THE GRIFFIN INSURANCE ASSOCIATION

"BASIS OF CONTRACT CLAUSES"

THE HIDDEN DANGERS OF CONVERTING INFORMATION PROVIDED TO UNDERWRITERS INTO WARRANTIES

SUMMARY

Following the Consumer Insurance (Disclosure and Representations) Act 2012, basis of contract clauses have been abolished in respect of policies taken out by consumer insureds.

However, the Court of Appeal has recently delivered its decision in Genesis Housing Association Ltd v. Liberty Syndicate Management Ltd & Others [2013] EWCA Civ 1173, which confirms that these clauses continue to be valid in respect of business insurance contracts.

The Law Commission recommends that new business insurance contracts are brought in line with the position in respect of consumer insurance. However, this is unlikely to happen before 2015, so brokers need to be aware of the continuing danger of these clauses in this intervening period.

This bulletin focuses on your need, as broker, to be aware of the effect of basis of contract clauses. It also highlights your potential role in negotiating with underwriters, on behalf of your commercial clients, in order to seek either the removal of such clauses, or the insertion of another provision within the policy which will render them of no effect. Where this is not possible, Members need to be prepared to explain the heightened duty of disclosure that their commercial clients face as a result.

WHAT IS A BASIS OF CONTRACT CLAUSE?

A basis of contract clause is a statement made by the insured, either in a proposal form or in the policy wording itself, that the representations made or information supplied by it will form the basis of the contract of insurance. As a result, the insured warrants that all information provided to underwriters prior to inception is accurate. In the event that such information is incorrect, the insured will be deemed to be in breach of warranty and insurers will be discharged from liability from the date of breach. Given that most (if not all) information will be supplied to underwriters prior to inception, insurers may never actually be on risk as a result. It is important to note that there is no need for the insurer to demonstrate that the information which has been warranted was material or that it influenced the insurer when assessing the risk.

A RECENT EXAMPLE - GENESIS HOUSING V. LIBERTY SYNDICATE

Genesis (a housing association) planned to use building contractors in order to convert a property into social housing. Before construction started, Genesis obtained cover against the risk of the building contractors becoming insolvent.

The relevant proposal form asked for the name of the builder to be disclosed, and Genesis entered "Time and Tide Construction Limited" ("TTC") accordingly. However, this information was incorrect as the builder being engaged was in fact a related (but legally separate) special purpose vehicle, named "Time and Tide (Bedford) Limited" ("TTB"). Crucially, the

proposal form also contained a declaration that Genesis agreed that "...this proposal and the statements made therein shall form the basis of the contract between us and the Insurer."

TTB was declared insolvent and Genesis had no option but to engage alternative contractors to complete the works. Genesis therefore claimed an indemnity from Liberty for the additional costs that it incurred as a result. However, Liberty declined the claim on the grounds that Genesis was in breach of warranty, for its failure to properly identify the correct builder (i.e. TTB) in the proposal form. Genesis subsequently issued proceedings against Liberty for recovery under the policy.

The judge (at first instance in the Technology & Construction Court) dismissed the claim, and held that Liberty was entitled to avoid liability on the basis of Genesis's breach of warranty, thus confirming that the courts will continue to give effect to basis of contract clauses in business insurance contracts. Genesis appealed. The Court of Appeal dismissed the appeal, holding that, even where the proposal form is not referred to in the policy wording, a basis of contract clause in the proposal form gives contractual effect to the declarations made in it, by turning those declarations into warranties under the policy.

Notably Lord Justice Jackson made the following comment:

"...the principle...cannot be displaced merely by omitting the proposal form from the list of contractual documents set out in the policy. If the parties intend to deprive of contractual effect a proposal form which purports to be the basis of their contract, they must do so by clear and unequivocal language."

THE RISK MANAGEMENT MESSAGE FOR BROKERS

The Genesis case highlights how these clauses can produce unfair results for business insureds. Pursuant to English law, insurers are already afforded a great deal of protection as a result of their ability to avoid liability following non-disclosure or misrepresentation of a material fact by the insured. However, basis of contract clauses give insurers even greater protection, and place an increased duty of disclosure on the insured to ensure that every statement given to underwriters is factually exact, regardless of whether it is material to the risk, or to the claim ultimately being made.

Despite the approach taken by the Court of Appeal, there are positive signs ahead. The Law Commission has recommended that basis of contract clauses be prohibited in the context of business insurance as well, on the basis that they make English insurance law unfavourable in the international market and that their effect lacks justification. However, any change to the current law is likely to take some years to be implemented.

In the meantime, some insurers have indicated a willingness to remove basis of contract clauses from their standard wordings, and Members should try to encourage this as much as possible in order to protect clients from being caught out by their draconian consequences. Alternatively, Members can approach underwriters with a view to inserting clauses in policy wordings that invalidate the effect of these clauses in completed proposal forms. However, care should be taken with the choice of wording used. As outlined above, the court in the Genesis case held that, if a party intends to invalidate the contractual effect of such a clause within a proposal form, it must use clear and unequivocal language in order to do so. The Griffin strongly recommends that Members contact it for assistance as soon as possible, as it can provide draft wordings and advice where necessary.

If Members are unable to obtain the removal of these clauses or insurers' agreement to nullifying clauses, the effect of the clauses should be clearly explained to clients at the earliest opportunity. As ever, Members are reminded of the importance of recording such advice where it is given. Members are strongly advised to ensure that proposal forms are completed as accurately as possible, and Members should check completed proposal forms very thoroughly for apparent errors or omissions. This should go some way to mitigate against the increased risk of insureds subsequently being deemed to be in breach of warranty, and for cover being declined.

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