

## WHEN CAN AN INSURER'S CONTRACTUAL DISCRETION TO AVOID A POLICY BE CHALLENGED?

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In **UK Acorn Finance Limited v Markel (UK) Limited** [2020], the High Court considered the limits on an insurer's contractual discretion to avoid a policy.

In this case, the policy contained an "unintentional non-disclosure" clause that allowed the insurer to avoid if it was satisfied there had been fraudulent/dishonest conduct. The insurer decided that the insured had acted fraudulently/dishonestly and avoided the policy accordingly. The insured subsequently issued proceedings to challenge that decision.

The issue the Court had to consider was whether the insurer had to meet any basic standards of fairness in deciding whether it was satisfied there had been fraudulent/dishonest conduct.

The Court held an insurer must act fairly and rationally when exercising a contractual discretion to avoid. It found the insurer had acted irrationally in concluding misrepresentations made by the insured were fraudulent. This decision is helpful to insureds and intermediaries who want to challenge insurers who have acted unfairly in exercising a contractual discretion to avoid. Unless the insurer can establish clear and justifiable grounds for finding dishonesty, any avoidance is likely to be unsuccessful.

### The Facts

UK Acorn Finance Limited ("UKAF"), a lender, obtained judgment, in excess of £13m, against Colin Lilley Surveying Limited ("CLS") for losses caused by negligent property valuation. CLS went into liquidation. UKAF then sought a recovery from CLS's professional indemnity insurer, Markel, under the Third Party (Rights Against Insurers) Act 1930. There were two relevant Markel policies ("the Policies").

Markel maintained that it was entitled to avoid the Policies as a result of misrepresentations and non-disclosures contained in documents submitted prior to renewal. In particular, CLS failed to inform Markel that it had carried out work for subprime lenders (defined by Markel as institutions which were not high street lenders or building societies).

The Policies were each subject to an unintentional non-disclosure clause ("UND clause"), which provided:

*"In the event of non-disclosure or misrepresentation of information to us, we will waive our rights to avoid this Insuring Clause provided that... (i) you are able to establish to our satisfaction that such non-disclosure or misrepresentation was innocent and free from any fraudulent conduct or intent to deceive."*

It was common ground between the parties that Markel could avoid the Policies only if the misrepresentations were free from any fraudulent conduct or intent to deceive. Markel took the position it could avoid as the alleged misrepresentations were not free from fraudulent conduct or intent to deceive. The issue in dispute was whether Markel could be satisfied, on the evidence, that there was such deceptive conduct.

## The High Court Decision

The Court took the view the UND clause created an inherent conflict for Markel. Markel was empowered to exercise a decision-making discretion in the clause. Also, it would benefit directly from the clause being operated in a particular way (i.e. by deciding it was satisfied CLS had acted to deceive Markel). Given this conflict, the Court held that in these circumstances, Markel's exercise of the UND clause was qualified by implying an additional clause in the policy that Markel could not exercise its decision making powers "arbitrarily, capriciously or irrationally".

The effect of this implied clause meant that Markel:

- could not take into account matters that it ought not to take into account of; and
- could not come to a conclusion that no reasonable decision maker would take.

As a result, the Court held that there was a breach of the implied term, and therefore Markel's decision to avoid the Policies could not stand.

In particular the Court held that Markel had:

- failed to approach the dishonesty issue with an open mind as it was inherently more probable in this case that a misrepresentation was innocent or negligent rather than dishonest; and
- failed to appreciate the conduct of CLS was consistent with an honest belief that Markel's objection to sub-prime lenders only applied to residential property lenders and not to commercial property lenders.

The Court held that the flaws in Markel's conduct permeated "the whole of the decision making exercise". As a consequence, Markel was not entitled to avoid the Policies.

## Observations

This case is likely to have a broader application to situations where insurers have an inherent conflict when exercising a contractual discretion to avoid in their favour. It resets the balance with insureds and makes it clear that insurers will be expected to act fairly and, with regard to dishonesty keep an "open mind", appreciating it is more likely that a misrepresentation has been made innocently or negligently rather than dishonestly.

This means that insurers who exercise such a discretion against an insured can be asked, by insureds and their intermediaries, to explain their decision making process. Ultimately, insurers' decision can be successfully challenged by an insured if no reasonable decision maker would have taken it.

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