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Insurance Act – Conditions Precedent

Guarding against the potentially unfair consequences of a breach of a condition precedent to liability

Guide 2017

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Herbert Smith Freehills is a full service international law firm with a market leading insurance practice. The firm has been Airmic's Preferred Service Provider on insurance law issues for many years and has assisted Airmic in producing a number of its technical guides for members, including on the Insurance Act 2015.

Herbert Smith Freehills lawyers have an outstanding reputation in complex, high profile insurance disputes and for providing strategic legal advice and representation to corporate policyholders. The firm assists with the resolution of major claims across all classes of policy as their core expertise, including advice on coverage, claim project management and claims advocacy to secure appropriate settlement of claims using the full range of dispute resolution procedures including litigation, arbitration and all the forms of Alternative Dispute Resolution. This unrivalled hands-on experience of coverage disputes informs Herbert Smith Freehills' approach to policy wording reviews and drafting. The team also advise on the interface between insurance and contractual risk allocation regimes in commercial contracts.

Herbert Smith Freehills' large dedicated contentious insurance practice is ranked as top-tier in both Chambers UK and Legal 500 in representing policyholders in the largest most complex coverage disputes in the London and international market.

1 Introduction

Airmic has noted the continued presence of conditions precedent to liability in insurance policy wordings. Indeed while the positive changes to English insurance law brought about by the Insurance Act 2015 (the "Act") (such as the down grading of the treatment of warranties under section 10 and the abolition of basis clauses by section 9 of the Act) are warmly welcomed, experience suggests that the use of conditions precedent to liability has actually increased. This has been reflected in members reporting an increased incidence of claims being declined for breach of notification clauses, which are still commonly expressed by insurers as conditions precedent to liability.

Airmic therefore issues this guide to alert members and help them identify these policy clauses and their effects. Airmic also offers its members a simple solution to guard against the potentially arbitrary consequences that a breach of a condition precedent to liability can bring about in relation to claims.

2 Conditions and conditions precedent: A quick reminder

In an insurance context, a condition is a contractual term obliging an insured either to act in a particular way, or a contingency upon which the validity of a policy or a claim may depend. Whilst the nature and types of insurance conditions may vary widely, they typically relate to the commencement of the risk, the conduct of the insured during the currency of the policy and the procedure to be observed for making and advancing claims under the policy.

Conditions can be divided into the following classes:

1. **Conditions precedent to the attachment of cover.** Some policies will make compliance with a particular action, such as the payment of premium or the carrying out of a particular survey, a condition precedent to the attachment of cover under the policy. If a condition precedent of this sort is not complied with, the insurer never comes on risk.

2. **Conditions precedent to the insurer's liability.** Most conditions precedent to liability are concerned with some aspect of the claims process and the insured's behaviour. Generally speaking, a failure to comply with a condition precedent to liability will prevent the insured from making the claim to which the breach relates, or to recovering an indemnity for a particular element of the claim such as defence costs, regardless of whether the insurer has suffered any prejudice as a result of the breach. If the condition precedent does not relate to a specific claim, but is of general application, a breach may suspend the insured's right to make any claim until they have complied with the obligation.

   By far the most common conditions precedent to liability to pay the claim are notification clauses setting out what the insured must do and within what timeframe to notify insurers in the event of a claim. Other common conditions precedent to liability may concern cooperation by the insured with the insurers in the conduct of the defence of a liability claim, seeking advance permission to incurring defence costs and making no admissions of liability without the insurer's consent.

3. **Bare conditions.** These are usually concerned with the insured's conduct during the currency of the policy. Breach of a bare condition does not entitle the insurer to avoid the claim. The insurer is entitled to damages (as the remedy for the insured's breach of the condition) for any loss suffered as a consequence of the insured's breach. However in practice it is often difficult for insurers to show that an insured's breach has caused prejudice capable of being expressed in money terms.

Identifying a condition precedent is not necessarily straightforward. While insurers should and often do use the words "condition precedent" to identify such a provision, a clause in a policy may be held by the courts to be a condition precedent to liability based on the construction of the clause and in the absence of identifying words. For example in the well-known case of *HLB Kidsons (A Firm) v Lloyd's Underwriters* [2008] EWCA Civ 1206, the Court of Appeal held that a clause dealing with notification of circumstances to a "claims made" professional indemnity liability policy was in fact a condition precedent to liability even in the absence of the words condition precedent. The relevant clause provided that:

"The Assured shall give to the Underwriters notice in writing as soon as practicable of any circumstance of which they shall become aware during the period specified in the Schedule which may give rise to a loss or claim against them. ***Such notice having been given*** *any loss or claim to which that circumstance has given rise which is subsequently made after expiration of the period specified in the Schedule shall be deemed for the purposes of this insurance to have been made during the subsistence hereof"* [emphasis added]

The Court of Appeal held that the words "such notice having been given" operated as a condition precedent to liability because, if the notice had not been given in the way prescribed in the previous sentence, the deeming provisions did not operate to link claims made outside the policy period (and, therefore, outside the insuring clause) back to the earlier notification of circumstances.

3 Airmic's position

Conditions precedent to the attachment of cover

Airmic recognises that, in certain circumstances, conditions precedent may be used for legitimate reasons, particular in relation to the attachment of cover.

For example, the insurer of property may require the insured to obtain an up to date survey of the property and to comply with certain specific requirements set out in the survey if cover is to attach. The insurer may require confirmation that certain information or statements be entirely accurate as a condition precedent to the attachment of the risk. To see an example of a policy clause adopting this approach, see LMA5253 the Critical Information clause (set out below), in which insurers seeking to incorporate this clause in their policies identify a limited number of matters which are regarded as critical to the underwriting of the risk.

> LMA5253
>
> *"It is a condition precedent to the insurer's liability under this insurance contract that the following matters are true and accurate at the time of inception of the contract"*

The result of LMA5253 would be that if, upon inception of the risk, any of the matters contained in the Critical Information clause were found not to be true, the insurer would have no liability under the policy.

Airmic recognises that in particular circumstances (but not as a matter of course), the complete accuracy of certain information provided pre-contract will be a legitimate underwriting concern. The danger of clauses such as LMA5253 is that, if misused, they can constitute an attempt by insurers to re-introduce basis clauses, when basis clauses have been abolished by the Insurance Act 2015 and are void in any contract of (re) insurance underwritten after the Act came into force.

Conditions precedent to liability

The conditions precedent used most commonly by insurers, particularly (but not exclusively) in liability policies and specialty risks, are conditions precedent to liability to pay a claim (or part of a claim). Conditions precedent may deal with at least the following situations (and possibly others not listed):

- to notify a claim within a specified timescale e.g. 7 days or as soon as practicable;
- to provide assistance to the insurer in the conduct of the claim generally, or to comply with the insurer's requests for information (without any limitation as to their scope, necessity or reasonableness);
- to seek consent to incurring defence costs in the face of a third party claim, often before any legal costs are even incurred (which takes no account of the need to respond quickly to unexpected claims);
- not to make admissions of liability or to settle a third party claim without the insurer's prior approval;
- to submit a proof of loss (in a first party claim) within a specified time period or in a specified form;
- to commence proceedings (suit) against the insurer within a specified period (often shorter than the limitation period under the general law) in the event that there is a coverage dispute with the insurer.

All of these are used by insurers in relation to the conduct of the insured during the policy period. The remedy for an insured's breach may be to bar the claim entirely, or all claims under the policy, or to entitle the insurer to decline some part of the indemnity that would otherwise be payable.

Sweeper clauses

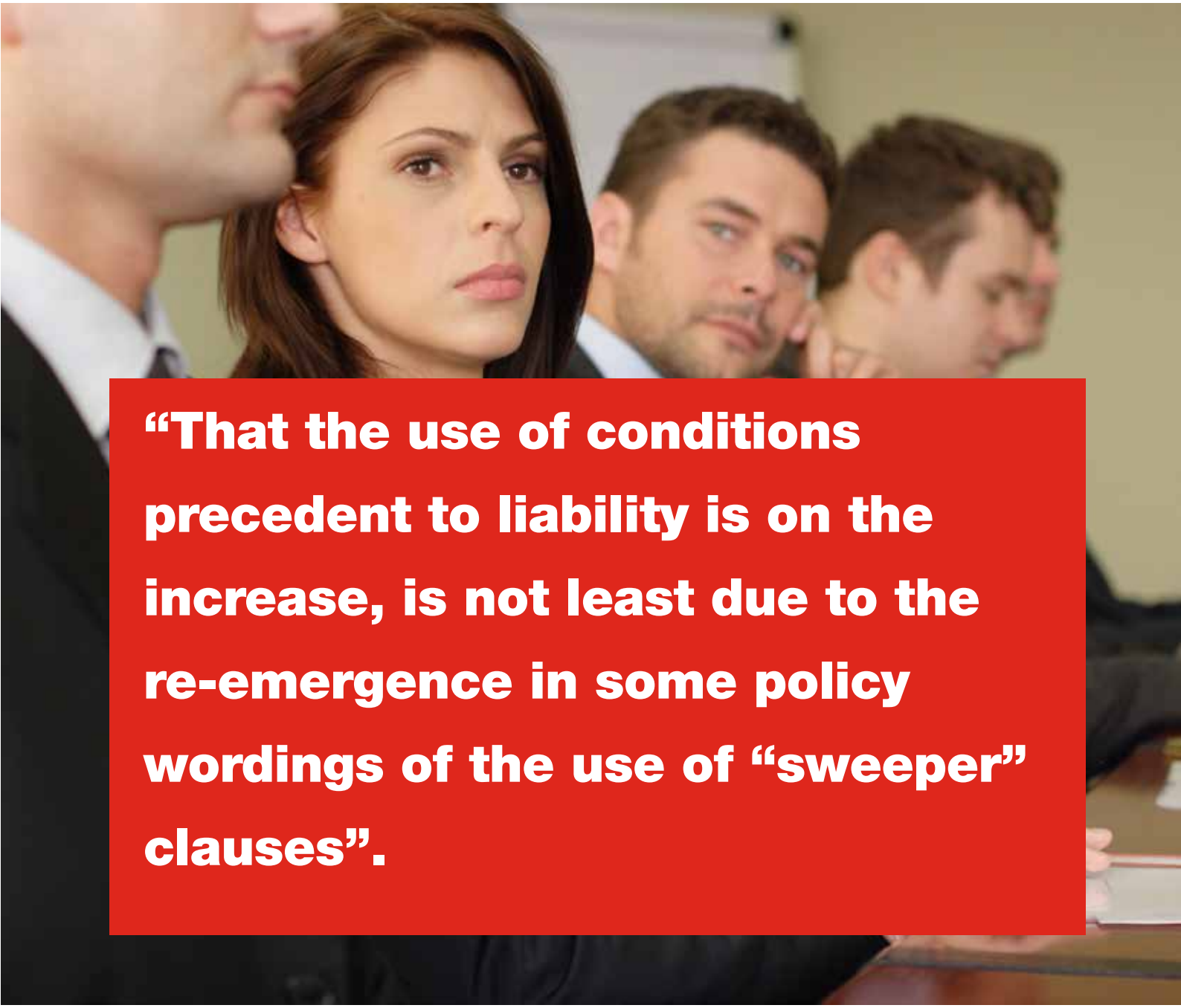
That the use of conditions precedent to liability is on the increase, is not least due to the re-emergence in some policy wordings of the use of "sweeper" clauses. These are terms usually appearing in the general conditions or claims conditions of the policy and make compliance with everything that the policy requires to be done by the insured a condition precedent to the insurer's liability to pay a claim. This development can circumvent effects of certain provisions of the Act (for example, by using a sweeper clause to re-characterise all policy terms, including warranties, as conditions precedent to guard against the changes made to warranties by section 10 of the Act or by requiring that the provision of accurate information on certain matters at inception is a condition precedent to the insurer's liability under the policy in response to the abolition of basis clauses by section 9 of

the Act). This may also be a reflection of subsisting soft market conditions.

Sweeper clauses (an example of which is set out below) can be legally effective and convert policy terms which are bare conditions and do not identify themselves as conditions precedent to liability into conditions precedent to liability. Airmic considers "sweeper" clauses to be fundamentally unfair and encourages members to resist them wherever they find them.

Example sweeper clause

"It is a condition precedent to any liability on the part of the Insurer under this Policy that the terms hereof so far as they relate to anything to be done or complied with by the Insured are duly and faithfully observed and fulfilled by the Insured and by any other person who may be entitled to be indemnified under this Policy."[1]



"That the use of conditions precedent to liability is on the increase, is not least due to the re-emergence in some policy wordings of the use of "sweeper" clauses".

[1] *This wording was held to be sufficient to convert a notice provision into a condition precedent – AXA Insurance UK Plc v Thermonex ltd [2012] EWHC B10*

A potential pitfall for the unwary

What is almost always the case, however, is that the remedy for breach of a condition precedent to liability is severe in its effect. It provides the insurer with an ability to decline the claim entirely in response to what is often entirely inadvertent conduct on the part of the insured in circumstances where no prejudice is suffered by the insurer. The most commonly seen example is late notification in which claims have been rejected by insurers on the basis that claims were notified late, often inadvertently or by trivial periods of time, which caused the insurer no prejudice.

By contrast, if the same provisions were expressed as bare conditions, the only remedy available to the insurer in the event of breach would be damages for the insured's breach. However, there are few reported cases in which an insurer has been awarded damages for breach of a policy condition, since it is rare that breach of a policy condition (particularly those relating to claims co-operation) will give rise to a quantifiable loss.

- In *Friends Provident Life & Pensions Ltd v Sirius International Corporation* [2005] EWCA Civ 601 Waller LJ described the remedy of damages for an insurer's loss of a chance as a result of a breach of a notification condition as "*illusory*". Mance LJ, however, was more measured, acknowledging that breach of such a condition was capable of sounding in damages.
- One of the few recoded cases where insurers have been awarded damages for breach of a bare condition is *Milton Keynes Borough Council v Nulty* [2011] EWHC 2847. In this case the insured delayed their notification of a fire under a public liability policy for 18 months. Edwards-Stuart J held that, while the insured's negligence was the proximate cause of the fire on the balance of probabilities (with the result that insurers were liable under the policy), insurers had been prejudiced by the late notification. In particular, they had not been involved in the post-fire investigations and, thus, had not had the opportunity to take contemporaneous witness accounts. As a result, they lost the chance to investigate alternative causes of the fire. Damages representing this loss of a chance were assessed (albeit arbitrarily) at 15% of the claim.
- In *Milton Furniture Ltd v Brit Insurance Ltd* [2014] EWHC 965 Jay J was of the view that a breach of a condition which required the assured to keep an alarm maintenance contract in force would have justified an award of damages in circumstances where a fire (which might have otherwise been limited in its effect) caused significant damage. However, in the end, the provision was held to be a condition precedent to liability absolving the insurers from liability altogether, so it was unnecessary for the court to decide what loss was caused by the insured's breach.

Airmic's view is that members should exercise vigilance and seek to remove conditions precedent to liability in their policies whenever possible. While insurers may suggest that the remedy of a condition precedent to liability operates as a deterrent to insureds ignoring their policy obligations at the expense of insurers, Airmic believes that its members take seriously their obligations under their policies and that the deterrent is unwarranted. Further, if insurers have suffered genuine prejudice then a bare condition would provide a remedy in damages; if they cannot prove prejudice reflected in money terms, Airmic does not believe the indemnity afforded to its members should be reduced

In Airmic's view conditions precedent to liability give rise to fundamentally different considerations to conditions precedent to the attachment of cover which, while onerous, can serve a legitimate purpose during underwriting if used sparingly and specifically.

Section 11 of the Insurance Act 2015

Section 11 of the Act does offer a certain amount of protection to policyholders from the arbitrary consequences of a breach of some conditions precedent to liability. Section 11 precludes insurers from relying on breaches of terms that are not relevant to the actual loss, with the exception of terms which define the risk as a whole. But for section 11 to operate the condition must be a policy term which tends to reduce the risk of loss of a particular kind, at a particular location, or at a particular time.

However, there are many policy terms frequently expressed to be a condition precedent to liability which will not meet these qualifying criteria. It may be difficult to argue that a notification clause or obligation to cooperate with insurers meets those criteria, leaving the insured in breach of such a clause without relief from section 11.

4 Airmic's proposals for risk managers

Policy review

Airmic considers that the best course for policyholders is to take active steps to review their policies and to remove all conditions precedents from their policy wordings at inception of the contract. This course of action has been advocated by Airmic for a number of years and many members have acted to improve their policies.

Policy endorsement

For those that have not, or face the introduction of new policy forms from insurers or existing wording with new clauses purporting to respond to the Insurance Act 2015, Airmic suggests that members consider including in all policies the following example wording by way of endorsement:

Proposed endorsement #1

"It is understood and agreed between the insured and the insurer that no term of this policy is intended to be nor should be construed as a condition precedent to the attachment of cover under this policy or to the insurer's liability to pay a claim or any part of it".

Identify conditions precedent

An insured may agree (or be obliged to agree through commercial necessity) to the inclusion of a limited number of conditions precedent to liability. In these circumstances the insured should be absolutely clear which terms are conditions precedent (to liability) by having them identified in terms.

In this situation Airmic encourages members to consider alternative wording to be included by way of endorsement:

Proposed endorsement #2

"No term of this policy is intended to be nor shall be construed as a condition precedent to the attachment of cover or to the payment of a claim unless the specific term is individually and expressly described as such. Any term of this policy which purports to make the compliance with any other term of this policy, whether identified specifically or generically, a condition precedent to the attachment of cover or to the payment of a claim shall be void and of no effect."

The effect of such wording will also be to place the onus on the insurer to identify any conditions precedent that are needed for legitimate reasons and to highlight them in the clearest of terms on the face of the policy. It will dis-apply and render void sweeper clauses which Airmic considers to be unwarranted.

Be aware

Even those insureds who do not wish to take active steps to counter the use by insurers of conditions precedent should, nevertheless, be alert to the policy wording developments described in this guide. It is in their best interests to consult with their broker to ensure that conditions precedents are kept to a minimum in their policies and that, wherever possible, terms are expressed as bare conditions. Where conditions precedent are necessary, insureds should discuss with their brokers which terms are likely to be classified as such and should ensure they understand the potential consequences of any breach.

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