

Conditions Precedent in Insurance Policies

A practical guide 2014



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Section 1: Executive Summary

Conditions precedent are contractual terms often found in insurance contracts. It is important to distinguish conditions precedent from bare conditions (also known as conditions subsequent) as the consequences following breach of each are different. A breach of a condition precedent in an insurance contract may allow insurers to avoid paying out under a claim regardless of whether they have suffered any prejudice as a result of the breach. Alternatively it may mean that cover never attaches in the first place so that the insurer is never in risk.

Given the consequences which follow from a breach of condition precedent it is important to phrase terms as bare conditions wherever possible. Policyholders should consult with their insurance broker to ensure that conditions precedent are kept to a minimum in their policies. If conditions precedent are necessary, policyholders should consult their brokers to ensure that they are aware which terms are likely to be classified as such. They should then seek to ensure that their businesses are in compliance.

This guide is designed to complement the technical guide produced by Airmic in 2013 with the assistance of Herbert Smith Freehills LLP relating to warranties in insurance policies. Read together, these guides provide a practical overview of different terms in insurance policies.

This guide has been produced with the assistance of Herbert Smith Freehills LLP as a preferred service provider to Airmic. The content of this guide relates to the position at English law and does not constitute legal advice. Members are advised to consult their lawyers should they require advice on any matter which forms the subject of this guide.

Section 2: Introduction to conditions and conditions precedent

In an insurance context, a condition is either a contractual term obliging the insured to act in a certain way, or a contingency upon which the validity of a policy or a claim may depend. The nature and types of insurance conditions vary widely as do the consequences of breach. Conditions typically relate to the commencement of the risk (including the date at which premium must be paid), the conduct of the insured during the currency of the policy and the claims procedure.

Conditions can be divided into the following classes:

- (i) Conditions precedent to the validity of the contract and the attachment of risk (such as the payment of premium).
- (ii) Conditions precedent to the insurer's liability. Such conditions are often concerned with the claims process such as notification of a claim within a specified time.
- (iii) Bare conditions or conditions subsequent. These are usually concerned with the insured's conduct during the currency of the policy.

Section 3: Consequences of a breach of a condition or a condition precedent

The consequences of a breach of condition depend on the type of condition.

- (i) Condition precedent to risk - If a condition precedent to risk is not fulfilled then the insurer never comes on risk and the insurance contract will be treated as having never come into existence. Any contractual obligations which have been fulfilled under the contract may be reversed. For example, if the insured has paid a portion of the premium he is entitled to have it returned.
- (i) Condition precedent to liability - Generally speaking, failure to comply with a condition precedent to liability will prevent the insured from making a claim. A breach in relation to one claim will not prevent the insured's right to pursue a separate claim under the policy if all the relevant conditions are complied with. So, for example, if a term of the insurance policy requires as a condition precedent the insured to notify the insurer of a third party claim against it within a defined period of time and the insured fails to do so, his right to claim an indemnity in respect of that claim may be lost. However, his right to pursue other claims under the policy is preserved.
- (ii) If the condition precedent does not relate to a specific claim but is of general application (such as an ongoing obligation to pay a premium) a breach may suspend the insured's right to make any claim under the policy until they have complied with the obligation.
- (iii) Policyholders should particularly beware if the consequences of a breach of condition precedent are suspensory in a general sense as this will prevent the insured from being able to bring any claim under the policy even when conditions in relation to specific claims have been complied with.
- (iv) Where there is a breach of a condition precedent to liability, the insurer will not normally be entitled to damages. One qualification to this is in cases where the insurer has suffered loss as a result of the insured's failure to comply with a condition precedent, for example in cases where the insured has failed to pay a premium. The insurer can make a separate damages claim for the premium.
- (v) Bare conditions - Where a bare condition is breached the insurer is not entitled to avoid liability for the claim. Instead he is merely entitled to damages for any loss which he might have suffered as a consequence of the insured's breach.

Section 4: Creating a condition precedent

Terms which are intended to constitute conditions precedent to risk or liability tend to be described expressly as being conditions precedent.

The use of the words condition precedent are not determinative; nonetheless, labeling the clause as a condition precedent normally means it will be construed as such unless the term is used indiscriminately.

By the same token, the absence of the label condition precedent is not determinative. It may be that the consequences of the breach are spelt out in such a way that indicates that the term is meant to operate as a condition precedent. For example, a clause may contain wording which shows that it is intended to operate as a condition precedent such as *“No claim...shall be payable unless the terms of this condition shall have been complied with”*.

Equally, there may be a general condition precedent clause (also known as a *“sweeping up”* clause) which states that compliance by the insured with all of the obligations placed on him under the policy is a condition precedent to the insurer’s liability to pay the claims. These types of conditions precedent should be avoided if possible as the consequence may be that a breach of any term of the policy may result in the insurer being able to avoid liability for a claim.

Sometimes general condition precedent clauses apply not only to the terms of the policy but also to the representations made in the proposal form. Such a clause may look like a basis clause and is normally a declaration made by the insured acknowledging that each of the representations in the proposal form as well as the policy will be treated as a condition precedent to the insured’s liability¹.

Any ambiguity in the wording will normally be construed against the insurer which may provide some protection for the insured from having to comply with uncertain obligations. However, since the consequences of a breach of condition precedent are far more serious than for a breach of condition, policyholders should make sure they are aware of how clauses in their insurance policies are likely to be classified.

We recommend that you consult your insurance broker to ensure that policy terms are phrased as bare conditions rather than conditions precedent wherever possible.

Examples of typical condition precedent wording can be found at the Annexes.

¹ For more information on proposal forms and basis clauses please refer to The Airmic Technical Guide to Basis Clauses, 2013 produced with the assistance of Herbert Smith Freehills LLP.

Section 5: Common types of condition precedent

It is important to remember that the examples given below will not always be conditions precedent. The nature of the clause will depend on the wording used. Policyholders should ensure they are aware of whether the clause in question is a condition precedent or a bare condition as, as has already been discussed, the consequences for breach of each vary considerably.

Examples of clauses which may be conditions precedent to risk are as follows:

- Delivery of a policy as a condition precedent.
- Provision of further information by the insured.
- Absence of overlapping insurance.
- Initial payment of premium.
- Satisfactory disclosure of all material facts or “fair presentation of the risk”.
- Survey of the insured subject matter and confirmation that there has been compliance with any recommendation set out in the survey.
- The implementation of security measures.

Examples of clauses which may be conditions precedent to liability are as follows:

- Ongoing payment of premium.
- Notification clauses. Generally these require the insured to give notice of a claim or loss to the insurer within a specified time.
- A clause requiring the provision of certain information by the insured to the insurer (e.g. monthly trading returns for the purpose of calculating the premium payable).
- An obligation to take all reasonable steps to avoid or mitigate damage for which a claim is being made under a policy.
- It may also be a general condition precedent in cases of co-insurance that one insurer will not face liability until co-insurers have also accepted liability.

Section 6: Options for airmic members

Members should consult their insurance broker to limit the inclusion of conditions precedent in their policies where possible. In particular, they should seek to ensure that there is no “sweeping up” clause as failure to comply may mean that breach of any term will prevent them bringing a claim. Equally, where a general condition precedent clause applies to a proposal form, breach of any of the representations in that form may mean that the insured is not liable under the policy. Members should therefore consult their insurance brokers where they suspect that there is a general condition precedent clause which applies to their proposal form.

Members should also consult their insurance brokers to make sure they are clear which terms in their policies are likely to be construed as conditions precedent and which are likely to be construed as bare conditions. Once they are aware that a term is a condition precedent they must ensure that their business is fully compliant otherwise they risk not being covered.

Section 7: Annexes

Annex A : Example wording - notification clause

The assured shall as a condition precedent 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.

Annex B: Example wording - “Sweeping up” clause

The liability of the insurer to make any payment under this policy will be conditional upon the compliance with its terms and conditions by the Policyholder or any person claiming indemnity or benefit.

Annex C: Example wording – General condition precedent applicable to a proposal form

The due observance of the terms, provisions, conditions, and endorsements of the Policy by the Assured in so far as they relate to anything to be done or complied with by the Assured and the truth of statements and answers and information supplied on or in connection with the Assureds proposal shall be a condition precedent to any liability of the Underwriter to make any payment under this Policy.



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