived its usefulness, both in terms of requiring the proposer to disclose material facts whether prior to or after the conclusion of the contract. Certainly, the duty is irrelevant to the forfeiture rules governing fraudulent claims, and the current state of English law requires fraud by an insurer to be shown in relation to claims handling by an insurer if liability is to result. Why fraud should require to be dressed up in a breach of good faith argument as distinct from simply being actionable in the tort of deceit is not immediately apparent. The Commission considers that the law would not be any less effective if in *Carter v Boehm* Lord Mansfield had limited the duty to pre-contractual disclosure.

8.66 The Commission considers that existing forfeiture of fraudulent claims case-law, as it has developed provides a generally satisfactory approach to what the Commission considers to be “bad faith” processing of claims by insurers. The same cannot be said for the law relating to possible “bad faith” processing of claims by insurers and the Commission favour the development of a more balanced bilateral/mutual approach to claims handling in the way sketched out in the PEICL, Article 6.

8.67 This leaves open the question whether “utmost good faith” should be retained as a guiding principle of Irish insurance contract law once the contract has been concluded. The Commission envisage that if Article 6 of PEICL is adopted, most practical problems will be addressed therein. But the good faith principle will remain, as an aid to interpretation of the contract. It is possible to envisage disputes emerging in which a court might consider that an insurer might be under a good faith obligation (eg a duty to warn an insured that, based on specific facts known to that insurer alone, a risk is more likely to materialise than was previously thought to be the case).

8.68 *The Commission provisionally recommends that legislation should set out the mutual duties on the insured and the insurer in respect of claims handling, so that the principle of good faith would then remain relevant only to pre-contractual formation of the contract and as an aid to interpretation.*

100 This Article is modelled on Article 3 para. 1 (d) Directive 2000/35/EC.

CHAPTER 9 THIRD PARTY RIGHTS[1]

A Introduction

9.01 Irish law still retains two rules that limit the capacity of individuals to benefit from the terms of an insurance policy, even if it appears on the face of the policy that the individual or individuals in question were intended to benefit therefrom. These rules are that a person who is a stranger to a contract cannot enforce that contract, or be the subject of obligations under such a contract[2] - the Privity rule. The other rule states that consideration for a contract must move from a promisee if the promisee is to be able to enforce a promise.[3] There has been a considerable level of controversy surrounding these two rules and whether the two rules are simply two different ways of stating the same proposition of law.

9.02 The most extensive discussion of these barriers to allowing a third party to directly enforce a contract of insurance took place in the High Court of Australia in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd.*[4] A workplace liability policy had been taken out by a company, BC. BC engaged contractors to carry out work on its behalf. An employee of the contractors was injured and the claim brought against the contractor by the employee was settled. The contractor, McNiece, sued Trident, the insurer even though Trident's contract of insurance had been taken out with Trident by B.C. This case predated the *Insurance Contracts Act 1984*, and therefore section 48 of the 1984 Act, discussed below, could not be invoked. A majority of the High Court of Australia found for McNiece. Mason CJ and Wilson J indicated that the "principled development" of the common law required that the older, unjust privity rule ought not to be followed and that McNiece was entitled to succeed in the action. Toohey J agreed but he formulated a privity exception specific to liability insurance contracts involving contractors. Gaudron J followed an unjust enrichment path in order to allow McNiece the chance to recover while the remaining three judges, Brennan, Deane and Dawson JJ applied the privity doctrine and would have allowed Trident's appeal: while expressing little or no affection for the privity doctrine, in Brennan J's words, "a doctrine which is both settled and fundamental," Brennan J remarked that the proposed solution not only flew in the face of precedent, it created uncertainty over central issues such as whether the newly minted third parties' right to sue is irrevocable.

9.03 The Commission cannot see the Irish Supreme Court following a decision such as the majority view in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd.* Such a course of action would in the opinion of the Commission be unnecessary and undesirable. The Commission has already examined the privity of contract question and has proposed legislative changes that will provide a more balanced response to the injustices that privity of contract can produce.[5]

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1 See generally Merkin *Privity of Contract* (LLP 2000) pages 44-53 (Merkin) and Chapter 9 (Henley): in Kelly and Ball, *Principles of Insurance Law* 2nd ed (Butterworths 2001); Lowry and Rawlings *Insurance Law, Doctrines and Principles* 2nd ed (Hart 2010) Ch. 6.

2 *Murphy v Bower* (1876) 10 IRCL 354.

3 *McCoubray v Thompson* (1868) 2 IRCL 354.

4 (1988) 165 CLR 107; see generally Kincaid, Privity and the Essence of Contract (1989) 12 UNSWLJ 59.

5 *Consultation Paper on Privity of Contract* (LRC CP40-2006); *Report on Privity of Contract and Third Party Rights* (LRC 88-2008).

B The Problem in Context

9.04 The decision of the Privy Council in *Vandepitte v Preferred Accident Insurance Corporation of New York*[6] clearly illustrates two formidable obstacles to third party recovery under an insurance contract. Mrs V was injured in a motor accident whilst travelling as a passenger in a vehicle. The driver of the other vehicle, Miss JB was a minor driving her father's vehicle with his permission. Miss JB was held to have been driving the vehicle negligently. Damages were awarded in favour of Mrs V but judgment was not satisfied; the relevant British Columbia statutory provision[7] indicated that where a person incurs liability for injury or damage, that person being insured, if there is judgment against that person which is unsatisfied, "the person entitled to the damages may recover by action against the insurer the amount of the judgment up to the face value of the policy, but subject to the same equities as the insurer would have if the judgment had been satisfied." While Miss JB's tort, as a minor, would have led to a claim[8] against her father, REB (who had given permission for Miss JB to drive the vehicle) being successful, Mrs V brought the action in tort against Miss JB directly, seeking to invoke the statutory provision above. While the British Columbia courts awarded damages against Miss JB's insurers, the Supreme Court of Canada overruled the Provincial Courts.[9] A further appeal to the Privy Council was dismissed. Lord Wright, giving judgment for the Privy Council indicated that in order to succeed under the British Columbia Statute it has to be shown that Miss JB was a party to the contract. In this regard, the policy itself referred to the insured and directed that the indemnity also extended to persons legally riding or operating the vehicle with the permission of the insured. Thus, while the indemnity was intended to be of benefit to Miss JB, the Statute could only be operative if Miss JB was insured against the liability. Lord Wright explained the thrust of Mrs V's arguments thus:

> "The contention was put in the alternative, either that Jean Berry was directly and in law a party to the contract being within the description of the persons other than R.E. Berry to whom the indemnity was available, or that, if not in law a party to the contract, she was *cestui que* trust of the promise contained in the contract to extend the indemnity to such a person as herself, R.E. Berry having so stipulated as trustee."[10]

9.05 The first contention, that REB contracted as agent for his daughter, was rejected on the basis that there was not intention on REB's part to contract other than for himself. Even if some such intention existed "he had no authority from [JB] to insure on her behalf and at no time did she purport to adopt or ratify any insurance even if made on her behalf." Lord Wright also rejected the second contention, that is, that the "insured" could be interpreted so as to describe both REB and Miss JB because REB created a trust in the insurers promise to indemnify for Miss JB as a beneficiary. Again, the action failed for want of any proof that REB had any intention to constitute a trust in the form of the promise of indemnity; if anything was likely to follow from persons being injured whilst Miss JB was driving his motor vehicle. JEB, "if he read the clause or thought about the matter at all, he would naturally expect that if she did damage, the claim would, under the Act quoted, be against him, as she was a minor living in his family."[11]

9.06 With the exception of the specific provisions that have been enacted in road traffic legislation in order to address compelling public policy considerations arising out of motor accident claims, Irish law still reflects *Vandepitte* in respect of third party "rights" in insurance contract law. While there are some nineteenth century decisions that pre-date the *Vandepitte* analysis (eg *Kenney v Employers' Liability Insurance Corp*[12]*)* and which suggest a more 'liberal' approach to the agency or trust exceptions, the

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6 [1933] AC 70.

7 Section 24 of the *Insurance Act 1925* (British Columbia).

8 Section 27, *Motor Vehicles Amendment Act 1927* (British Columbia).

9 *Preferred Accident Ins Co Of New York v Vandepitte* [1932] SCR 22. Contrast *Fraser River Pile and Dredge Ltd v Can-Drive Services Ltd* [1998] 3 WWR 177.

10 [1933] AC 70 at 76-77

11 [1933] AC 70 at 80

12 [1901] 1 IR 301.

general view that the Commission takes in relation to insurance contract law reform and third party rights mirrors the position taken in the 2008 Privity Report. In other words, while it should remain possible for a court to utilise and even develop the existing exceptions to the Privity doctrine, it will not suffice to leave the resolution of difficult questions arising out of third party rights in insurance law to the existing patchwork of common law rules and exceptions, equitable remedies and *ad hoc* legislative solutions.

C Third party recovery – What the Commission will not address

(1) Road traffic legislation

9.07 Section 78 of the *Road Traffic Act 1933* provides for situations in which compulsory motor insurance should be taken out and related matters such as an injured person's rights of direct recourse to the insurer (eg when the insured driver cannot be fund (eg *Bellew v Zurich General Accident and Liability Insurance Co*[13]*)*. Section 76(1) of the *Road Traffic Act 1961* has replaced section 78 of the 1933 Act. The question of how road traffic victims are compensated when injured by uninsured drivers is not the subject of specific legislation. As between the Government and the Motor Insurance Industry, an agreement dating back to 1955 has provided a mechanism whereby claimants may seek a remedy from the Motor Insurance Bureau for Ireland Fund in respect of loss or injury caused by an untraced or uninsured driver.[14] This scheme is funded via a levy on insurers. The Commission believe that because this system is the result of specific legislation and Industry/Government agreement it is outside our terms of reference. Another reason why the Commission believes that this issue cannot be reviewed within the context of Irish insurance contract law can be found in the fact that the European legislator has intervened in this area on many occasions. In 2010 the English Court of Appeal, in *Churchill Insurance Co v Wilkinson*[15] referred section 151(8) of the *Road Traffic Act 1988* (a provision barring an injured person from recovering damages when travelling in a vehicle as a passenger when the driver is uninsured) to the ECJ so as to test the section by reference to Article 13(1) of Directive 2009/103/EC, the Consolidated Motor Insurance Directive. Article 13(1) provides that the bar to recovery is limited to passengers injured whilst travelling in stolen vehicles.

(2) Employers Liability

9.08 The rather sophisticated legislative mechanisms that the compulsory motor insurance model has created serves to point up how deficient the law currently stands in relation to employer's liability. While the motor insurance industry has created a fund of last resort to compensate injured persons when compulsory motor insurance has not been taken out, no similar system is in place in regard to workers injured in their place of employment due to an industrial disease, the relevant insurer being untraceable or the employer not being insured in respect of the injury.[16] The Commission is aware that a Consultation Process was started in the United Kingdom by the Department of work and Pensions in February 2010[17] with a view to establishing an Employer's Liability Insurance Bureau; a Private Members Bill was introduced into the UK Parliament by Andrew Dismore MP in January 2009. The Association of British Insurers is opposed to such legislation on moral hazard gounds, *ie* law abiding employers will have to subsidise unscrupulous employers who fail to take out appropriate insurance in the knowledge that the Fund will support injured workers.[18]

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13 [1937] Ir Jur Rep 69;*Hayes v Legal Insurance Co Ltd* [1941] Ir. Jur. Rep. 49; *Power v Guardian PMPA Ins* [2007] IEHC 105.

14 See www.mibi.ie

15 [2010] Lloyd's Rep IR 591. Section 151(8) has been held incompatible with with EU law – Case C-442/10, ECJ decision of December 2, 2011.

16 See O'Sullivan, [1995] CLJ 241. Note that employer's liability insurance in the UK has been mandatory since 1969.

17 Consultation Document, *Accessing Compensation – Supporting People who need to trace*

18 In reply to a written question to Minister of State Chris Grayling on 22 March 2011 the Minister of State said the Government would bring forward "proposals in due course".

D Exceptions to the Privity Rule

(1) Exceptions via judge-made law

(a) Agency

9.09 The law of agency allows a principal to enforce a contract even if the principal is undisclosed or the principal's identity is unknown. It is now clear that this situation is applicable to insurance contracts.[19] Situations where the agency exception has been invoked in general terms involve sometimes convoluted contractual analysis in response to commercially compelling circumstances.[20]

(b) Trusts

9.10 This was at the heart of the *Vandepitte* litigation and cases such as *Watrs v Monarch Life and Fire Insurance*[21] consider the "trust" notion as a kind of duty following upon bailment of goods. Resort to the trust concept is uncertain in terms of results as an intention to create a trust must be found if the argument is to be made out.

(c) Assignment

9.11 Indemnity policies create a chose in action[22] which is assignable under the common law, equitable and statutory rules on the assignment of choses in action. An examination of the law of assignment is outside the scope of this Consultation Paper but the assignability of insurance contracts, and the right to insurance moneys represent a very significant privity exception, constrained as it is only by the insurable interest requirement for the assignor in life policies.[23]

(d) Statutory Exceptions

9.12 The injustice that decisions such as *Vandepitte* create has been recognised by the Oireachtas by way of a number of statutory enactments that allow third parties to proceed against an insurer.

9.13 Section 7 of the *Married Women's Status Act 1957*, based largely upon section 11 of the *Married Women's Property Act 1882* provides that a policy of life assurance or endowment expressed to be for the benefit of, or by its express terms purports to confer a benefit upon, the spouse or child of the insured, is enforceable by that spouse or child by way of a statutory trust.

9.14 Section 76(1) of the *Road Traffic Act 1961*[24] allows a third party making a claim in respect of injuries or damage caused by an insured motorist to proceed directly against the motorist's insurer by way of service of a notice detailing the claim or a judgment obtained against the insured.

9.15 Section 62 of the *Civil Liability Act 1961* affords a third party with rights to proceed against an insurer in cases of the death or personal or corporate bankruptcy of the insrued. Section 76(4) of the *Road Traffic Act 1961* contains a similar provision. In the 2008 *Report on Privity of Contract*, the effect of section 62 is stated at paragraph 1.43 (footnotes abridged):

> "Section 62 of the *Civil Liability Act 1961* states that where an individual who has effected a policy of insurance in respect of liability or a wrong becomes a bankrupt or dies, moneys payable to the insured under the policy are only applicable in discharging valid claims against the insured. No part of the insurance money is to be applicable to the payment of the other

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19 *Siu Yin Kwan v Estern Insurance Co Ltd* [1994] 2 AC 199: *National Oilwell Ltd v Davy Offshore (UK) Ltd* [1993] 2 Lloyd's Rep 582.

20 *Prentis Donegan and Partners Ltd v Leeds and Leeds Co* [1998] 2 Lloyd's Rep 326. See also *The Zephyr* [1985] 2 Lloyd's Rep 529.

21 (1856) 26 LT 217. See also Commercial trusts relating to goods such as the jewellers' block policy.

22 *Re Moore, Ex parte Ibbetson* (1878) 8 ChD 519.

23 See generally MacGillivray, Ch 20. Life policies have been assignable since the *Policies of Assurance Act 1867*: MacGillivray, Ch 24.

24 Hayes v Legal Insurance Co [1941] Ir Jur Rep 40; *Herlihy v Curley* [1950] IR 15; *O'Leary v Irish National Insurance Co* [1958] Ir Jur Rep 1.

debts of the insured. The section 62 of the 1961 Act represents a policy decision to separate insured debts from insolvency proceedings. Although it does not expressly confer a positive right of action on those entitled to an award of damages against the insured, it has been decided that this section gives an entitlement to an injured party to sue the insurers of a bankrupt party to ensure compliance with the section.[25]

9.16 While section 62 is clearly very useful in cases of deceased or insolvent insureds, and recent case-law illustrates that there are other more indirect routes whereby a third party creditor may obtain access to insurance policy proceeds,[26] such piecemeal solutions, especially when no direct right of action or implementing machinery is included, do not create the necessary clarity and certainty required in this difficult area of the law.

9.17 The Commission notes that in the United Kingdom the *Contracts (Rights of Third Parties) Act 1930* was much criticised in the way in which it operated in the context of insolvency. The Commission speculate on whether section 62 of the *Civil Liability Act 1961*, a model of brevity, has had greater success in Ireland than the 1930 Act has had in the United Kingdom. Criticism of the 1930 Act was expressed by the Law Commission:

> "owing to the way the 1930 Act has been applied by the courts, third parties are often not assisted by it at all or are unnecessarily required to expend substantial time and money enforcing their rights."[27]

9.18 The *Third Parties (Rights against Insurers) Act 2010,* repeals the 1930 Act but builds upon the 1930 Act insofar as both Acts transfer to a claimant an insured's rights against an insurer, once the insured has been shown to be both liable on the claim and insolvent within the terms of the legislation. The most important reform effected by the 2010 legislation relates to the possibility that the claimant can commence one set of proceedings so as to establish the insured's liability and the insurer's obligation to indemnify the claimant. The 2010 legislation also removed the third parties' requirement to restore a dissolved company to the register of companies before being able to sue it. The enhanced information to be disclosed is also much expanded. However, the failure to amend the insurer's defences provisions in some significant ways has attracted criticism.[28]

9.19 The Commission has a limited amount of information on how section 62 of the *Civil Liability Act 1961* operates. The Commission notes that in the United Kingdom the *Contracts (Rights of Third Parties) Act 1999* did not render the *Third Parties (Rights against Insurers) Act 1930* redundant:[29] indeed, the recent passage of the *Third Parties (Rights and Insurers) Act 2010* suggests that there may well be a need to review existing Irish legislation having the same effect.

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25 Citing *Dunne v PJ White* [1989] 1 ILRM 803.

26 Section 62 has been recently considered in one of a series of decisions arising out of product liability claims resulting form the dioxin pigmeat contamination controversy in late 2008. In *Millstream Recycling Ltd v Companies Acts* [2009] IEHC 571, application for holding a meeting of creditors under section 201 of the *Companies Act 1963* was brought, the creditors in question being purchasers of contaminated animal feed from the applicant company. These creditors were divided on whether to agree to a composition which would have averted the winding up of the applicant company (and thus short-circuit the application of section 62), the creditors being compensated *pro rata* from FBD product liability insurance. It is clear that section 201 of the *Companies Act 1963* will allow the court to hear both the creditors and the insurer even thought the creditors are clearly not party to the insurance contract. Laffoy J ordered a meeting be held under section 201 of the 1963 Act.

27 Law Com No. 272, 31 July 2001, para 1.5. For a recent decision see *William McIlroy (Swindon) Ltd v Quinn Insurance* [2011] EWCA Civ 825.

28 See Law Commission Report 272, Part 5: Hemsworth [2010] LMCLQ 376.

29 See Merkin, in Lowry and Rawlings, *Insurance Law, Doctrines and Principles* 2nd ed (Hart 2010) at 344-352 for an account of the 1930 Act.

9.20 Because Ireland has not adopted the 1930 Act, the Commission cannot give a considered view on whether legislation of this kind is in need of revision. Any such recommendations should in any case be seen in the context of Irish insolvency law rather than Irish insurance contract law and the Law Commission in its 2001 Report stressed that privity of contract and the 1930 Legislation raised different issues. For example, the Law Commission took the view that even the implementation of the *Contracts (Rights of Third Parties) Act 1999* would not support an argument that the 1999 legislation rendered the 1930 Act redundant because:

- insurers would not write insurance contracts so as to enable third parties to rely on the 1999 Act,
- rights to information about the insurance position of persons against whom claims are considered are not addressed in the 1999 Act.

9.21 On the other hand, there are some features of the 2010 legislation that do provide some improvements to insurance contract law rules on notification. Conditions that oblige an insured to provide information are rendered ineffective if the insured has ceased to exist through death or corporate dissolution, for example,[30] and notification conditions are now capable of being complied with by the claimant as well as the insured.[31]

9.22 The Commission proposes that section 62 of the *Civil Liability Act 1961* should be augmented by borrowing from section 51 of the Australian *Insurance Contracts Act 1984*. That section, in a much less detailed form, replicates the provisions in section 62 of the *Civil Liability Act 1961*. However, the reference in section 51 to an insured who cannot, after reasonable enquiry, be found, appears to the Commission to be a useful addition to those sections and the Commission recommends that those sections in the two 1961 Acts be amended to include those untraceable insureds.

9.23 *The Commission provisionally recommends that section 62 of the Civil Liability Act 1961 should be extended to allow a third party to proceed against the insurer where the insured cannot be located.*

E Insurable Interest and Privity[32]

9.24 The decision in *Vandepitte v Preferred Accident Insurance Corporation of New York*[33] also addressed the insurable interest question, the Privy Council holding that the insured, father of the driver of the vehicle which caused the appellants injury, had no insurable interest at law. The Privy Council held that the property exceptions such as those developed in *Waters v Monarch Life and Fire Insurance Co*[34] had no application. The Commission's provisional recommendations, in Chapter 2 of this Consultation Paper, particularly the recommendation that the fact that an insurance claim should not of itself fail because of the absence of an insurable interest (as traditionally defined) would remove this aspect of the Privy Council's judgment from forming a part of Irish law. Additionally, the fact that Irish law does not expose non life policies where an insurable interest does not exist to the full rigour of the *Gaming and Lotteries Act 1956* is also to be welcomed in the context of a modern and effective system of regulating gambling. It should be noted that while English case-law at one stage[35] inclined towards the view that absence of an insurable interest will lead to the conclusion that the contract is a gaming contract, the better view is that "if either party was not wagering, the contract is not a wagering contract."[36]

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30 Corporate dissolution was proposed in the Law Commission Report at para 5.19. Section 9(3) of the 2010 Act also includes individuals who have died.

31 *Third Parties (Rights against Insurers) Act 2010,* section 9(2).

32 See generally Ch 6 of Lowry and Rawlings, *Insurance Law, Doctrines and Principles* 2nd ed (Hart 2010).

33 [1933] AC 70; see also *Jovanovic v Broers* (1979) 25 ACTR 39, discussed at para 122 of ALRC Report No. 20 (1982).

34 (1856) 5 E & B 870; *A Tomlinson (Hauliers) Ltd v Hepburn* [1966] AC 451.

35 *Newbury International v Reliance National Insurance Co (UK) [1994] 1 Lloyd's Rep 83.*

36 Hobhouse J in *Morgan Grenfell & Co v Welwyn Hatfield District Council* [1995] 1 All ER 1 at 10.

9.25 In the 2008 Report the Commission considered the relationship between the insurable interest question and the recommendations made in respect of statutory reform of the privity of contract requirement. In the Report the Commission recommended that the general privity reforms were not to affect the existing insurable interest requirements but that this recommendation did not "preclude the possibility of the future reform of this rule."[37] As this Consultation Paper recommends a broader definition of insurable interest as well as redrawing the categories of person who may be held to possess such an interest *ie* in the context of family and analogous relationships and does not recommend the introduction of any new insurable interest requirement in other non-life, non-indemnity policies, the statutory reforms outlined in the 2008 Report will not be in conflict with the insurable interest rules, as reformulated in this Consultation Paper.[38]

F Recommendations of the Commission in the 2008 Report

9.26 The Commission, in the 2008 Report, suggested that it was undesirable to allow Irish contract law to retain a privity requirement and that judicial erosion of the doctrine or additional legislative adjustments were not satisfactory responses to the hardship that the privity doctrine could create.

9.27 In the Report the Commission set forth six guiding principles, four of which were intended to protect the legitimate interests of contracting parties, while the last two were directed at third party interests, particularly the expectation interest, and the third parties' right to access rights to use contractual promises in a defensive way (eg rely on an exemption clause).[39] The Commission considers these six principles to be especially relevant in the context of insurance contracts.

9.28 The Commission, in the 2008 Report, set out three circumstances in which a third party should be able to directly enforce the provisions in a contract, summarised at paras 3.17 to 3.19:

> "3:17 The Commission recommends that a third party should be able to enforce a term of a contract when the term expressly confers a benefit on the third party. However, the third party should not be able to enforce the term if it appears on a proper construction of the contract that the contracting parties did not intend the term to be enforceable by the third party. The contract should be interpreted in accordance with the ordinary rules of contractual interpretation, but surrounding circumstances should only be taken into account if they are reasonably available to the third party.
>
> 3.18 The Commission recommends that a third party should be able to enforce a contract or a term of a contract when the contract expressly states that they may.
>
> 3.19 The Commission recommends that a third party should have the right to rely on a term of a contract which excludes or limits the liability of the third party, provided that was the intention of the parties. This is subject to the normal statutory and common law rules on the incorporation and construction of exception clauses.

9.29 Recent English case-law attests to the utility of changing the law. The question whether a person who is not in a contractual relationship with an insurance broker may nevertheless have a right of action in tort and/or contract, where the insurance is arranged for that person's benefit, was considered in the English High Court in *Crowson v HSBC Insurance Brokers.*[40] Crowson was the managing director of Hughes Brickwork Ltd. The company arranged new liability insurance cover through the defendants. Liability cover that had been arranged through their previous brokers gave directors and officers liability

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37 Report, para 3.124.

38 This will still make it likely that an insurer will contractually seek to use an insurable interest requirement, as a matter of contract, to limit the scope of any non-indemnity policy for example. Even though section 16 of the 1984 Act, as amended in 1995 abolishes insurable interest even in life policies, underwriting practice may require this – see Mann, *Annotated Insurance Contracts Act*, para. 18.20 cited by Merkin in his Australian *Reverse Transportation* Paper at para. 8.7.

39 Report, paras 2.89-2.95.

40 [2010] Lloyd's Rep IR 441.

cover but the defendants failed to renew or obtain this cover. The failure to do so was alleged by Crowson to constitute various breaches of a common law duty of care owed by the defendant brokers to Crowson as a director of the insured. The defendant argued that it owed Crowson no duty of care and that the only contractual duty existed *vis-à-vis* the defendant and Hughes Brickwork Ltd. Although the case was decided on the foot of a motion to strike out the case for want of a cause of action, Master Bragge was prepared to hold that it was arguable that a duty of care existed when a broker was instructed to arrange insurance for that person and others; also (and here Master Bragge was stating an alternative argument, based on *Punjab National Bank v De Boinville*[41] and *Ross v Caunters*[42]) a duty could exist if a broker can be taken to be aware that the company instructing the broker intended the policy to cover directors and officers. While Master Bragge indicated that there was a body of tort case-law[43] that stood against this approach, reliance on the *Contracts (Rights of Third Parties) Act 1999* was more soundly based. After citing section 1, where the third party is either a member of a class or within a particular description, Master Bragge said:

> "it is well arguable that the Act applies on the basis that if Mr Crowson is not a party to a contract (a third party) he can enforce a term of the contract because that is one which confers a benefit on him, namely insurance as a director. Further he would be a member of a class or answers to a particular description within section 1(3).[44]

G Variation or cancellation of the Third Party Right?

9.30 The 2008 Privity Report addresses the question whether third party rights, once they are contained in a contract, should be fixed and immutable, or like most contractual terms, be capable of being varied or terminated by mutual agreement: the Report sets out the general position thus:

> "Contracting parties are generally free to modify or alter the terms of a contract by mutual agreement. However, if that contract is enforceable by a third party, any such modification of the contract could have an impact on the rights of the third party. If the contracting parties had an unlimited power to vary the contract, the third party's rights would be relatively meaningless; as these rights could be changed by the mutual agreement of the contracting parties at any time. However, if the contracting parties could never agree to vary the terms of the contract it could be commercially inconvenient and restrict the contracting parties' freedom of contract. It is thus important to strike a balance between the interests of the contracting parties to vary the contract and the interest of the third party in securing the promised benefit.[45]

9.31 The Commission, in the 2008 Report, recommended that if a third party assents to the contract, by word or conduct, the contracting parties should not be free to cancel or vary the contract once either contracting party is aware of third party assent.[46] However, the parties are to be free to qualify these third party rights by way of an express term in the contract giving the contracting parties the right to vary or terminate the contract.

9.32 While the Commission has no reason to change views on this issue, an exploration as to whether there are circumstances in which the consensual variation or termination of an insurance contract should be prohibited or made the subject of a judicial determination, eg when the third party beneficiary is likely to be seriously prejudiced through the exercise of any variation or termination right held by the contracting parties, would be desirable. At the level of principle, one may well agree with

41 [1992] 1 Lloyd's Rep 7.

42 [1980] Ch 297.

43 *Verderame v Commercial Union Assurance Co Plc* [2000] Lloyd's Rep PN 557; *Texas Homecare Ltd v Royal Bank of Canada Co (Jersey) Ltd* [1996] CLC 776.

44 [2010] Lloyd's Rep IR 441 at 443. On privity in the context of group policies see *Re Harris* [1939] 1 DLR 495.

45 2008 Report, para 3.28.

46 2008 Report, para 3.41-2.

Professor Merkin's view[47] that there is nothing to suggest that insurance contracts should be treated any differently to other contracts, but, in practice, the Commission is concerned that in certain kinds of contract the freedom of the parties to renegotiate a contract are subject to commercial or other restraints or factors that make an individualised bargaining model inappropriate. The 2008 Report itself recognised that employment contracts involving a number of potential third party beneficiaries may present difficulties in relation to assenting to the contract.[48]

9.33 Specific issues may arise in the case of Group Insurance cover that is negotiated between an employer and an insurer, perhaps either or both parties being represented by a broker. If contracting out is permitted, that is, the parties are able to expressly stipulate that the contract is not to be enforceable by a third party in his or her right, the benefits of this reform will be negated. Similarly, if the contract provides for variation or termination rights in any third party rights may be short lived or diluted somewhat. The view that an employer may enjoy the right to terminate or vary insurance benefits which are essentially part of the employee's remuneration package, as a matter of private law, appears to be out of kilter with general principles of employment law[49] and it may well be that additional difficulties may present themselves should a trade union be involved in representing members. Could a trade union afford the necessary assent; as the assent provision stands in the draft Bill appended to the 2008 Report the answer would be in the negative as a union would not be "another such third party." Similarly issues may arise as to whether a trade union's consent could be effective to bind other non-union employees?

H Third Party Beneficiary – A definition?

9.34 One matter that perhaps needs to be addressed is whether a definition of third party beneficiary is required. It should be recalled that the *Life Assurance Act 1774* contained a requirement that persons to benefit under the contract had to be named on the policy, this requirement being relaxed in 1989 in Ireland in respect of group insurance beneficiaries.[50] This question has been considered in other jurisdictions in the specific context of insurance contracts and a recent Australian proposed change affords a useful precedent.

9.35 The Australian Treasury Review, and subsequent Bill[51] consider the question whether a definition of third party beneficiary is necessary. Part 1 of Schedule 1 to the *Insurance Contracts Amendment Bill 2010* defines a third party beneficiary under a contract of insurance as:

> "a person who is not a party to the contract but is specified or referred to in the contract, whether by name or otherwise, as a person to whom the benefit of the insurance cover provided by the contract extends."

9.36 The Commission provisionally recommends that a third party beneficiary under a contract of insurance should be defined in legislation as a person who is not a party to the contract but is specified or referred to in the contract, whether by name or otherwise, as a person to whom the benefit of the insurance cover provided by the contract extends.

I The Australian General Insurance Provision as a Model?

9.37 Following on from the ALRC recommendations on general insurance law reform, the 1984 Insurance Contracts Actprovides, in section 48, the following provision, the marginal note being "Entitlement of named persons to claim." Section 48 provides:

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47 Merkin, *Reforming Insurance Law: is there a case for Reverse Transportation?* (2006) paragraphs 8.49 to 8.51.

48 2008 Report, paras 3.39 to 3.42.

49 Generally requiring consensual variation or alteration of a contract.

50 *Insurance Act 1989, section 26.*

51 *Insurance Contracts Amendment Bill 2010.*

(1) "Where a person who is not party to a contract of general insurance is specified or referred to in the contract, whether by name or otherwise, as a person to whom the insurance cover provided by the contract extends, that person has a right to recover the amount of the person's loss from the insurer in accordance with the contract notwithstanding that the person is not a party to the contract.

(2) Subject to the contract, a person who has such a right:

(a) has, in relation to the person's claim, the same obligations to the insurer as the person would have if the person were the insured; and

(b) may discharge the insured's obligations in relation to the loss.

(3) The insurer has the same defences to an action under this section as the insurer would have in an action by the insured.[52]"

9.38 Section 48(1) states that the third party entitlement is determined by the contract. Section 48(2) subjects the third party to the same obligations as those imposed on the insured such as observing the duty of utmost good faith and giving the insurer notice on any loss, such notice being effective in discharging the insurer's obligations under the contract. Section 48(3) makes the same defences as would have operated against the insured available to the insurer as against the third party.

9.39 Professor Merkin points out [53] that section 48, unlike the 1999 legislation, cannot be the subject of contracting out and he states that because section 48 has been loosely drafted, it has produced a significant amount of litigation. However, Professor Merkin, after noting that the 1999 legislation in England and Wales has proved ineffective because policies in virtually all cases exclude the 1999 Act, goes on to remark that "the Law Commissions will plainly not contemplate adopting a similar [measure to section 48] given that the English 1999 Act is a far clearer piece of legislation."[54]

9.40 In the Commission's view the choice presented by the English 1999 legislation and section 48 of the 1984 legislation is rather an unhappy one. The general English model threatens to be ineffective by virtue of a contracting out provision while the specific Australian insurance precedent may be too inflexible and uncertain. In the final analysis the Commission believes that the solution to general privity problems in insurance law lie in the general privity reform proposal in our 2008 Report. The Commission cannot see, in principle, why insurance contracts should be treated any differently to other contracts and the Commission believes that the 2008 Report contains a balanced solution to difficult questions of law and social policy.

9.41 *The Commission provisionally recommends that, in the context of third party rights in insurance contracts, it would, in general, be sufficient to protect such rights if the Oireachtas enacted legislation based on the draft Contract Law (Privity of Contract and Third Party Rights) Bill in the Commission's 2008 Report on Privity of Contract and Third Party Rights. In addition, the Commission invites submissions as to whether additional specific provisions should be enacted in the context of the operation of insurance contracts in specific settings for example, in insolvency, on the death of an insured person and during the completion of a contract for the conveyance of land.*

J The Australian Treasury Review and Section 48

9.42 Section 48(1) of the 1984 Australian legislation is currently under review in order to clarify the rights of a third party beneficiary. Schedule 6 of the *Insurance Contracts Amendment Bill 2010* proposes to amend section 48(1) so as to read:

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52 While section 48 deals with general insurance separate provision has been made in respect of ordinary life policies and policies connected to retirement savings account.

53 Merkin, *In Reforming Insurance Contract Law: Is there a case for reverse transportation?* (2006)

54 Para 8.49.

"A third party beneficiary under a contract of general insurance[55] has a right to recover from the insurer, in accordance with the contract, the amount of any loss suffered by the third party beneficiary even though the third party beneficiary is not a party to the contract."

9.43 As previously stated, section 48 is not capable of being excluded by contract. The Australian approach, under both the 1982 Report and the 1984 Act, approximated the rights of non contracting parties to those of the insured. Schedule 6 of the 2010 Bill seeks to carry this process further by allowing the third party beneficiary to enjoy rights to information from the insurer on a par with rights currently enjoyed by the insured. This should be seen in the context of the proposed amendments to section 13 of the 1984 Act. It is proposed[56] that the post contractual duty of good faith is to be extended to third party beneficiaries *vis-a-vis* the processing of claims, that failure to comply with the duty is to be regarded as a breach of the Act, thus triggering a new power in the financial regulator to bring a representative action in cases of systemic failure.[57] There is a case to be made for providing for greater information rights in isolation from these questions of wider enforcement powers. For present purposes however, the extension of section 48 of the 1984 Act, so as to become applicable to third party beneficiaries, is intended to dissuade an insurance company from dilatory processing of claims where payment is to benefit a person other than the insured. Adjustments to section 48(2)(a) and 48(3) also copper-fasten the rights of the third party beneficiary with those of the insured, as well as exposing the third party beneficiary to whatever defences would have been available if the claim had been brought by the insured. In the Treasury Review and the discussion of third party rights issues it was said that, because the 1984 Act did not provide a comprehensive answer to third party rights issues by extending all rights an obligations of insureds under the 1984 Act to specified third party beneficiaries, uncertainly was engendered which "ultimately leads to higher risk premiums being charged in relation to the affected policies and also results in outcomes that may be anomalous or inconsistent."[58] Rather than going down the path of extending all of the provisions in the 1984 Act to third party beneficiaries the Treasury Review took a *via media* between total approximation of rights and doing nothing. The Review concluded that extension of all rights to third parties might resolve issues of third party uncertainty whilst adding significant administrative costs in the form of third party notice requirements.

9.44 The preferred option was summarised thus:

This option would treat specified third party beneficiaries as insureds under the Insurance Contracts Act only for the purposes of:

- subrogation, in that the insurer would be able to substitute for the third party beneficiary in an action against a third party who is liable for a loss that has been paid by the insurer;
- the duty of utmost good faith (but not pre-contractually); and
- circumstances where Insurance Contracts Act allows an insured to request the insurer provide them with particular information by way of written notice.[59]

K The Australian Insurance Contracts Amendment Bill 2010 – Breach of the Duty of Good Faith and Third Parties

9.45 Following upon a protracted process of review, a number of changes to the *Insurance Contracts Act 1984* have been suggested in order to, *inter alia*, enhance the rights of third party beneficiaries.

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55 Effectively non life insurance. Part 2 of Schedule 6 applies to general insurance: similar adjustments for life insurance are made in Part 3 of Schedule 6.

56 Part 1(4) of Schedule.

57 Proposed section 14A.

58 Regulation Impact Statement to Insurance Contracts Amendment Bill 2010, para 3.144.

59 Regulation Impact Statement to Insurance Contracts Amendment Bill 2010, para 3.149.

9.46 The privity doctrine confines the duty of utmost good faith to contracting parties. Notwithstanding this, the current position in English law indicates that damages for breach of this duty by an insurer does not entitle the insured to damages for any loss suffered as a result of this breach of contract – *Banque Financiere v Westgate Insurance Co.*[60] *Ipso facto*, where there is no duty, as is arguably the case in relation to strangers to the contract, there can be no breach of a duty. The pattern set in Australian litigation is to build upon section 13 of the *Insurance Contracts Act 1984*, which creates a post formation duty of utmost good faith, breach of the duty being actionable in damages. In Ireland and England and Wales, the law in relation to the post contractual duty of utmost good faith is less fully developed than elsewhere, save in respect of the fact that the England and Wales 1999 statutory privity reforms may suggest that there are third party rights of a contractual nature, when the contracting parties so desire. But the question whether a third party may have an effective remedy to enforce a promise may become a more controversial question should the (contractual) duty become available to third parties or independently actionable in tort or under statute. Irish law is silent on post contractual good faith as a general principle.

9.47 The Australian 1984 legislation, by recognising the duty of utmost good faith as an implied term in the contract of insurance, clearly limits the implied term to the contractual context within which it operates. However, the proposal to extend the duty of utmost good faith to third parties, by way of an amendment to section 13 does not mean that a full range of contractual remedies will become available to third parties. The proposed amendment to section 13 will allow the regulator to intervene on behalf of third party beneficiaries and while the Bill does seek to improve information access rights under section 41 of the 1984 Act for third parties, there will be no expansion of damages remedies for third party beneficiaries. The Commission are of the view that it is best to maintain the present position whereby third parties cannot rely on a duty of utmost good faith. If, in contrast, the duty to act in utmost good faith is actionable in tort, as it is in the United States, a number of consequences follow hard upon. For example, if the tort is to be regarded as being closely related to fraud or deceit, there would be an argument for applying not only the very generous tort rules in relation to foreseeability but also the rules applicable to remoteness of damage for fraudulent misrepresentation. The Law Commissions, in their Good Faith Issues Paper 6, point to the fact that the vast majority of US States allow for the award of punitive damages often even in third party claims cases.[61]

9.48 If a decision is taken to extend the duty of utmost good faith, as an implied term, for instance, into the contract of insurance, the implied term would presumable only be broken as between the policy holder and the insurer. This appears to be the existing situation in Australia. Post contract breach of the duty by an insurer is most likely to arise in relation to bad faith processing of a claim or a failure to warn or advise an insured. The Commission do not recommend that third party beneficiaries should be able to invoke good faith obligations which should be owed only to contracting parties.

9.49 It should be noted that Irish law, by way of the provisions in sections 7 and 8 of the *Married Women's Status Act 1957* already permits recovery of damages in a limited range of circumstances that can include consumer insurance contracts within a family context and that the proposed reforms in the 2008 Report will provide a mechanism for third party recovery.

9.50 Should a decision be taken against allowing a third party to be able to invoke a contractual duty of utmost good faith, by way of an exception to the privity of contract doctrine, the question may arise whether such a duty should arise in tort. While the Commission does not wish to inhibit the development of the law of negligence, or indeed any other tortious liability on a case by case basis, there appears to be no strong argument favouring the expansion of tort law. The Law Commissions, in their Issues Paper 6, were against developing the duty of good faith by holding it to be actionable as a separate tort or deficit

[60] [1990] 2 All ER 947. See Eggers Picken and Foss, *Good Faith in Insurance Contracts* (2010) (3rd Edition) paras 16.95 to 16.135.

[61] Damages for Late Payment (March 2010), Chapter 7. Third party claims cases involve actions brought directly against the insurer of persons other than the insured, often on state laws involving strict liability, bad faith, or negligence: see (2004) *Tort Trial and Insurance Practice Law Journal* 39(4); (2010) *Tort Trial and Insurance Practice Law Journal* 46(2).

because this would leave open an insurer to a more extended and unpredictable liability.[62] Most of the responses to the Consultation exercise (and most were form lawyers and insurers) were against the award of tort damages being available for breach of good faith. This must be seen in the light of the decision of the Law Commissions to oppose the development of a duty of utmost good faith as either an implied term or a tort,[63] favouring instead a statutory "stand alone" duty subject to legislative restrictions.

9.51 Arguments of this kind provide a compelling case for declining to extend third party rights into good faith obligations under insurable contract law. The Commission believes that section 8 of the *Married Women's Status Act 1957* already provides members of a family who are envisaged as beneficiaries under a contract of insurance with statutory rights to compensation in specific circumstances and the Commission believes that the extension of a post contractual duty of good faith to third party beneficiaries is unwarranted.

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62 *Ibid.*

63 Para 9.28 of Issues Paper 6 with possible increases in premiums. *Summary of Responses to Issues Paper 6: Damages for Late Payment and the Insurers' Duty of Good Faith*, para 4.8.

CHAPTER 10 REMEDIES

A Introduction

10.01 In this chapter the Commission will seek to develop and contextualise a number of issues relating to remedies that have been examined elsewhere in the Consulation Paper. The shift away from providing that the primary remedy for non-disclosure and misrepresentation should be avoidance of the claim for example requires an examination of the proportionality remedy. The Commission will also consider whether the *Sale of Goods and Supply of Services Act 1980*, when viewed in the context of the proposed reforms found in the UK *Consumer Insurance (Disclosure and Representations) Bill 2011* provides guidance on the way forward. The Commission will also examine some of the issues addressed in Chapter 4 on whether the misrepresentation provisions in Part V of the *Sale of Goods and Supply of Services Act 1980* can be modified in respect of proposer misrepresentation and non-disclosure. In relation to compensatory provisions for late payment of a claim the Commission will review the existing law with a view to improving the current position in Irish law. Outside the area of compensation the Commission will consider responding to some isolated contract rules which have been widely criticised such as the subrogation rights of employers arising out of employee breaches of duty. The Commission will also consider whether legislative changes to the rescission/avoidance relief in relation to an insured's failure to observe a condition precedent would improve Irish law.

B Compensatory Remedies – Proportionality

(a) The Australian Position

10.02 The Australian 1982 Report (after providing a cogent critique of avoidance or rescission as being a disproportionate remedy for a proposer's misrepresentation or non-disclosure) concluded that "the substitution of a right to damages for the existing right of avoidance would provide an adequate deterrent to misrepresentation and non-disclosure. It would also ensure that insurers were entitled to adequate compensation for loss suffered as a result of breach of the insured's duties. Disproportionate burdens would no longer be placed on the insured. Even so, an important problem arises: the method by which damages should be assessed".[1]

10.03 In the discussion that followed, the ALRC broadly agreed with the Law Commission which in its 1980 Report saw a proportionality test as having a degree of attractiveness when the area of insurance is statistically based, the premium being calculated by way of a set tariff. In other cases where the premium is set on a "once off" basis, or calculated by reference to qualitative factors (health) or moral hazard considerations, the process is more difficult. Proportionality was rejected in favour of an across the board adoption of the common law damages measure applied in cases of fraudulent misrepresentation, which the ALRC characterised as being "the amount which would place the other party in the position he would have been in had the misrepresentation not been made."[2] This tortious measure was seen by the ALRC as providing a more accurate application of the *restitution in integrum* principle, save in cases where the loss does not arise before the proposer's breach becomes known prior to avoidance and the occurrence of any loss.[3] In a robust defence of the move towards adopting the principle that "the insurer's redress should depend on the nature and extent of the loss which it has suffered as a result of the insured's

[1] ALRC Report No. 20, Para 187.

[2] ALRC Report No. 20, Para 194.

[3] ALRC Report No. 20, Para 187.

conduct",[4] the ALRC went on to address the evidentiary difficulties while insisting that the interests of justice required that they should be overcome:

> "it is not always easy in retrospect, to determine what the insurer would have done had it known the true facts. In numerous cases, however, the insurer would be able to establish, whether from rating guides, from its instructions to its agents or staff or from its prior conduct, the nature and extent of the loss which it had suffered. It is true that it would sometimes be difficult to establish how it would have reacted to additional moral, as distinct from statistical, risks. But difficulties of proof cannot be avoided if a proper balance is to be reached between the interests of the insurer and those of the insured. It is quite plainly contrary to the true principle of *uberrima fides* to impose on the insured a burden which far exceeds the harm which he has done. The insurer should not be entitled to any redress which exceeds the loss which it has in fact suffered. That is the basic principle which lies behind the law of damages, both in contract and in tort."[5]

10.04 For general insurance policies, ie policies other than life insurance, the ALRC thus rejected a strict proportionality approach, noting at the same time that certain life offices had in fact adopted proportionality in relation to life insurance; written and oral misstatements and non-disclosure that were innocently made should be remediable in damages calculated on a restitutionary basis. The 1984 Act provides a right to damages for non-disclosure or misrepresentation (s.28(3)) in cases of general insurance with a right to avoid the policy being limited to instances of fraud, subject to a judicial discretion to disregard the avoidance under s.31. For life policies under section 29 a proportionality approach has been adopted. Professor Rob Merkin, in his Paper, *Reforming Insurance Law: Is there a case for Reverse Transportation?* Points out that the damages provisions in particular have "generated a mass of confusing and not particularly logical case-law and has left the courts to develop their own principles on the assessment of damages."[6] Merkin also refers to the "illogicality in distinguishing between life and general insurance, applying proportionality to the former but not to the latter." The availability of damages calculated on a restitutionary basis, despite the apparent rejection of the proportionality principle by the ALRC, appears to be the norm in Australia and the 2010 Bill in Australia seeks to align life and general insurance in significant areas. Australian courts seem to apply proportionality. This is certainly the view taken of section 28(3) of the *Insurance Contracts Act 1984* by the Law Commissions who cite that section as authority for the proposition that "if the insurer would have demanded an increase in premium and a claim has arisen, proportionality should be applied. In other words, if the [negligent] misrepresentation or non-disclosure led to the insurer only paying 50% of the correct premium of the claim...if the insurer would not have accepted the risk had it known the truth, or if it would have inserted an exception which applies to the claim, the insurer's liability is reduced to nil"[7]

(b) The Law Commissions Consultation Paper

10.05 The Law Commissions Proposed that the law should provide a compensatory remedy aimed at putting the insurer in the position it would have been in if the insurer had been aware of the true facts specifically:

(1) If the insurer would have excluded a particular type of claim, the insurer need not pay claims that would fall within the exclusion;

(2) Where the insurer would have imposed a warranty or excess, the claim will be treated as being subject to that warranty or excess;

(3) Where the insurer would have charged more, the payment on the claim to be made is to be reduced proportionately;

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4 ALRC Report No. 20, Para 194

5 *Ibid.*

6 Para. 4354-4.60.

7 Law Commissions 2007 Consultation Paper, para. 4.157.

(4) Where the risk would have been declined altogether, the policy may be avoided, premiums returned and the claim refused.

10.06 The December 2009 Law Commissions Report,[8] which of course is limited to misrepresentations in consumer Insurance, endorses the earlier approach in relation to compensatory remedies for careless misrepresentations. In the December 2009 Report the Law Commissions stressed that the changes are compensatory, directed at calculating the insurer's loss. The Law Commissions also pointed out that some three quarters of respondents favoured a proportionality approach although "a minority disagreed with the proposal on the basis that the problems would be too great". The Law Commissions recommendation was that:

> "where the consumer has made a careless misrepresentation, the insurer is entitled to a compensatory remedy as follows:
>
> (1) If the insurer would not have entered into the contract on any terms, the insurer may avoid the contract (but must return the premiums);
>
> (2) If the insurer would have entered into the contract on different terms (apart from those relating to the premium), the contract is treated as if it were made on those terms;
>
> (3) In addition, if the insurer would have charged a higher premium, the insurer may reduce the amount of the claim proportionately."[9]

10.07 This approach avoids the somewhat unnecessary set of distinctions that have bedevilled Australian case-law under the 1984 Act and subsequent legislative changes while retaining a focus on restitutionary principles. The 2009 Report, and the *Consumer Insurance (Disclosure and Representations) Bill 2011* provides valuable insights into how a restitutionary/proportionality range of remedies can opertate.

(2) The Irish Experience

10.08 It is arguable that the proportionality approach to assessing an insurer's loss strikes some judges as a sensible and fair one, and there is one striking illustration of this in *O'Callaghan v Irish National Insurance,*[10] a policy of industrial insurance. The correct age of the life to be insured was not inserted into the proposal form; the form contained a basis of contract clause. When the correct facts came to light the company sought to avoid the policy but Circuit Judge Kenny felt that he was free to disregard the answer given as long as the claim was limited to the amount the insurer would have provided cover for had the true facts been disclosed. The Divisional Court held that the Circuit Judge had no such power and granted the insurer a declaration that the policies were void. While the Óireachtas provided some relaxation of this strict rule[11] in the *Insurance Act 1936* in relation to industrial insurance, this is one legislative exception that proves the rule. However, the Financial Services Ombudsman has on several occasions permitted recovery of a percentage of an insured amount, notwithstanding that the insurer had some basis in law for avoiding the policy. In the December 2008 *Summary of Decisions* the Ombudsman ruled on refusal to honour a holiday insurance cancellation policy on the grounds of non-disclosure of a pre-existing condition. The Ombudsman ruled that

> "While accepting that the company had justifiable grounds for refusing the claim on the grounds of non-disclosure nevertheless the Ombudsman taking into account all the circumstances of the case and bearing in mind what was fair and reasonable, found the complainant was entitled to 50% of the benefit payable under the policy in respect of the cancellation of the policy."

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8 *Consumber Insurance Law: Pre Contract and Misrepresentation* (December 2009).

9 *Ibid*, para. 6.62.

10 (1934) 68 ILTR 248.

11 *Insurance Act 1936*, s.64(2).

10.09 The earlier decisions of the Insurance Ombudsman[12] reflect a more principled approach to looking for solutions based upon proportionality. In case study 49 of the Digest the insurer declined to pay a death benefit claim for non-disclosure of a pre-existing medical condition; on investigating the complaint however the Insurance Ombudsman noted that there were inconsistencies in the documentation which led to the conclusion that non-disclosure was innocent, ie "the company had produced insufficient evidence to justify a finding of fraud or deception on behalf of the deceased, nor had it proved reckless or negligent non-disclosure. Accordingly, I decided to apply the principle of proportionality to the complainant's claim." Even though the company gave no evidence of what the loading would have been, had the time facts been known, the Insurance Ombudsman said she was satisfied that a loading of 50% of the sum insured was appropriate. Similarly, in some instances where the policy itself referred to payment of proportionate sums, the Insurance Ombudsman on several occasions ruled that the company should be required to exercise this discretion rather than decline to meet the claim. In case study 149 of the digest, for example, an earnings protection policy had to be met by the insurer, the benefit being calculated on the basis of the insured's reduced earnings in the relevant period and payment of a proportionate amount of the benefit.

10.10 The Law Commissions in the December 2009 Report,[13] provide some helpful insights into proportionality remedies in respect of three scenarios involving variations in cover, excesses and premiums. The examples given suggest that when the analysis starts from a position where the proposer's degree of fault is the primary question, and the probable reaction of the insurer to the true facts can be assessed, a workable accommodation of proportionality and avoidance remedies can be established. Again, it must be emphasised that the current analysis and the Commission's provisional recommendations do not seek to in any way abridge an insurer's right to avoid the policy where a fraudulent misrepresentation has been made by the proposer.

10.11 The Commission questions whether the debate on whether proportionality should be adopted as the relevant means of calculating and awarding the insurer the loss arising out of non-disclosure, a misrepresentation or other breach of contractual duty is an entirely artificial one. Certainly at this distance the Law Commission's initial 1980 objections appear to be directed as much at the proposed European Directive itself as at the substantive arguments against a proportionality principle: the Commission does concede that the Law Commission was correct in pointing to the fact that in the proposed Directive the remedy being contended for by the European Commission was not well defined, but this of itself does not appear to the Commission to be dispositive.[14] The Law Commission's objection that proportionality would require the specific insurer to underwrite a risk that the insurer might well have decided to decline, or subject to limiting provisions, is also in the view of the Commission, beside the point. In this situation it would be appropriate to allow the insurer to prove that, because the proposal would have been declined altogether, or made the subject of a tailored limitation or exclusion, damages should be reduced by up to 100%.

10.12 Situations of this kind are commonplace in many damages assessments: the licensing measure of compensation following upon the infringement of intellectual property rights requires a court to value the worth of a patent or design as between a willing licensor and a willing licensee, but this measure may and often is inappropriate to other forms of exploitation, and in cases where the rights owner would not have granted a licence in any circumstances. The debate over proportionality seems to ignore the possibility that this approach to the assessment of quantum might well be appropriate in the vast majority of insurance contracts that involve consumers, "small businesses", telephone and internet insurance, and so on. In insurance that is broker arranged or bespoke, or addresses unusual or "one off" risks it may be that difficulties of proof are exaggerated. This was certainly the view of the Law Commissions in 2007 and 2009. It will certainly be the case that premiums and exclusions may differ quite markedly and that the assessment will not always by easy. Even in *Manor Park Homebuilders Ltd v AIG Europe (Ireland) Ltd*[15] the policy provided by AIG was limited cover as distinct from the earlier "all

[12] *Decisions of the Insurance Ombudsman, 1992-1998* (Digest).

[13] *Consumer Insurance Law: Pre Contract Deisclosure and Misrepresentation.*

[14] Law Com No. 104, *Insurance Law: Non Disclosure and Breach of Warranty*, para. 415.

[15] [2009] 1 ILRM 190.

risks” policy provided by Royal and Sun Alliance. Three other companies declined to quote in that case so it will often be factually difficult to value cover and speculate on what an insurer would have done.

10.13 But starting from the perspective that a court “should be alert, energetic and if necessary ingenious to assess damages where it is satisfied that a significant injury has flowed from breach,”[16] the process of estimating the insurer’s loss may be no different or more difficult to any other hypothetical exercise. The explosion in cases where judges are required to estimate the money value of a loss of chance affords a very telling example.[17] Judicial experience in the process of discounting damages in relation to contributory negligence are not entirely dissimilar, despite the Law Commission’s protestations in 1980 to the contrary.[18]

10.14 In the Commission’s view the position taken by the Law Commission in 1980 and the Australian Law Reform Commission in 1982 is fortified by the assessment made by the Law Commissions in their 2007 Consultation Paper, where the Law Commissions concluded that, on the difficulty in estimating hypothetical premiums:

> “We think that experience has shown that the 1980 Report exaggerated the difficulties. As the National Consumer Council pointed out, the Insurance Ombudsman Bureau applied proportionality, and its current successor, the FOS also does so. We found cases in FOS files where they had no trouble in dealing with an exclusion that would have been added, or in working out the effect on a premium of an additional motoring conviction. The approach appears to have gained acceptance from the industry, and we note that it also has the support of the British Insurance Law Association.[19]

10.15 As the Commission has provisionally recommended the abolition of the right to avoid or rescind a contract of insurance for an innocent non-disclosure that falls outside the reformulated duty of disclosure, as well as in instances of innocent misrepresentation, the question whether a remedy in damages should be available in either case does not arise. The insurer will have to meet any claim in full. The guiding principle should be to ask what this particular insurer would have done if the full facts were disclosed or known. If this cannot be determined for whatever reason then it might be possible to estimate the remedy by reference to general common law principles, as informed by the Law Commission’s view that the French Courts often determine a fair deduction as a matter of fact or discretion, rather than arithmetical precision.[20] Alternatively, the court may resort to some objective standard such as the prudent insurer who actively operates in the insurance field in question. The Commission do not think that in this residual area, where proportionality will be based on what the actual insurer would have done, any inflexible mechanism directing how this adjudication is to be made is possible.

10.16 Where however the insurer would have declined the proposal or excluded the loss that has arisen, the Law Commissions raise the question whether the courts should have a discretion to allow the insurer to recover a proportion of the claim where the proposer’s error was a minor one, and other insurers would have accepted the risk, at a higher premium.[21] This situation raises an important question for the Commission’s provisional recommendations and an affirmative answer would provide a convenient way of forestalling a number of difficult questions such as policing the boundary between innocent and negligent conduct as well as possible arguments about the applicability of contributory negligence. On the other hand, such a recommendation would have the effect of weakening the important policy objective that stands at the core of our proposals for reform, namely, that the law should require proposers to act

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16 Finlay P in *Grafton Court v Wadson Sales* High Court, 17 February 1975; *ESL Consulting Ltd v Verizon (Ireland) Ltd* [2008] IEHC 369.

17 *Philp v Ryan* [2004] IESC 105; *Lett & Co v Wexford BC* [2007] IEHC 195.

18 Law Com No. 104, para. 4. 106.

19 Consultation Paper, Para. 4.162.

20 Law Com No.104 para. 4.7.

21 Consultation Paper, para. 4.178.

carefully and responsibly when seeking to enter into a contract of insurance. The Commission would welcome views on whether this situation should be addressed in the forthcoming Report on Insurance Contracts but the Commission, at this time, would not favour creation of such discretionary powers.

10.17 Perhaps the most problematical question that arises is the scope of the Commission's recommendations relating to the creation of a compensatory remedy. Should the shift away from avoidance and rescission as the insurer's primary remedy to damages (save in instances of fraud) apply across the board? This is the situation in Australia. In the United Kingdom the Law Commissions certainly felt that this should be the case, *as a matter of principle*, but the joint Consultation Paper stopped short of recommending the demise of the avoidance remedy in business insurance as well as in consumer insurance cases where the proposer has been negligent. In the 2009 Report this disctinction between fraudulent and negligent non disclosure and misrepresentation was maintained; the *Consumer Insurance (Disclosure and Representations) Bill 2011* provides for different remedies for an insurer following upon deliberate or reckless misrepresentations and careless misrepresentations. In the first situation the insurer may avoid the contract and refuse all claims, retaining the premium except to the extent that it would be unfair to the consumer to retain them. In cases of careless misrepesentations the remedies to the insurer are based upon what the insurer would have done had the duty not to make a misrepresentation been observed. If the insurer would not have entered the contract on any terms, the claim may be declined and the premiums returned. If the insured would have added terms (eg disclaimers) the contract should be read as if it contained those terms. If a higher premium would have been charged "the insurer may reduce proportionately the amount to be paid on a claim. After taking the position that "avoidance in every case of negligence over-compensates the insurer for the loss it has suffered"[22] the Joint Consultation Paper addressed three main arguments against restricting the availability of the avoidance remedy in business insurance.

(1) it is difficult to prove the insured acted dishonestly;

(2) the difficulty of sharing what the insurer would have done (creating a field day for expert witnesses);

(3) the need to maintain strong incentives for proposers to act carefully.

10.18 The Law Commissions did not take a view on this, inviting submissions both on the question whether the law should distinguish between dishonest and negligent misrepresentation/non-disclosure and whether, for negligent conduct,

> "should the law provide a remedy which (unless the parties have agreed otherwise) aims to put the insurer into the position it would have been had it known the true circumstances?"[23]

10.19 In the United Kingdom the Law Commissions propose to return to business insurance contract issues late in 2011. The signs are that if the Law Commissions recommend anything at all, the changes proposed will be default rules that can be avoided by agreement, subject to the possibility that some small businesses, who do not arrange insurance through a broker, may be treated as if they were a consumer proposer. The Commission think that this is a reasonable inference to be drawn from the 2007 Consultation Paper.

10.20 The Commission concludes that the law should continue to distinguish between dishonest and negligent conduct and that dishonesty should continue to allow the insurer to refuse to meet the claim and retain the premiums. In cases of negligence the position to be adopted should be based upon what the insurer would have done had the misrepresentation not been made. The Commission conclude that this will provide the insurer with a remedy in damages in accordance with the principle that the insurer is to be put in the position the insurer would have been in had the insurer known the true circumstances: in cases of non-disclosure where the proposer negligently breaches the reformulated duty of disclosure, and in

22 Consultation Paper, para. 5.88. Soyer, in "Are the Law Commissions on the Right Track?" [2008] JBL 385 and "Reforming Pre-Contractual Information Duties in Business Insurance Contracts – One Reform Too Many?" [2009] JBL 15 argues that the Law Commissions restrictions on the availability of avoidance for negligent breach go too far.

23 Consultation Paper, para.5.107.

relation to negligent misrepresentation, the insurer should only avoid the policy or rescind the contract where the insurer can show that the risk would not have been accepted or that an exclusion applicable to the risk that materialised would have been imposed.

10.21 The Commission provisionally recommends that avoidance of the insurance policy should no longer be the main remedy, and that in cases of non-disclosure and misrepresentation the principal remedy should be one of damages in proportion to the failure by the insured.

10.22 The Commission provisionally recommends that the insurer should be able to avoid the policy prospectively upon discovery of a negligent non-disclosure or misrepresentation even if the insurer is bound to meet any claims submitted by the insured. Should the insurer decide to exercise this right the avoidance will be effective upon giving the insured written notice of this decision.

C Compensatory Remedies – Building on the 1980 Act

(a) Damages for Innocent misrepresentation?

10.23 For historical reasons the common law has not afforded the victims of an innocent misrepresentation any rights to seek damages: the primary remedy has been a right to rescind the contract. Case-law in the twentieth century began to recognise both the injustice and the inappropriateness of such a position by broadening promises into contractual terms, and by creating new tortious actions for negligent misstatements and breach of a fiduciary duty. Section 2(1) of the *Misrepresentation Act 1967*, the template for section 45(1) of the *Sale of Goods and Supply of Services Act 1980*, provided a misrepresentee with a statutory right to damages;

> "(1) Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true."

10.24 In theory this cause of action could be useful in relation to both insurers and insureds, insofar as a contract of insurance is within the statute as being a contract for services (see s.43 of the 1980 statute). But, as it will be shown, there are some obstacles preventing either party from using these provisions and judicial opinion stands against creating a right to damages for breach of a contract of insurance.

10.25 The Law Commissions noted that the English courts have taken a policy decision in relation to the scope of the s.2(1) action for damages following upon a non-fraudulent misrepresentation but it is the Commission's view that the impact of *Highland Insurance*[24] can be overestimated: that case concerned a contract of reinsurance effected as between sophisticated and experienced commercial entities and Steyn J's observations must be seen in this context. Nevertheless, s.2(1) does appear to set the bar at a high level, if *Banque Financiere v Westgate Insurance Co.*[25] is to be followed in Ireland. In the Court of Appeal Slade LJ observed that if the plaintiff is to recover damages under s.2(1), "the ingredients of a fraudulent misrepresentation have to be present save for the ingredient of dishonesty."[26] Because the plaintiff could not show that a misrepresentation had been made with the intention that it be acted upon by the other party, an essential element in the tort of a deceit was missing. More importantly perhaps, Slade LJ held that s.2(1) could not be used where a misrepresentation in the strict sense had not been made. If the defendant failed to observe a duty of disclosure that stopped short of a misrepresentation, s.2(1) is of no avail: after referring to the use of "misrepresentation...made" in s.2(1) of the 1967 Act, Slade LJ said the expression:

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[24] *Highland Insurance Co v Continental Insurance Co* [1987] 1 Lloyds' Rep. 109.

[25] [1989] 2 All ER 952.

[26] *Ibid,* p.1003, decision affirmed by the House of Lords [1990] 2 All ER 947.

"would, in our judgment, on the ordinary meaning of words be inapt to refer to a misrepresentation which had not been made in fact but was (at most) merely deemed by the common law to have been made. If it had been the intention of the legislature that a mere failure to discharge the duty of disclosure in the case of a contract *uberrimae fidei* would fall to be treated as the 'making' of a representation within the meaning of the 1967 Act, we are of the opinion that the legislature would have said so."[27]

10.26 Rix LJ in *HIH Insurance* also stated that breach of the duty of good faith leads to only to an avoidance remedy.[28]

(b) The discretion to award damages in lieu of rescission

10.27 Section 2(2) of the *Misrepresentation Act 1967*, which was the legislative template for section 45(2) of the *Sale of Goods and Supply of Services Act 1980,* provides an additional statutory relief by way of damages following a pre-contractual misrepresentation:

"(2) Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed in any proceedings arising out of the contract that the contract ought to be or has been rescinded, the court may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party."

10.28 Paragraphs in the *Tenth Report of the Law Reform Committee*[29] explain the thinking that prompted this legislative change. The Law Reform Committee clearly felt that it was necessary to restrict the representee's right to rescind the contract on the basis that damages would be a more proportionate remedy: after referring to the "drastic" remedy of rescission and proposals in the Report to make this remedy more widely available than hithertofore, the Committee recommended that damages should be available to a court as an alternative to rescission:

"Unless the court's power to grant rescission is made more elastic than it is at present, the court will not be able to take account of the relative importance or unimportance of the facts which have been misrepresented. A car might be returned to the vendor because of a misrepresentation about the mileage done since the engine was last overhauled, or a transfer of shares rescinded on account of an incorrect statement about the right to receive the current dividend. In some cases the result could be as harsh on the representor as the absence of a right to rescind under the present law can be on the representee."[30]

10.29 Section 2(2) of the *Misrepresentation Act 1967* has also been adopted in some Australian jurisdictions and in Hong Kong. What is surprising about the provision is just how little the provision has been used by the judiciary. Some of the reasons for this underutilisation may be traced back to the rather tentative nature of the 1967 reform itself. There is no right to damages in lieu: the Law Reform Committee recommended a judicial discretion be enacted:

"we recommend that wherever the court has power to order rescission it should, as an alternative, have a discretionary power to award damages if it is satisfied that these would afford adequate compensation to the plaintiff, having regard to the nature of the representation and the fact that the injury suffered by the plaintiff is small compared with what rescission would involve."

10.30 Section 2(2) clearly has no application to cases of fraudulent misrepresentation. It is also arguable that in cases where an insurer is seeking to avoid a contract of insurance for innocent misrepresentation or non-disclosure, *rescission* is not the remedy that the insurer seeks to invoke. The

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27 [1989] 2 All ER 952 at 1004.

28 *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2001] 2 Lloyd's Rep. 483.

29 (July 1962). Cmnd. 1872, *Innocent Misrepresentation.*

30 Ibid. Paragraph 11.

insurer is seeking to *avoid* the contract *ab initio* and it is arguable that the decision by the insurer to avoid may pre-empt any judicial discretion; Professor Malcolm Clarke has made this argument and even though it has been rejected by other authorities there is no clear judicial decision on the point. Furthermore, the relevance of the section to cases where an insurer seeks to avoid the contract for a breach of a representation of fact that has been converted into a contractual term – for example, the insurances proposal form or the policy makes a statement of fact a warranty – has not been established by case-law, but there does not seem to be any judicial discussion on such an obvious point. The learned authors of *Chitty on Contracts* observe that while the point is an open one this is not thought to be the result of s.2(2) and that "in any event it is very unlikely that the court would exercise its jurisdiction to prevent an insurer rescinding on the ground of misrepresentation by the insured." With respect, this seems to be a curious argument. If fraud is removed from the equation, there is no reason why a court could not decide that an innocent misrepresentation might be best remedied through an award of damages, regardless of whether the statement is or is not a contractual term. The same may also hold true in cases where the representation was made negligently. The section 2(2) discretion appears to be rather inelastic if observations of the kind made by *Chitty* represent the law.

10.31 It might be possible to build upon section 45(2) of the 1980 Act by clarifying that the judicial discretion does indeed apply to instances of *ab initio* avoidance and that the discretion applies even to misrepresentations that are integrated into the contract as warranties of existing or future fact. It is arguable that such a revision of s.45(2) would inject into this provision some of the vitality that the authors of the provision had in mind when this reform was initially contemplated in England and Wales.

(c) Damages – measure of loss under section 45(2)

10.32 As shown above, section 2(2) of the *Misrepresentation Act 1967* (UK) and section 45(2) of the *Sale of Goods and Services Act 1980* have not been used to any extent and there are no authoritative decisions on the measure of loss that a court would award should the discretion be exercised.

10.33 In the 1980 Report the Law Commission did not address the relationship between the 1967 Act and insurance law. The Law Commissions, in the 2007 Consultation Paper appear to have discounted the s.2(2) remedy on the ground that case-law is against applying the provision to commercial insurance and because the measure of damages "is obscure"[31]. The Commission is forced to conclude that the uncertain nature of section 45 of the 1980 Act makes it an unsatisfactory basis upon which to build a compensatory remedy. Nevertheless, it may be asked whether these objections to judicial use of section 45(2) are necessarily valid, especially in the light of the *Consumer Insurance (Disclosure and Representations) Bill 2011*. Schedule 1 of the Bill provides a set of rules that should guide any judge when deciding whether to exercise any discretion available in respect of section 45(2) of the 1980 Act and the relevant provisions are these (in abridged form):

10.34 The insurer's remedies are based on what it would have done if the proposer had complied with the duty. If the insurer would not have entered into the 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 insurance contract, but on different terms (exluding 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. In addition, if the insurer would have entered into the 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 reduce proportionately the amount to be paid on a claim. "Reduce proportionately" means that the insurer would need to pay on the claim only X% of what it would otherwise have been under an obligation to pay under the terms of the contract.

D Compensatory Remedies – damages for late payment of a claim

10.35 One of the most controversial aspects of insurance contract law is not addressed by the Law Commission in their 2007 Consultation Paper, possibly because the question resonates across the law relating to compensatory reliefs in commercial law. Should the insurer be required to pay compensatory damages to an insured when the failure by the insurer to settle a claim has caused consequential loss?

[31] Consultation Paper 2007, para.2.14.

There are a number of aspects to this question. The core issues are addressed in relation to the duty of good faith and whether any breach of duty on the part of an insurer should attract an award of damages in respect of consequential loss. Two provisions in the *Principles of European Contract Law (PEICL)* provide a convenient benchmark:

Article 6:103

Acceptance of Claims

(1) The insurer shall take all reasonable steps to settle a claim promptly.

(2) Unless the insurer rejects a claim or defers acceptance of a claim by written notice giving reasons for its decision within one month after receipt of the relevant documents and other information, the claim shall be deemed to have been accepted.

Article 6:104 (3) provides that payment of insurance money, whether relating to the whole or part of an as yet unquantified claim, shall be made no later than one week after acceptance or qualification. The PEICL continue:

Article 6:105

Late Performance

(1) If insurance money is not paid in accordance with Article 6:104, the claimant shall be entitled to interest on that sum from the time when payment was due to the time of payment and at the rate applied by the European Central Bank to is most recent main refinancing operation carried out before the first calendar day of the half-year in question, plus seven percentage points.

(2) The claimant shall be entitled to recover damages for any additional loss caused by late payment of the insurance money.

(a) The position in English law

10.36 English law clearly supports the proposition that there can be no cause of action in respect of the late payment or non payment of monies due on a policy of insurance. As the time for assessing the loss occasioned by the event that triggers the claim is the time of that event, and no later date, the fact that the costs of reinstatement, for example, have risen or fallen is irrelevant. The decision of the House of Lords in *President of India v Lips Maritime Corporation* is authority for the proposition that "there is no such thing as a cause of action in damages for late payment of damages."

10.37 This bizarre situation is due to the view that, at common law a contract of indemnity gives rise to an action for unliquidated damages arising from the failure by the indemnifiers to prevent the indemnified person from suffering damage, the common law also supporting the view that the cause of action does not arise until the indemnified person can show actual loss. It is the specified loss that is recoverable: *The Fanti:*[32] The Law Commissions, in *Issues Paper 6, Damages for Late Payment*[33] chart the rather unhappy line of authority, whilst noting that the Scottish courts have rejected the view that the obligation on an insurer is to hold harmless the insured, not pay damages, preferring instead to hold that the insurer has an obligation to pay a valid claim once it has had the opportunity to investigate the validity of the claim: *Strachan v The Scottish Boatowner's Mutual Insurance Corporation.*[34] This is also the position taken in Australia, Canada and the United States.[35] Unfortunately the scant authority available in Ireland inclines towards the English position.[36]

32 [1991] 2 AC 1.

33 March 2010.

34 [2001] Scots CS 138.

35 See Appendix A of Issues Paper 6.

36 *Kerry Tree (Technology) Ltd v Sun Alliance and London Insurance* [2001] IEHC 144.

10.38 The decision of Hirst J in *The Italia Express (No.2)*[37] applied the reasoning in *Lips* (a case on demurrage) to a case involving payments of insurance withheld whilst investigating suspected fraud. In *Sprung v Royal Insurance*[38] the Court of Appeal rejected the argument that an insured had a claim in damages arising out of the insurer's failure to pay out promptly on a policy, the insurer, if in breach of contract, being answerable only to the insured by way of interest. Professor Merkin summarises English law as having adopted the position that "an assured who is paid late, and who in the meantime loses his business for want of funds to reinstate his premises, has no additional remedy against his insurers."[39] While this is generally the accepted position, there are some decisions that provide some prospect of change. Even *Sprung* itself reflects a degree of unease with a rule of law that displaces the general application of *Hadley v Baxendale*. Evans LJ in *Sprung* said that while the *Italian Express* states that late or non payment *per se* is not actionable if, on the other hand:

> "the plaintiff is able to show that the defendants have committed some other and separate breach of contract, and if specifically he can show that the defendants were in breach by failing to accept liability or to approve of the reinstatement at an early stage, then the recovery of damages would not be restricted to the discretionary award of interest in the other case."[40]

10.39 In *Tonkin v UK Insurance Ltd*[41] Judge Coulson QC approved both the general principle and the exception sketched out by Evans LJ in *Sprung*. In *Tonkin* the plaintiff sought to have damages assessed by reference to the increased cost of reinstatement work that resulted from the insurer's failure to pay out promptly on the claim, the insurers defending the action by arguing that the insured had failed to provide proper information to support the claim. While on the facts the insured's claim was extremely weak, *Tonkin* does open up the possibility of some movement on this point in English law. Rix LJ, in *Mandrake Holdings Ltd v Countywide Assured Group*[42] opined that this matter was a matter for review by the House of Lords but, as the Law Commission's Issues Paper No.6 indicates, the House of Lords did not grant leave to appeal to the House. Issues Paper No.6 points up the extent to which the English approach is somewhat isolated and in need of reform.

10.40 In Ireland, the only real guidance on this point is somewhat oblique. *Kerry Tree (Technology) Ltd v Sun Alliance and London Insurance*[43] concerned a claim brought against an insurer involving allegations that the insurer had caused a business to fail when imposing unreasonable duties to mitigate loss before setting an insurance claim. The insurers put forward the argument that *Sprung* is authority for the proposition that a claim for damages for late payment of damages is not a claim know to the law and Ms Justice Carroll affirmed that such a proposition is part of Irish law.

10.41 The Commission would support the view that *Italia Express* and *Sprung* should not be followed and that the law needs to be changed so as to reflect mainstream reasoning on remoteness of damage in contract law as well as emerging principles of restitution. In this context however, the Commission suggests that Article 6:103 and 6:105 of the Principles of European Contract Law should form a part of Irish law.[44]

10.42 *The Commission provisionally recommends that any damages awarded to an insured arising from the insurer's failure to comply with the proposed post-contractual duties of the insurer should reflect: (a) general principles of damages in contract law, namely whether the loss is a reasonably foreseeable*

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37 [1992] 2 Lloyd's Rep. 281

38 [1999] 1 Lloyd's Rep. 111.

39 Merkin, "Reforming Insurance Law: is there a case for *Reverse Transportation?"*, paragraph 8.12

40 [1999] 1 Lloyd's Rep. 111 at 116

41 [2007] Lloyd's Rep IR 283.

42 [2005] EWCA Civ 840

43 [2001] IEHC 144.

44 The Law Commissions support the view that damages should be recoverable for late payment of a claim and provide a seven stage test which an insured must satisfiy to successfully claim such damages. See, Joint Consultation Paper 2011: Insurance Contract Law: Post Contactual Duties and Other Issues.

consequence of the breach of contract (and in particular, damages that are reasonably foreseeable from a refusal in bad faith to meet a valid claim); and (b) emerging principles of restitution.

10.43 *The Commission invites submissions as to the period of time within which an insurer should meet valid claims.*

E Non-Pecuniary Loss and Damages

10.44 If an insured seeks to recover damages for distress, stigma, injured feelings, physical or mental injury occasioned by the way in which an insurer processes or rejects a claim, and the court finds that the insured's complaint has some validity, an obstacle to recovery may involve principles of remoteness of damages. In general terms, commercial contracts may be attended by stress, but a plaintiff is unlikely to recover damages for mental distress created by a commercial contract that is breached by a defendant. In one recent English case damages for stress and inconvenience occasioned to a 'do it yourself' enthusiast when a flat pack, self assembly suite of wardrobes did not meet the measurements provided and could not therefore fit into existing furniture units[45].

10.45 Where however the contract in question has a predominantly non-commercial purpose or no significant economic dimension to it – holidays, family occasions such as a wedding for instance – damages for stress and disappointment can be recoverable. Furthermore, if the contract is one in which the plaintiff can be said to have sought relief from a stressful situation, or contracted for a professional service aimed at ameliorating some of the unfortunate events that attend human experience, remoteness of damage principles may not be a bar to recovery. In *Hamilton Jones v David & Snape (a firm)*[46] Neuberger J awarded damages for mental distress caused by a firm of solicitors who conducted child custody proceedings carelessly, permitting the children's father to take the children outside the jurisdiction when appropriate procedures existed to prevent this. Holding that the claimant had engaged the firm to obtain pleasure, relaxation, peace of mind and freedom from molestation, objectives that had not been met, damages of £25,000 for mental distress were awarded. While there are no Irish decisions that hold that an essential purpose behind an insurance contract is protecting the insured form foreseeable disasters, it is submitted that consumer and small business insurance should not be regarded as exclusively commercial contracts in the strict sense.

10.46 The decision of Quirke J, in a High Court action brought by a Dublin solicitor, John Hennessy, in respect of injuries occasioned by a fall from a horse when undertaking a riding lesson at Adare Manor Equestrian Centre, Limerick, demonstrates that there is some room for non-economic loss to be recoverable when an insurer is the substantive defendant. Mr Hennessy alleged the injuries were the result of leaving him, as an inexperienced rider, alone and unsupervised. The defendant's insurers, Quirke J observed, according to a press report[47] defended the action by way of "a most serious allegation of fraud against Mr Hennessy which was maintained over two full days of evidence. This allegation was made with disregard for the consequences for his reputation, the judge added." Damages of €45,000 were awarded to compensate Mr Hennessy for his injuries and €30,000 in aggravated damages were awarded "to compensate him for the added hurt caused by the defendants "outrageous conduct" and to deter the defendant and his indemnifiers from similar conduct in the future."

10.47 Because of the fact that there are no Irish cases in which the availability of damages for breach of any duty of good faith has been considered, one must consider how the *Marine Insurance Act 1906* addresses the issue of an available remedy. Section 17 indicates that the only remedy is avoidance, and in the leading case of *Banque Financiere de la Cite SA v Westgate Insurance Co*[48] the House of Lords approved the reasoning of the Court of Appeal; in English law therefore damages of any kind are not available for breach of the duty of utmost good faith.

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45 *Artis v MFI* [2006] CLY 1013; on the general rule and exceptions see *Farley v Skinner* [2002] 2 AC 732

46 [2001] 1 WLR 924. In property insurance see *AXA Insurance UK v Cunningham Lindsey UK* [2007] EWHC 3023 (TCC).

47 See "€30,000 awarded to solicitor over fraud accusation made against him" *Irish Times* May 13, 2009.

48 [1991] 2 AC 249.

10.48 The Ontario Court of Appeal, in *702535 Ontario Inc v Tinmouth and others*[49] observed that an insurance contract is one of utmost good faith:

> "there is an implied obligation in every insurance contract that the insurer will deal with claims form its insured in good faith[50]… good faith requires the insurer to act both promptly and fairly when investigating, assessing and attempting to resolve claims made by its insureds.
>
> The first part of this duty speaks to the timeliness in which a claim is processed by the insurer. Although an insurer may be responsible to pay interest on a claim paid after delay, delay in payment may nevertheless operate to the disadvantage of an insured. The insured, having suffered a loss, will frequently be under financial pressure to settle the claim as soon as possible in order to redress the situation that underlies the claim. The duty of good faith obliges the insurer to act with reasonable promptness during each step of the claims process. Included in this duty is the obligation to pay a claim in a timely manner when there is no reasonable basis to contest coverage or to withhold payment….[51]
>
> The duty of good faith also requires an insurer to deal with its insured's claim fairly. The duty to act fairly applies both to the manner in which the insurer investigates and assesses the claim and to the decision whether or not to pay the claim. In making a decision whether to refuse a claim from its insured, an insurer must assess the merits of the claim in a balanced and reasonable manner. It must not deny coverage or delay payment in order to take advantage of the insured's economic vulnerability or to gain bargaining leverage in negotiating a settlement. A decision by an insurer to refuse payment should be based on a reasonable interpretation of its obligations under the policy."[52]

10.49 These Canadian cases distinguish damages for breach as being independent of damages payable in respect of the underlying claims. Aggravated and punative damages are also possible. In contrast to the English position, the Canadian and Australian courts have been clearer on both the nature of the post contractual duty placed on the isurer either via a contractual implied term (as in Canada), and by virtue of statute law (as in Australia). These cases clearly envisage the award of damages from breach of the duty of good faith, in an appropriate case: *Fidler v Sun Life Assurance Co of Canada.*[53] The Canadian courts have ruled that it is not necessary to prove an independent actionable wrong for damages for mental distress to be recoverable, nor need the "very essence" of the bargain to seek to obtain relief from mental anxiety, for example.

10.50 The High Court of Australia, in *CGU Ltd v AMP Financial Planning Pty Ltd*[54] had to consider whether an insurer had breached the section 13 *Insurance Contracts Act 1984* post-contractual duty of good faith by, belatedly, putting the insured to an obligation to show that claims made and settled, with the insurer's apparent approval, were claims in respect of which liability would have been made out. The case is a complex one in which much of the evidence concerned the conduct of the trial and the reasoning of the Full Court of the Federal Court (which itself involved a 2:1 majority decision), but there was agreement in the High Court of Australia that it is not correct to argue that absence of good faith is limited to cases of dishonesty. Gleeson CJ and Crennan J wrote:

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49 (2000) 184 DLR (4th) 687.

50 Citing *Whiten v Pilot Insurance Co*. Ontario Court of Appeal decision [1999] (Can LII 3051), see later the decision of the S.CC. at [2002] 1 SCR 595.

51 Citing *Bullock v Trafalgar Insurance Co of Canada* [1996] O.J. No. 2566; *Labelle v Guardian Insurance Co* [1989] 37 CCLI 274; *Jauvin v L'Ami Michel Automobile Canada* (1986) 57 O.R. (2d) 528.

52 *Ibid;* see also *Maschke Estate v Gleeson* (1986) 54 OR (2d) 753; *Finlay v Trimac Corp* [2008] Can LII 16191; *Veno v United General Insurance Corporation* (2008) 330 NBR (2d) 237.

53 [2006] 2 SCR3; *McQueen v Echelon General Insurance Co* [2009] Can LII 50865. Privity of contract may be required – *Mirjagic v State Farm Mutual Automobile Insurance Co* [2009] Can LII 44415.

54 [2007] HCA 36: see also (2007) 235 C.LR 1.

"The classic example of an insured's obligation of utmost good faith is a requirement of full disclosure to an insurer, that is to say, a requirement to pay regard to the legitimate interests of the insurer. Conversely, an insurer's statutory obligation to act with utmost good faith may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured. Such an obligation may well affect the conduct of an insurer in making a timely response to a claim for indemnity.[55]

10.51 Callinan and Heydon JJ agreed, drawing an analogy between the reciprocal duty of good faith and the "clean hands" doctrine that underpins the availability of equitable reliefs, "observing that the doctrine was, like the maxim that "he who seeks equity must to equity"[56] In his dissenting judgment, Kirby J, wrote that the absence of honesty was a universal feature of section 13 duty; following ealier case-law Kirby J favoured the adoption of a test of whether a party was guilty of "dishonest, capricious or unreasonable conduct."[57]

10.52 The Commission note that in Issues Paper 6 the Law Commissions have suggested that damages for breach of the duty of utmost good faith should be available. However, damages for distress and disappointment do not generally feature in the Issues Paper (there is a limited discussion at paragraphs 5.43 to 5.48) and English courts suggest that where awards are possible the award should be "restrained and modest"[58] although the decision in *Farley v Skinner* from which this standard is taken is not always appropriate. In contrast, in Ireland, the Financial Services Ombudsman has taken a different view in some instances.

- In one case, where non disclosure avoided a life policy of €20,000 the Ombudsman awarded compensation of €5,000 to mark the fact that the insurer's own sales guidelines has not been followed by the company representative.
- In a case of high pressure sales practices deployed to sell an inappropriate product, the insurer had returned all premiums when discovering how company representatives had acted. The Ombudsman awarded compensation of €1.500 "for the distress caused" to the vulnerable insured.
- Maladministration of a high value Whole of the Life policy led to an award of €50,000 in lieu of an offer of €15,000 offered by the insurer to mark the "great inconvenience" and "loss of trust" caused.
- A compensatory award of €8,000 was ordered, partly to reflect the fact that the company had refused to pay the claim "without adhering to its own policy requirements".
- Refusal to repatriate the remains of a deceased insured under a travel policy based on (unsatisfactory) allegations that death occasioned by alcohol. Compensation of €500 for distress caused to the family was awarded.
- Reductions in maternity cover protection effected under the guise of an "upgrade" were ruled impermissible with the insured receiving a compensatory payment of €2,000.
- Compensation of €4,000 awarded to a man who made claims on a loan protection policy that became operative upon becoming unemployed "by way of compensation for the wholly inadequate and unprofessional level of service provided to him and the degree of inconvenience caused".
- Following upon the death of his wife the insured had wrongly been told on four occasions that death benefit cover would result in a payment of €130,000. The Ombudsman ordered a goodwill payment of €7,500 "in recognition of the distress caused".

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55 Para. 16 of the Judgment.

56 Para. 257 of the Judgment.

57 Para. 131 of the judgment, following Owen J in *Kelly v New Zealand Insurance Co Ltd* (1996) 130 FLR 97 at p.111; *Speno Rail Maintenance Australia Pty Ltd v Metals and Minerals Insurance* [2009] WASCA 31

58 Paragraph 5.47.

- An insurer cancelled a motor insurance policy by telephone call when the policy itself required to to be done in writing. Compensation of €800 ordered for "inconvenience and confusion" caused.
- An insured suffered injuries while on a skiing holiday in Austria. Delays in processing payments on a holiday insurance policy led the Austrian health provider to threaten legal action for recovery of the outstanding fees. Compensation of €200 ordered for "stress and inconvenience caused"

(a) Aggravated Damages and the 2000 Report

10.53 In the Report *Aggravated, Exemplary and Restitutionary Damages*[59] the Commission drew attention to the distinction between exemplary damages and aggravated damages. While the courts utilise exemplary damages so as to punish a defendant and deter the defendant and others from embarking on similar outrageous conduct in the future,[60] aggravated damages are regarded as being compensatory. However, the conduct of the defendant in acting in blatant disregard of the reasonable expectations of the plaintiff may of course be seen as a factor that could deepen the sense of hurt and distress felt by the plaintiff and the Commisison observed that while some Irish courts have identified aggravated damages as compensatory, some judges have referred to the conduct of the defendant in ways "which sit uneasily with a compensatory definition".[61] This terminological confusion led the Commission to recommend a legislative measure defining aggravated damages thus:

> "Aggravated damages are damages to compensate a plaintiff for added hurt, distress or insult caused by the manner in which the defendant committed the wrong giving rise to the plaintiff's claim, or by the defendant's conduct subsequent to the wrong including the conduct of legal proceedings."

10.54 It is perhaps suprising that the Commission did not recommend that aggravated damages should be available in breach of contract cases: at paragraph 5:26 the Commission recommended that "aggravated damages should be available for all torts and for breach of constitutional rights." In any event several post-2000 cases hold that aggravated damages may be awarded so as to mark the way in which a defendant has breached a contract, occasioning injury to the plaintiff outside any economic test.

10.55 In *Dinnegan and Dinnegan v Ryan*[62] a publican refused to provide contracted services to a wedding party occasioning considerable distress and humiliation for the plaintiff bride and groom. Damages of €6,000 were awarded to each of the plaintiffs. "Stigma" damages within the context of breaches of duty have been held to be available remedies for employees.[63] There is no doubt that future case-law will continue to push at the boundaries of the compensatory principle while retaining, as a general rule, the view that stress and disappointment occasioned by a commercial venture that goes awry is not to be recoverable in an action for breach of contract.

10.56 The decision of Quirke J in relation to John Hennessy's riding accident, unreported but outlined at paragraph 10.46 above, suggests that Irish Law has already provided aggravated damages to an insured in circumstances when a claim has not been met by a bona fide defence on the part of the defendant and the defendant's insurers. However, that claim may well have been brought in tort only. Discussion has often focused on the possibility of establishing a distinct tort in relation to good faith as well as the emergence of an action for breach of an implied term in a contract of insurance, but, within this context, it is not necessary to go further than the view expressed in the Supreme Court of Canada in *Whiten* in which existing damages principles were utilised in contract.

10.57 The Commission wishes to emphasise that, in most cases of commercial insurance, the view expressed by the English Court of Appeal in *The Italia Express,* denying damages for distress will be applicable for breach of a commercial contract.

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59 LRC 60-2000.

60 *Conway v. INTO [1991] 2 IR 305*

61 Paragraph 5.15, citing Finlay CJ in *Conway v INTO* [1991] 2 IR 305.

62 [2002] 3 IR 178.

63 *Orr v Zomax Ltd* [2004] IEHC 47, *McGrath v Trintech* [2004] IEHC 342.

10.58 However, that case concerned a contract of marine insurance and to extrapolate from that case a proposition denying aggravated damages to all insureds is quite out of step with later developments such as Farley v Skinner[64].

10.59 The definition of aggravated damages in the 2000 Report is a broad one: it reflects the need to take account of the distress and injury caused to the plaintiff as well as the unacceptable conduct of the defendant. In the present context the Commission considers that the notion of utmost good faith will provide the court with a relevant benchmark, seen in this context, and in the light of other considerations set out in the 2000 Report.

10.60 The Commission believes that this residual compensatory power will be used sparingly and only in the most egregious cases.

F Exemplary Damages and the 2000 Report

10.61 In 2000, the Commission, in its Report considered whether exemplary damages should be extended to cases of breach of contract. While the Commission considered that "an extension of exemplary damages to contract cases would be at odds with the traditional concept of contract law as having an exclusively private law character", the Commission went on to say that the Commission "does not, however, recommend that exemplary damages for breach of contract should be prohibited by legislation; rather, any possible development of the law on this matter, should be left to the courts where it can be judged on a case by case basis.[65]

10.62 Subsequent developments in other jurisdictions suggest that there may be an argument for holding that an insurer who breaches the duty of utmost good faith should, in an appropriate case, be liable to pay exemplary damages whenever the court considers that a compensatory award will not punish a defendant for his outrageous conduct and provide a sufficient deterrent to the adoption of a similar course of conduct in the future.

10.63 In the Canadian courts, damages awards that have been made in favour of an insured for the insurer's breach of the duty of good faith, include non-compensatory elements in the quantum[66]. The Supreme Court of Canada, in *Whiten v Pilot Insurance Company*[67] upheld a jury award of $1 million in punitive damages where an insurer adopted an exceptionally reprehensible attitude to an insured's claim under a domestic fire insurance policy, forcing the insured to litigate by making contrived and unsustainable allegations that the insured had torched her own property. One feature of the case that is of some importance is the fact that the unfounded allegation of arson had a significant stigmatising effect on the reputation of the insured within the locality, and the distress that the insured experienced was significant and protracted; loss of this kind is often characterised as aggravated loss and it is possible to compensate a plaintiff for this kind of non-economic loss without characterising the exercise as constituting an award of exemplary damages.

10.64 Nevertheless, the majority of the Supreme Court of Canada, in *Whiten*, identified a need for some actionable conduct to be present if exemplary damages are to be awarded. Binnie J indicated that the situation before the Court was not simply a case of a breach of contract to meet the insurance claim: breach of the contractual duty of good faith is independent of and in addition to the breach of contractual duty to pay the loss. However, Binnie J stressed that *Whiten* was an exceptional case that justified an exceptional remedy.

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64 [2002] 2 AC 732. See generally Swaby and Richards, "Insurance Reforms: Rebalancing the Kilter?" [2011] JBL 535.

65 LRC 60, para. 1.56.

66 Eg. *Fidler v Sun Life Assurance* [2006] 2 SCR3; *McQueen v Echelon General Insurance Co.* [2009] Can LII 66152

67 (2002) 209 DLR (4th) 257; in South Africa Van Niekerk, "Something must be Done about Insurer Bad Faith" (1998) 10 SA Merc LJ 110 bemoaned the lack of judicial activism in South Africa in relation to tardy insurers in a case where the insured's death by cardiac arrest may have been contributed to by the insurance dispute.

G Subrogation – Public Policy Exceptions

10.65 Subrogation is a right that is normally exercised by an insurer who, having paid a loss that has arisen under a policy executed as between the insurer and an assured, steps into the shoes of the assured in order to eliminate or reduce the loss in question. The insurer is able to obtain the benefit of any rights and remedies available to the assured against third parties and may in fact sue any third party in the assured's name.

10.66 In the leading Irish case of *Driscoll v Driscoll,*[68] O'Connor MR said that:

> "the foundation of the doctrine of subrogation is to be found in the principle that no man should be paid twice over in compensation for the same loss. The corollary to this is that a contract of indemnity against loss should not have the effect of preventing the insured from being paid once in full. I do not think that this can be disputed.[69]

10.67 Examples of the first situation outlined above can be found in Irish cases such as *Ballymagauran Co-operative Agricultural and Dairy Society Ltd v The County Councils of Cavan and Leitrim,*[70] and *Doyle v Wicklow County Council.*[71] In both of these cases actions were brought for compensation for malicious damage against local authorities. The fact that the applicants had contractual actions against their insurers, or had actually been paid on the foot of insurance, did not provide a defence on the malicious injury claim. In *Doyle v Wicklow County Council* Griffin J, for a unanimous Supreme Court wrote that:

> "it is irrelevant whether the applicant in the present case had insured against the risk of damage by fire or otherwise, or whether or not he had been paid on foot of his policy of insurance. If he had already been paid on foot of the policy of insurance he, as the insured, must account to the insurers for any benefit he receives from his claim for compensation."[72]

10.68 Part of the subrogation principle involves a more proactive proposition: "[t]he insurer is subrogated to any claim of any character which the assured is entitled to bring in proceedings against a third party to diminish his loss."[73] While the insurer cannot recover against the wrongdoer in circumstances where the insured could not have successfully mounted an action, the possibility that the insured could have theoretically recovered against a wrongdoer may leave open subrogation rights. It matters not that the insured would not have commenced proceedings for obvious reasons, *ie*, the wrongdoer was a family member or an employee, the likelihood that such a person had, or was expected to have, separate insurance being non-existent.

10.69 In *Lister v Romford Ice and Cold Storage Co Ltd*[74] an insurer was held entitled to be subrogated to the right to sue an employee of the insured who had injured a fellow worker in the negligent carrying out of employment duties. Because the contract of employment did not give the negligent employee an express or implied right to be indemnified by the employer for the negligent carrying out of contractual duties, the way was left open for the insurer to utilise subrogation rights without the consent of the employer – indeed, even if this was contrary to the wishes of the employer, not least because the insurer can conduct subrogation litigation in the name of the insured.

10.70 There are two situations in which this subrogation right has a public policy dimension.

i) Where the insured and the wrongdoer live together in a family unit (and possibly where those persons are related or part of a social unit analogous to that of a family)

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68 [1918] 1 IR 152.

69 *Ibid at 159*

70 [1915] 49 ILTR 49

71 [1974] IR 55.

72 *Ibid* at p74.

73 McGillivray, paragraph 22-036.

74 [1957] AC 555

ii) Where the insured and the wrongdoer are parties to an employment contract with each other so as to trigger vicarious liability.

(i) Subrogation – Intra Family Claims

10.71 In the first situation, the 1982 Australian ALRC Report made the following observation:

> "It is not appropriate that subrogation be available in circumstances where double indemnity is, as a practical matter, not in issue and where the liability to be relied upon. The most obvious cases concern domestic insurance. In the field of householder's insurance, for example, cover is offer extended to members of the insured's family living with him in the household. But it is not extended to members of his family living apart, nor to other close relatives or friends who might visit him. Suppose an insured makes a claim for damage to furniture caused by a fire started when a relative of the insured carelessly dropped a lighted match into a wastepaper basket. Unless the relative carries liability cover, there would normally be no question of the insured himself seeking to recover damages for his relative's negligence. Yet the insurer is entitled to bring an action against the relative in the insured's name"[75]

10.72 This situation has arisen for consideration in Ireland. In *Moynihan v Moynihan*[76] the plaintiff, a two year old child, injured herself whilst visiting the home of her grandmother as a result of what Henchy J called "an unforeseeable sequence of fortuities". The injuries occurred due to the alleged negligence of the grandmother and Marie, one of the plaintiff's aunts in relation to voluntary acts of supervision. As such, the plaintiff's case tested the boundaries or vicarious liability for it was clear that no employment relationship existed of any kind. Nevertheless, Walsh J, O'Higgins CJ concurring, found that the trial judge was wrong to withdraw the issue of liability from the jury on the basis that the grandmother could not be vicariously liable, in law, for the gratuitous acts of Marie. Henchy J dissented saying that the absence of any employment relationship between the defendant and her daughter Marie, "the circumstances of the accident do not fit into any of the exceptions to the rule that a principal is not liable for the negligence of an independent contractor or a gratuitous helper or a delegate who is not a servant."[77]

10.73 One can only speculate on the possibility that the defendant was selected because some policy of domestic insurance was in place in her name; Marie may have been put in the supervisory role but possibly was not insured against such an event. Henchy J was clearly aware of such a scenario:

> "Much as one might wish that the law would allow this plaintiff to recover damages from some quarter for the consequences of the unfortunate accident that befell her, the inescapable fact is that there is a complete absence of authority for the proposition that liability should fall on the defendant (who was innocent of any causative fault) rather than on Marie whose conduct is alleged to have been primarily responsible for the accident. I see no justification for stretching the law so as to make it cover the present claim when, by doing so, the effect would be that liability in negligence would attach to persons for casual and gratuitous acts of others, as to the performance of which they would be personally blameless and against the risks of which they could not reasonably have been expected to be insured. To transfer or extend liability in these circumstances from the blameworthy person to a blameless person would involve the redress of one wrong by the creation of another. It would be unfair and oppressive to exact compensatory damages from a person for an act done on his behalf, especially in the case of an intrinsically harmless act, if it was done in a negligent manner which he could not reasonably have foreseen and if—unlike an employer, or a person with a primarily personal duty of care, or a motor-car owner, or the like—he could not reasonably have been expected to be insured against the risk of that negligence."[78]

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[75] ALRC Report No 20, paragraph 305.

[76] [1975] IR 192.

[77] [1975] IR 192 at 202.

[78] [1975] IR 192 at 202-3

(ii) Subrogation – Employee Liability

10.74 *Lister v Romford Ice and Cold Storage Co Ltd* was cited with apparent approval by McCarthy J in *Sinnott v Quinnsworth*[79] at least insofar as McCarthy J was considering whether a negligent employee who injures another employee whilst driving a motor vehicle in the course of employment is entitled to be indemnified by an employer under section 21(1) of the *Civil Liability Act 1961*. This question was answered in the negative. However, in a very different context, that of subrogation rights of two insurers arising out of the same incident in respect of which two overlapping policies are in place. McCarthy J clearly viewed the logic of *Lister* as having unsatisfactory results. In the case of *Zurich Insurance Company v Shield Insurance Company Ltd,*[80] a postscript to *Sinnott v Quinnsworth* itself, McCarthy J remarked that the negligent driver , Edward Durning, in the view of one of the two insurance would be personally liable to indemnify one of the insurance companies at least to 50% of the amount in question. McCarthy J responded by stating that Irish law did not have such an effect:

> "Happily, the employees of Quinnsworth, and indeed, any other employees including those of insurance companies, who drive company cars and give lifts in the course of work to fellow employees, are not faced with such dire consequences."[81]

10.75 It is arguable therefore that Irish law is somewhat ambiguous on the scope of *Lister* and its relevance in Irish law. In *Sinnott v Quinnsworth* McCarthy J cited both the *ratio decidendi* of the majority judgment, and the reasoning of the two dissenting Lords in relation to underlying policy, with apparent approval.[82] These contrasting views, form one outstanding jurist, are understandable when bearing in mind that McCarthy J was considering a range of distinct issues. The Commission will examine how some other jurisdictions have addressed the issue of public policy limitations on subrogation rights.

(2) Limitations on Subrogation Rights

(a) The Principles of European Insurance Contract Law

10.76 Article 10:101(3) contains an important provision that addresses these public policy considerations in a quite sweeping fashion:

> "The insurer shall not be entitled to exercise rights of subrogation against a member of the household of the policyholder or insured, a person in an equivalent social relationship to the policyholder or insured, or an employee of the policyholder or insured, except when it proves that the loss was caused by such a person intentionally or recklessly and with knowledge that the loss would probably result."

10.77 The notes to Article 10:101(3) provide the following comments:[83]

> "National legal systems deal with the issue covered by this paragraph in different ways, but at least some of them provide for similar restrictions on insurer's subrogation rights and there are equivalent voluntary ones elsewhere. The purpose of these restrictions is to prevent the social harm that could result from a person appearing to bring a legal action against someone with whom he or she might be in an extremely close relationship, even if in reality the action is brought by the insurers. There are sound policy reasons for providing such exclusions. To take a simple example, it does not seem sound to allow an insurer who has indemnified the owner of, say, a vase whom it has indemnified, to claim against the owner's partner who was simply careless in causing the vase to fall to the floor and break.
>
> It is clear that such restrictions do not apply when the insurer can prove that the defendant caused the loss deliberately or recklessly and with knowledge that loss or damage would probably result....there is no good policy reason to exempt from liability someone who has

[79] [1984] ILRM 523.

[80] [1988] IR 174.

[81] [1984] ILRM 523.

[82] [1984] ILRM 523 at 537-8.

[83] Page 257.

caused loss in such circumstances. On the other hand, the paragraph does protect the defendant who has been negligent.

Three categories of persons are protected by Article 10:101 para.3. The restrictions extend to persons connected with the policyholder and not just with the insured. "Member of the household" should be understood to mean someone living in the same household as the policyholder or insured. The second category – those in an equivalent social relationship – should be construed to cover members of the family of the policyholder or insured who do not live with the latter and such persons as close friends or neighbours because action against such persons could lead to a breakdown in relationships. As to the third category, it should always be clear whether or not a person is an employee of the policyholder or insured.

10.78 In developing the thinking behind some of these national law exceptions, the PEICL authors stress that the decision to deny an insurer a subrogation right is based upon the fact that the insured himself "would have brought no claim and who might take *defacto* or *de jure* recourse against the policyholder or the insured. Another argument is that the insurance is often taken out also in the interest of those individuals."[84]

> "The group of protected persons varies from country to country. It is generally agreed that close family members such as the insured's spouse, children, and parents as well as persons living with the insured in the same household are protected under the exception clause....In addition, some statues also include persons employed in the household of the insured.... The Netherlands adopts the broadest approach extending the protection also to the employer or employee of the policyholder or insured, or to persons employed with the same employer.
>
> As a general rule, the exception to subrogation does not apply where the third party caused the insured event intentionally....[In Switzerland] on the other hand, the exemption clause is only applicable if the third party in question acted with *slight* negligence or with no fault at all (see art. 72 para. 3 ICA)."[85]

(b) The Australian Experience

10.79 The reaction to *Lister* in Australia has been of considerable interest, demonstrating both a judicial and a legislative reaction (at both federal and state levels) to the majority decision in *Lister*. The position in Australia is a complex one in the sense that the insurance law issue concerns matters of a federal nature while the vicarious liability situation in employment law has been addressed by the Australian States.

10.80 In the 1982 Report, the ALRC opined that it is the expectations of employees that:

> "the burden of risks attendant upon employment will be borne by the employer. The employer is expected to insure himself against liability to third parties...exercise, in this context, of an insurer's rights of subrogation is inconsistent with sound practice in the field of industrial relations."[86]

10.81 The ALRC noted that South Australia had reversed *Lister* New South Wales had at that time introduced similar legislation, while Tasmania required insurance be taken out by an employer to cover employees injuring fellow employees. The ALRC recommended that in the context of insurance, the South Australian approach be adopted.

10.82 The situation in New South Wales is of direct relevance insofar as the *Employee's Liability (Indemnification of Employer) Act 1982* closed off all employers' rights to recover damages for breach of contract by an employee, but the statute was silent on concurrent liability in tort. Subsequent litigation allowed the judiciary to close this gap through a process of interpretation. In *McGrath v Fairfield Municipal Council*[87] the High Court of Australia gave amending legislation, the New South Wales

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[84] Note N7 page 259 PEICL.

[85] Note N8 to N9, pages 259-60 PEICL (references to Articles of various civil codes omitted).

[86] ALRC Report No. 20 paragraph 306.

[87] (1985) 156 CLR 672.

Employee's Liability (Indemnification of Employer) Act 1982 a broad interpretation so as to allow the employee to avoid liability in respect of both an indemnity and a contribution as joint tortfeasor (see section 21(1) of the *Irish Civil Liability Act 1961*), a unanimous Court observing that:

> "It is scarcely to be supposed that the legislature intended to exclude the employer's right to recover in contract but to leave on foot his right to recover contribution from his employer as a concurrent tortfeasor...[t]he 1982 amendment sprang from a deeply rooted and general concern with the substance of the problem as it was thought to exist under the law as expounded in *Lister v Romford Ice,* namely, the perceived injustice in the employer's entitlement to recoupment whether under s.5(1)(c) or under the contract from an employee whose fault resulted in the employer becoming liable to a plaintiff."[88]

10.83 The critical point of course is the legislative purpose the 1982 NSW legislation. In contrast, the Supreme Court, in *Sinnott v Quinnsworth* applied the majority decision in *Lister v Romford Ice* to a case where one employee injured another employee in a motor accident that occurred during the course of employment. The Supreme Court indicated that section 21(1) of the *Civil Liability Act 1961* afforded no right to an indemnity, especially in the case at bar where the driver of a motor vehicle can scarcely be described as "innocent" when driving negligently. McCarthy J indicated that he saw no merit in awarding an indemnity in favour of an employee against an employer when the employer "presumably, employed him to drive safely".[89]

10.84 While section 6(1)(c) of the *Law Reform (Married Women and Tortfeasors) Act 1935* was the legislative template for section 21(1) of the *Civil Liability Act 1961*, and its predecessor, section 5 of the *Tortfeasors Act 1951*, the drafters of the 1961 Act clearly had in mind the desirability of seeking to do justice in each individual case. Section 21(2) requires a court to award, by way of an amount, what is "just and equitable having regard to the degree of the contributor's fault." Unlike the 1951 Act, the court is to consider comparative blameworthiness rather than causation: see *Connolly v Dundalk UDC*[90] and Keane J in *Iarnród Éireann v Ireland.*[91] Glanville Williams[92] was extremely critical of the majority decision in *Lister v Romford Ice.*

10.85 In the United Kingdom the policy issues raised by the decision in *Lister v Romford Ice* lead to the appointment of an Inter Departmental Committee[93] by the Minister for Labour "to study the implications of the payments in the case of *Lister v Romford Ice and Cold Storage Co Ltd* as they might affect the relations between employers and workers." The Committee noted that numbers of the British Insurance Association had entered into "a gentleman's agreement" stating that:

> "Employers Liability Insurers agree that they will not institute a claim against the employee of an insured employer in respect of the death or injury to a fellow employee unless the weight of evidence clearly indicates (i) collusion, or (ii) wilful misconduct on the part of the employee against whom a claim is made."

10.86 The ALRC indicated that no similar agreement existed in Australia and the ALRC cited judicial opinion[94] which indicated that the law was in an unsatisfactory state. The *Insurance Contracts Act 1984* contains three related provisions. Section 65 relates to insurers who are liable in respect of an insured loss where an insured has not or is not reasonably likely to exercise rights of action because of a family or other personal relationship between the insured and the third party. The section also relates to injuries caused by a third party who has used a motor vehicle with the express or implied consent of the insured. Section 66 applies in situations where an insured becomes liable because of conduct by an employee

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88 *Ibid*

89 [1984] IR 523 at 538.

90 Supreme Court unreported, November 18 1992.

91 [1995] 2 ILRM 161 at 197.

92 Williams, "Vicarious Liability and Masters Indemnity" (1957) 20 MLR 20.

93 See Gardner (1959) 22 MLR 652.

94 *Marrapodi v Smith-Roberts (1970) 44 ALJ4.*

occasioning in the course of, or arose out of, his/her employment. Sections 65 and 66 do not displace subrogation rights if the loss was caused by conduct that was "serious or wilful misconduct".

10.87 In his review of the Australian experience, Professor Rob Menkin did not really comment on sections 65 and 66 of the 1984 Act, suggesting that these reforms have not proved controversial.[95].

10.88 Apart from the Federal Insurance Statute, there has been some analysis of the issue of vicarious liability, particularly in relation to the extension of liability in respect of teachers and voluntary child supervisors. Because this is of relevance to Irish law after *Moynihan v Moynihan*, the Commission will briefly examine the *Queensland Report on Vicarious Liability.*

(3) The Queensland Report on Vicarious Liability

(a) Employee Liability

10.89 While the 1984 Legislation addresses the question of *Lister v Romford Ice* within the context of insurance contract law, the residual question of how vicarious liability should take account of the potential conflict of indemnity and contractual principles is a matter of state jurisdiction in Australia. The Queensland Law Reform Commission in a 1995 Discussion Paper,[96] and a Report,[97] published in 2001, considered the *Lister* decision within the context of vicarious liability and a joint tortfeasor's exposure to indemnity or contributions. The Queensland Law Reform Commission saw the Rule in *Lister v Romford Ice* as a mechanism whereby an employer who is vicariously liable for the tort of an employee is "able to shift the responsibility for paying compensation for the loss or injury resulting from the commission of the tort to the employee".[98] The main objections to retention of *Lister v Romford Ice* were summarised thus:

> "the Commission is concerned that the right of an employer to an indemnity from an employee defeats the effect of vicarious liability in that it results in an employee becoming personally liable for the amount awarded in damages caused by the employee's tortuous conduct during the course of the employment relationship.
>
> The continuation of the common law principle that an employer who is found to be vicariously liable can seek an indemnity from a negligent employee is objectionable on other grounds.
>
> These are:
>
> - that if the employee only were sued by the plaintiff, he or she might be able to benefit from any insurance policy held by the employer on behalf of the employee; but if sued jointly with the employer, the employee could become liable if the insurer exercises its right of subrogation;
> - that the existing law is contrary to the promotion of good industrial relations and harmony by virtue of the fact that employees are exposed to potential litigation by employers"

10.90 The Queensland Law Reform Commission rejected the UK "Gentleman's agreement" solution on the ground that it:

> "could lead to uncertainty, since it relies on the good faith of insurers. It is also unsatisfactory, and potentially unfair, in that the agreement relates only to actions brought by insurers (in the name of an insured employer) against an employee for personal injury caused to a fellow employee, and does not affect the question of indemnity of an employer by an employee where an employer is uninsured or where the damage is outside the scope of the employment."

10.91 The Queensland Law Reform Commission recommended the statutory abrogation of *Lister v Romford Ice* and that:

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95 *Reforming Insurance Law: is there a case for reverse transportation?* Paragraphs 8.19 to 9.19.

96 *Vicarious Liability* (QLRC WP, July 1995).

97 *Vicarious Liability* (Report No. 56 December 2001).

98 Ibid at Chapter 5.2 (a)

> "an employer should be liable to indemnify an employee in respect of liability incurred for any tort committed by the employee during the course of, or arising out of, the employment relationship."[99]

10.92 The only circumstance in which an employee should be denied the protection against such a shield, the Queensland Law Reform Commission recommended, is where the conduct of the employee amounts to "serious and wilful misconduct". This position mirrors that found in the *Insurance Contracts Act 1984*, sections 65 and 66.

(b) Vicarious Liability of parents, adult supervisors and Teachers

10.93 While in general terms the common law does not impose vicarious liability upon adults who are charged with supervision or control of a child (largely because of the absence of any employment relationship or economic interest in most cases) the possibility that an insurance policy may be in existence has tested the boundaries of vicarious liability to employees and other excepted cases such as persons driving motor vehicles with the consent of an insured person but there has been no systematic analysis of this subject. Broadly speaking, the Queensland Law Reform Commission considered the issues raised by the principles of vicarious liability, agency, and instances where liability could arise as the result of a duty being non-delegable. In this context the availability of insurance cover was said to be a relevant consideration in "considering any statutory extension of the principle of vicarious liability to relationships between parents and children, teachers and pupils and adult supervisors and charges.[100]

10.94 The Queensland Law Reform Commission found that there was insufficient justification, both in terms of economic efficiency and broader societal goals, to warrant expanding principles of vicarious liability *vis-à-vis* parents, adult supervisors and teachers for the torts of children. The 1984 insurance legislation in Australia does not appear to address this matter in general terms.

(4) Canada – Lister

10.95 There has been no legislative response to *Lister* in Canada and while some decisions appear to favour a wide application of liability principles more recent cases suggest otherwise. In *Douglas v Kinger.*[101] In this case a 13 year old boy was engaged by the plaintiff to work in and around the plaintiff's cottage doing manual work for $8 per hour. Whilst fuelling the lawn mower the boy struck a match igniting the fuel vapours and causing destruction of the cottage by fire. The plaintiff sued the boy in tort and contract. The Ontario Court of Appeal tested the issue of liability by reference to the modified two stage test endorsed by Canadian courts after *Anns v Merton London Borough Council.*[102] At the first stage of the analysis, a search for a duty of care and proximity, the Ontario Court of Appeal held that a duty of care only arose in cases of employee relationships where expectations representations and reliance would create such a duty. In the case of an unskilled boy being paid at a low rate of pay no duty could reasonably be imposed. The second stage in the *Anns* analysis also favoured the defendant. The policy considerations that were relevant in deciding whether liability should be imposed – deterrence of employee negligence is not best achieved by imposing liability save in cases of wilful misconduct or gross negligence – also made the imposition of liability undesirable. Lang JA cited as one of the factors that supported a decision to negative liability in this case the fact that:

> "I have already noted, a determination that, in the ordinary course, employees are not liable to indemnify employers for ordinary negligence, accords with practice or legislation in many other jurisdictions that have already abolished the right of insurers to subrogate against employees under general liability policies."[103]

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99 *Ibid*

100 Chapter 2.4.

101 (2008) 294 DLR (4th) 267.

102 [1978] AC 728: in the Canadian Courts see *Anns,* as applied in *Kamloops (City of) v Nielson* [1984] 2 SCR 2, at p.10-11.

103 (2008) 294 DLR (4th) 267, para 64. Liability in contract was denied on the basis that the employment contract was not a beneficial contract of service.

10.96 Leave to appeal to the Supreme Court of Canada was refused.[104]

(5) Reform of Lister in the United Kingdom

10.97 There have not, as yet, been any legislative proposals regarding the public policy exceptions to the subrogation principle. The January 2006 Law Commissions Scoping Paper[105] sought submissions on *Lister v Romford Ice. The Analysis and Responses Paper that the Scoping Paper*[106] produced indicated that 75% of respondents thought that subrogation generally should be examined. The Association of British Insurers (ABI) said specifically that the *Lister* Gentleman's Agreement, which is administered by ABI should be the subject of a review: whether such a review should be intended to form the basis of legislation is unclear. Indeed, the extract from the submission quoted in the Analysis and Responses Paper hints at the expansion of self regulation : The Review should consider, *inter alia:*

> "the extension of the application of the principles ensconced in the Market *Lister v Romford Ice* Agreement and clarify subrogation rules in scenarios, for example, involving members of the policyholder's family."[107]

10.98 Two other submissions[108] suggested that consideration be given to allowing an insurer to sue in the name of the insurer rather than that of the insured, this overcoming objections bases on commercial grounds that are voiced by insureds.

10.99 In the event the Law Commissions concluded that subrogation was not a priority issue for the Law Commission and that attention to the subject would be paid as a separate topic if time allows after the Commission's other work has been concluded.[109]

(6) Discussion and Recommendation

10.100 These two public policy exceptions are too important to be left to a self regulatory mechanism such as the UK Gentleman's Agreement which, the Commission understands, is observed in Ireland. In any event, the issue of subrogation within families and other analogous relationships remains unresolved, at a regulatory level within the United Kingdom. The Commission are persuaded that the merits of restricting subrogation rights in these cases are not seriously debated within the Insurance Industry. The Commission also find it remarkable that an ad hoc solution such as the *Market Lister v Romford Ice Agreement*, first put together in 1953, should still regulate the employee liability issue despite its arbitrary results. As Gardiner pointed out in 1959; the 1953 Agreement only covered the employer's liability market. Further, only employees whose employer is insured may benefit from the Agreement. Gardiner concluded his view by remarking that while such a Gentleman's Agreement is not unique, "[i]t may be doubted whether, on general grounds, this rather peculiar method of law reform should be encouraged.

10.101 *The Commission provisionally recommends that legislation provide that subrogation rights should be limited in two situations: (a) claims between family members and (b) the employer-employee relationship. The Commission invites submissions as to the precise form these restrictions should take.*

H Recasting Conditions and Warranties as Innominate Terms

10.102 The general approach to arguments that express terms or obligations are conditions, breach of which entitles rescission or avoidance of the policy, is to require these terms to be clearly set out.

10.103 Some conditions precedent have been made out even if poorly drafted. In *London Guarantie Co v Fearnley*[110] a policy of insurance was obtained which indemnified the proprietor of a tavern on Duke

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104 (2008) Can LII 65718 (SCC).

105 Insurance Contract Law: A Joint Scoping Paper.

106 Insurance Contract Law: Analysis of Responses and Decisions on Scope (August 2006).

107 Paragraph 3.24. This was also the primary recommendation made in the Inter-Departmental-Review, (1959) 22 MLR 652 at 655.

108 X Changing Claims Services and the Liverpool Underwriters and Marine Association at paragraphs 3.26-

109 Paragraph 3.270.

Street Dublin against the embezzlement of the takings of the tavern by an employee. A claim was made and in its defence the insurer argued that a clause requiring the insured to prosecute the suspected wrongdoer with diligence had not been observed and that this was a condition precedent to liability. The Court of Appeal in Ireland found that this was not a condition precedent but this decision, (Selborne LC dissenting) was reversed by the House of Lords. Despite Lord Blackburn's observation that the case revolved around "the construction of an ill-penned instrument," there is no indication that the majority of the House of Lords subjected this contract to anything other than a very benign process of construction that favoured the insurer. Should the language used be held to be ambiguous the insurer will be held to have a remedy in damages only for the insured's breach of promise. Collateral promises may be held to exist unless the court finds that such a conclusion would not provide the insurer with appropriate reliefs, the primary reasons why the majority of the House of Lords in *Fearnley* held that the insured's failure to prosecute was a breach of a condition precedent was because it was prejudicial to the company.

10.104 The argument is made that many of the difficulties that arise are a consequence of the view that contractual terms are either conditions, or warranties, in the *Sale of Goods Act 1893* sense. A fairer result, on a case by case basis, could be afforded by eschewing this a priori classification in favour of holding all terms to be, or potentially be, innominate terms. The appropriate remedy would be determined, at the date of breach, according to the merits of each case.

10.105 Despite the flexibility of the innominate term mechanism – the court does not have to characterise the term as being either a condition or a warranty but may decide that the parties intended the breach of the obligation would give the injured party a right to rescind depending upon the seriousness of the breach – it has been cirticised in the context of insurance law. In *Friends Provident Live and Pensions Ltd v Sirius International*[111] a claims notification (as distinct from a separate general notice condition precedent) was held in the English Court of Appeal not to be an innominate term. Lord Justice Mance, departing form the view of earlier English courts,[112] gave compelling reasons why such a development is undesirable. Apart from the criticism that the innominate term approach is uncertain and requires the party seeking to establish serious consequences in fact, Mance LJ pointed out that if an insurer wants to obtain a right to avoid a policy, the onus should rest upon the insurer to draft the contract accordingly. Mance LJ accepted that insurers are in a difficult position when attempting to quantify potential losses when a policy is being negotiated but

> "the difficulty is anyway no justification for the introduction, whether as an implied term or as a rule of law or by a previously unknown extension of the doctrine of repudiatory breach or on any other basis, of a novel form of protection for insurers. If insurers consider that they want or need such protection, they can and should try to express it in their insurance contracts and see if insureds and the broking market will accept it….[e]nglish insurance law is strict enough as it is in the insurer's favour. I see no reason to make it stricter."[113]

10.106 The Commission favours the reasoning of Mance LJ on this point and do not recommend either the statutory or judicial expansion of the innominate term into insurance law to be worthy of consideration.

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110 (1879) LR 5 App Cas. 911; see however *Aspen Insurance Co v Pectel Ltd* [2008] EWHC 2804 (Comm).

111 [2005] Lloyd's Rep. 517: see Lowry and Rawlings [2006] LMCLQ 135.

112 *Alfred McAlpine plc v BAI (run-Off) Ltd* [2000] 1 LI. R 437; *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 LI R 563; *Bankers Insurance Co v South* [2003] EWHC 380 (QB).

113 At para. 33 of Mance J's judgment.

CHAPTER 11 PROVISIONAL RECOMMENDATIONS

The provisional recommendations made in this Consultation Paper may be summarised as follows.

Chapter 1 – Regulatory Context

11.01 The Commission provisionally recommends that regulatory bodies (in particular the Financial Regulator and the National Consumer Agency) who currently have statutory responsibilities in connection with the insurance industry should continue to liaise with each other, and with representatives of the insurance industry, in order to develop comprehensive statutory Codes of Practice setting out standards of best practice, building on the best practice standards developed by the Irish Insurance Federation and on the statutory model of the Financial Regulator's Consumer Protection Code 2012. The Commission also provisionally recommends that these statutory Codes of Practice should form the basis for the content of insurance contracts. [Paragraph 1.68]

11.02 The Commission provisionally recommends that legislation should provide that in any litigation or other dispute resolution process statutory Codes of Practice setting out standards of best practice should be admissible in evidence; and that, if any provision of such Code is relevant to a question arising in the litigation or other dispute resolution process, the provision may be taken into account in determining that question, but that this would be without prejudice to the substantive rights between the parties. [Paragraph 1.69]

11.03 The Commission provisionally recommends that the legislative framework being proposed in this Consultation Paper should, in general, apply to consumers as defined for the purposes of the jurisdiction of the Financial Services Ombudsman, namely natural persons and businesses with an annual turnover not exceeding €3 million. [Paragraph 1.70]

Chapter 2 – Insurable Interest

11.04 The Commission provisionally recommends that legislation should provide that an otherwise valid insurance claim cannot be rejected by the insurer solely because the insured lacks an insurable interest as it has been traditionally defined, that is, a legal or equitable relationship between the insured and the subject matter of the insurance contract. [Paragraph 2.60]

11.05 The Commission provisionally recommends that insurable interest should, in the interests of certainty, be more broadly defined in legislation as an interest that subsists when a person may benefit from the continued existence or safekeeping of the subject matter of the insurance or may be prejudiced by its loss; and that this definition would apply both to non-life insurance (in particular property and liability insurance) and to life insurance. [Paragraph 2.61]

11.06 The Commission provisionally recommends the repeal of the Life Assurance Act 1774, as extended to Ireland by the Life Insurance (Ireland) Act 1866. [Paragraph 2.67]

11.07 The Commission invites submissions as to whether, on the issue of valuation, an insurer should be free to fix any value with the proposer at the time of concluding the policy of insurance. [Paragraph 2.86]

11.08 The Commission provisionally recommends that, in connection with life insurance, the following should also be deemed to have an insurable interest in the life policy: (a) spouses in relation to each other; (b) civil partners in relation to each other; (c) cohabitants in relation to each other; (d) a child in relation to his or her parent or guardian; and (e) a parent or guardian in relation to his or her dependent adult child. [Paragraph 2.97]

11.09 The Commission invites submissions as to whether, in connection with life insurance, the following should also be deemed to have an insurable interest in the life policy: (a) a grandparent in relation to his or her grandchild; and (b) siblings in relation to each other. [Paragraph 2.98]

Chapter 3 – Duty of Disclosure

11.10 The Commission provisionally recommends that the pre-contractual duty of disclosure in insurance contract law should be retained, but that it should (in accordance with authoritative case law in Ireland) be restricted to facts or circumstances of which the person applying for insurance cover – the proposer – has actual knowledge; and that the duty of disclosure would not, therefore, extend to every fact or circumstance which ought to be known by him or her (constructive knowledge). The Commission provisionally recommends that this modified pre-contractual duty of disclosure should apply to all insurance, other than Marine, Aviation and Transport (MAT) insurance, which would continue to be regulated in this respect by the *Marine Insurance Act 1906.* [Paragraph 3.22]

11.11 The Commission provisionally recommends that legislation should continue to provide that, because the proposer possesses more relevant information than the insurer, the pre-contactual duty of disclosure should continue to be the basis on which a contract of insurance is a contract of utmost good faith. [Paragraph 3.27]

11.12 The Commission provisionally recommends that legislation should provide that, in respect of all contracts of insurance, an insurer shall not be permitted to repudiate liability on the basis of non-disclosure of material facts of which the insured could not reasonably be expected to have had actual knowledge at the time of applying for cover. [Paragraph 3.28]

11.13 The Commission proviaionally recommends that an insurer should be required to show that non-disclosure of a material fact played a part in the insurer's decision to enter the contract. [Paragraph 3.33]

11.14 The Commission invites submissions as to which of the following two definitions of "material facts" should be provided for in legislation: ***either*** (a) facts which, in the circumstances, a reasonable insured would know to be highly relevant and should be disclosed; ***or*** (b) facts which, in the circumstances, a reasonable insured would know to have a decisive influence on the insurer's decision in accepting the risk or in setting the level of the premium (the price). [Paragraph 3.37]

11.15 The Commission provisionally recommends that the insurer should be under a statutory duty to explain to a proposer both the nature of the duty of disclosure and the consequences of non-disclosure. [Paragraph 3.103]

Chapter 4 – Pre-contractual Misrepresentation and Insurance Contracts

11.16 The Commission provisionally recommends that legislation should provide that the insurer shall ensure that any question posed in writing to the proposer is drafted in plain, intelligible language; that any such question should be specific as to the information being sought by the insurer; and that where there is doubt about the meaning of a question, it should be interpreted by reference to a standard of what is fair and reasonable. [Paragraph 4.14]

11.17 The Commission provisionally recommends that if an insurer does not follow up on the failure by the proposer to answer a question, or in respect of an obviously incomplete answer, this should be regarded as a waiver by the insurer of the duty of disclosure and the duty to answer questions honestly and carefully; this would not apply where there has been fraudulent concealment by the proposer (intentional or reckless concealment). [Paragraph 4.23]

11.18 The Commission invites submissions as to whether the existing duty of disclosure and/or rules on misrepresentation, intended by insurers to identify the moral hazard that an underwriter may be facing, need to be reconsidered; and in particular, in relation to convicted persons, whether there are circumstances where a conviction (other than for insurance fraud) should be exempt from the duty to disclose or the duty to answer questions carefully and truthfully. [Paragraph 4.26]

11.19 The Commission provisionally recommends that section 20 of the *Marine Insurance Act 1906* should be repealed in relation to consumer insurance and mass market insurance products (including mass market insurance products to all businesses, not limited to the jurisdictional limit of the Financial Services Ombudsman); and that the duty in section 20 of the 1906 Act to furnish "true" answers should be replaced by a duty to answer specific questions honestly and carefully. [Paragraph 4.34]

11.20 The Commission invites submissions as to whether Part V of the *Sale of Goods and Supply of Services Act 1980*, which concerns misrepresentation, should be tailored to insurance contracts so as to provide a remedy in damages in place of recission (repudiation of the insurance contract) in respect of pre-contractual misrepresentations made by the proposer and the failure to observe the proposed duty of disclosure in insurance law. [Paragraph 4.46]

11.21 The Commission provisionally recommends that where a proposer has exercised due care and attention in understanding the questions put and has provided the answers to such questions honestly and with due care and deliberation, the insurer should not be able to avoid liability on the policy that has arisen prior to discovery of the innocent misrepresentation. [Paragraph 4.72]

Chapter 5 – Warranties

11.22 The Commission provisionally recommends that the entitlement of an insurer to avoid a policy or a claim for breach of warranty should depend on whether the insured was provided at the pre-contractual stage, or contemporaneously with the conclusion of the contract, with the information required by the duty of disclosure (as already defined in this Consultation Paper). The Commission provisionally recommends that, in respect of promissory or continuing warranties that arise after the contract has been agreed, the insurer must provide the proposer with a clear statement prior to the formation of the contract about the scope of the continuing obliations imposed upon the proposer when he or she becomes insured. The Commission invites submissions on how this requirement may best be satisfied, particularly when the cover is obtained on-line. [Paragraph 5.22 and 5.60]

11.23 The Commission provisionally recommends that statements of fact or opinion shall not be converted into a contractual warranty by anything stated in the contract, so that "basis of contract" clauses shall be deemed invalid. [Paragraph 5.29 and 5.62]

11.24 The Commission provisionally recommends that breach of a contractual warranty in an insurance contract should no longer lead to the contract being avoided from the date of breach, but that, as in other cases of misrepresentation, the contract should be voidable at the option of the person to whom the misrepresentation was made (and that, to avoid any doubt, it should be provided that section 33(3) of the *Marine Insurance Act 1906,* which deals with breach of a contractual warranty, is confined to MAT insurance). [Paragraph 5.58]

11.25 The Commission provisionally recommends that, where an insurer is entitled to avoid an insurance policy claim for breach of warranty, the insurer should also be free to reject the claim without repudiating the entire insurance policy. [Paragraph 5.59]

11.26 The Commission provisionally recommends that legislation should provide that a breach of warranty does not arise in respect of matters of past or present fact where the insured can prove that the statement was true to the best of his or her knowledge or belief. [Paragraph 5.61]

11.27 The Commission provisionally recommends that where the insured establishes that there is no causal link between the failure to observe a promissory warranty and the loss the insured should be able to recover on the claim; and the Commission invites submissions as to whether the failure to observe a promissory warranty will only lead to the contract being invalidated where the insured has acted fraudulently (intentionally or recklessly). This provisional recommendation should apply to all insurance contracts within the terms of the Financial Services Ombudsman jurisdiction, even if the dispute comes before the courts. In relation to other insurance contracts the Commission invites submissions on whether a provision of this kind should serve as a default rule in commercial insurance contracts generally. [Paragraph 5.79]

11.28 The Commission provisionally recommends that legislation should provide that promissory warranties must be drafted in plain, intelligible language; and that where there is doubt about the meaning of a promissory warranty, it should be reviewed in terms of whether it is an unfair term within the meaning of the *European Communities (Unfair Terms in Consumer Contracts) Regulations 1995.* [Paragraph 5.98]

Chapter 6 – Exclusions and Unfair Terms

11.29 The Commission provisionally recommends that legislation be enacted to provide that an insurance contract should be subject to a good faith requirement, namely that if reliance on a term in an insurance contract would constitute a failure to act with the utmost good faith the party may not rely on that term. [Paragraph 6.08]

11.30 The Commission provisionally recommends that there should be a statutory duty on an insurer to draw attention to unusual terms. [Paragraph 6.10]

11.31 The Commission provisionally recommends that Regulation 4 of the *European Communities (Unfair Terms in Consumer Contracts) Regulations 1995* (which deals with specific circumstances in which a contract term shall not of itself be considered to be unfair) should be clarified in the context of insurance contracts so that it is provided, to avoid any doubt, that: (a) a term in an insurance contract shall not in itself be regarded as unfair where the subject matter of the term has actually been considered by the insurer in the calculation of the premium (price); (b) that this has been drawn to the attention of the proposer; and (c) that this clarification to Regulation 4 should apply to consumers as defined for the purposes of the jurisdiction of the Financial Services Ombudsman, namely natural persons and businesses with an annual turnover not exceeding €3 million. [Paragraph 6.46]

Chapter 7 – Formalities

11.32 The Commission provisionally recommends that legislation should provide that it is not a necessary pre-condition to the validity of an insurance contract that it be in writing. The contract may be proved by any means, including oral testimony. [Paragraph 7.40]

11.33 The Commission provisionally recommends that, subject to a cooling-off period (if any), the insurer should transmit the insurance policy document to the insured within 15 working days of the contract being agreed. [Paragraph 7.43]

11.34 The Commission provisionally recommends that legislation should provide that insurance contracts be subject to prescribed requirements of notices, notification and forms that are comparable to those already found in existing consumer protection legislation, such as the *European Communities (Distance Marketing of Consumer Financial Services) Regulations 2004.* The Commission also provisionally recommends that legislation should include a statutory duty on insurers to provide a proposer with the prescribed requirements of notices, notification and forms. The Commission invites submissions on the precise nature and content of such prescribed requirements. [Paragraph 7.50]

Chapter 8 – The Duty of Utmost Good Faith – Post Contractual Aspects

11.35 The Commission provisionally recommends that the law should continue to provide that an insured should be prohibited from recovering on a claim by submitting a fraudulent claim or fraudulent evidence to support a claim; but that it should also provide that an innocent co-insured or beneficiary may recover on a proportionate basis; provided that the fraudulent insured cannot benefit from the policy. [Paragraph 8.50]

11.36 The Commission provisionally recommends that legislation should set out the mutual duties on the insured and the insurer in respect of claims handling, so that the principle of good faith would then remain relevant only to pre-contractual formation of the contract and as an aid to interpretation. [Paragraph 8.68]

Chapter 9 – Third Party Rights

11.37 The Commission provisionally recommends that section 62 of the *Civil Liability Act 1961* should be extended to allow a third party to proceed against the insurer where the insured cannot be located. [Paragraph 9.23]

11.38 The Commission provisionally recommends that a third party beneficiary under a contract of insurance should be defined in legislation as a person who is not a party to the contract but is specified or referred to in the contract, whether by name or otherwise, as a person to whom the benefit of the insurance cover provided by the contract extends. [Paragraph 9.36]

11.39 The Commission provisionally recommends that, in the context of third party rights in insurance contracts, it would, in general, be sufficient to protect such rights if the Oireachtas enacted legislation based on the draft *Contract Law (Privity of Contract and Third Party Rights) Bill* in the Commission's 2008 *Report on Privity of Contract and Third Party Rights.* In addition, the Commission invites submissions as to whether additional specific provisions should be enacted in the context of the operation of insurance contracts in specific settings, for example, in insolvency, on the death of an insured person and during the completion of a contract for the conveyance of land. [Paragraph 9.41]

Chapter 10 Remedies

11.40 The Commission provisionally recommends that avoidance of an insurance policy should no longer be the main remedy, and that in cases of non-disclosure and misrepresentation the principal remedy should be one of damages in proportion to the failure by the insured. [Paragraph 10.21]

11.41 The Commission provisionally recommends that an insurer should be able to avoid a policy prospectively upon discovery of a negligent non-disclosure or misrepresentation even if the insurer is bound to meet any claims submitted by the insured. Should the insurer decide to exercise this right the avoidance will be effective upon giving the insured written notice of this decision. [Paragraph 10.22]

11.42 The Commission provisionally recommends that any damages awarded to an insured arising from the insurer's failure to comply with the proposed post-contractual duties of the insurer should reflect: (a) general principles of damages in contract law, namely whether the loss is a reasonably foreseeable consequence of the breach of contract (and in particular, damages that are reasonably foreseeable from a refusal in bad faith to meet a valid claim); and (b) emerging principles of restitution. [Paragraph 10.42]

11.43 The Commission invites submissions as to the period of time within which an insurer should meet valid claims. [Paragraph 10.43]

11.44 The Commission provisionally recommends that legislation should provide that subrogation rights should be limited in two situations: (a) claims between family members and (b) the employer-employee relationship. The Commission invites submissions as to the precise form these restrictions should take. [Paragraph 10.101]