

INDEMNITY ISSUES FOR INSURERS

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Introduction

1. These notes address indemnity issues arising from policies of liability insurance.
2. Liability insurance is insurance protection which indemnifies an insured in respect of liability to third persons: Public Liability, Employers' Liability and policies of motor insurance.
3. Policies of liability insurance are contracts between insurer and insured. They vary widely in their terms. In determining whether or not the insured is entitled to indemnity for a potential third party liability, the starting point must, therefore, be the policy terms.

Cover

4. The first issue when insurers are notified of a potential claim under a liability policy is whether the insured was in fact covered against the risk which has arisen.
5. The question of cover involves consideration of the following issues:
 - (a) the existence of a policy of insurance;
 - (b) the period of cover;
 - (c) the cause of the loss.
6. Existence of a policy.

In long tail industrial disease claims, there is not infrequently doubt about the existence of a relevant policy of insurance. See, for example, the recent case of *Hall v. (1) Newall Heating Ltd (2) AGF Insurance Ltd* (QBD, 14th April 2010):

The Claimant ("C") sought to recover damages from the insurer ("AGF") in respect of mesothelioma. His case was that the disease was caused by exposure to asbestos while employed by Newall Heating Ltd ("N") between 1967 and 1974. N was not trading and was insolvent and C obtained a default judgment against N for damages to be assessed. C sought to identify insurers who were on risk during the relevant period and who might therefore be liable to satisfy the judgment pursuant to the Third Parties (Rights Against Insurers) Act 1930. AGF was identified as an insurer and added as a party to the action. At trial, after investigation of events going back more than 40 years, it was held that C had failed to establish that AGF had ever issued a policy of employers' liability insurance in respect of N.

7. Period of cover.

The question is whether an event giving rise to potential liability to a third party has occurred within the period of cover provided by the policy of insurance. In a policy of motor insurance, this is generally straightforward: did the accident occur while the policy was in force? The issue is also generally straightforward in cases of accidents under EL and PL policies giving rise to immediate and obvious injury.

8. The situation is far from straightforward, however, with long tail disease claims where the damage may be latent for many years. Consider cases of mesothelioma: inhalation of asbestos fibres may result in the development of a tumour 40 years later. Which insurer is on risk? The insurer at the time when the Claimant was exposed to the asbestos or the insurer at the time, many years later, when the Claimant actually develops the tumour? In the arena of PL claims, the Court of Appeal held in *Bolton MBC v. Municipal Mutual Insurance Ltd* [2006] EWCA Civ 50 that the right PL policy to respond in cases of asbestos-related disease was the policy in force at the time when

the disease first occurred or manifested itself, rather than the policy in force at the time when exposure occurred. The basis of the reasoning was that the mesothelioma was an accidental injury which did not occur at the time of exposure but at the time when the tumour first manifested itself.

9. The law has taken a different course in EL claims. Following *Bolton*, insurers had declined to pay out on EL policies in force at the date of inhalation by employees who had gone on to develop mesothelioma. In litigation known as the “Trigger Litigation”, more formally *Durham v. BAI (Run Off) Ltd*¹, the High Court considered a group of consolidated cases where this issue arose under EL policies.² It was held by Burton J that an insurer which provided EL cover for “injury sustained or disease contracted” had to pay out in a mesothelioma case if it was the insurer on risk at the time when the employee inhaled the asbestos fibres. It was held that although on the medical evidence there was no injury or disease at the time of the inhalation, the mesothelioma had been contracted, in the sense that it had been caused, at the time of inhalation. The “trigger” for liability was held to be inhalation rather than the actual development of the tumour. *Bolton* was distinguished on the basis that it was a PL policy with different policy wording which included use of the word “occur” rather than “sustained or contracted”.
10. Occurrence of an insured event.

Assuming that there is a policy and that it is in force at the relevant time, the question is whether the cause of the potential liability was a cause covered by the insurance. Example: a typical policy of motor insurance may not cover use of the insured vehicle “off-road”. If the insured driver has taken her 4x4 into a farmer’s field and, while giving friends an exciting ride around the field, rolled the vehicle, seriously injuring a passenger, then such an accident would not be covered by a policy which excluded off-road use.

11. Similarly, many policies of livestock insurance exclude PL losses arising from business use. When a claim is presented, careful consideration needs to be given as to whether or not the loss has in fact arisen from private use. Not infrequently, for example, the insured turns out to have been buying and selling horses with such frequency that it can only properly be regarded as a business activity, in which there may not in fact be cover for a riding accident which has occurred when a potential buyer was trying out a horse.

Repudiation of the policy of insurance

12. A policy of insurance is a contract of “utmost good faith” – *uberrimae fidei*. The reason for this is that contracts of insurance are generally based on facts which are known only by the insured at the time of formation of the contract. Only the insured knows what modifications have been made to his car, how many miles he is going to drive it every year and the purposes for which he is going to drive the car. The insurer has to rely on the information provided by the insured in assessing the risk and determining the appropriate premium.
13. The obligation to observe utmost good faith gives rise to 2 duties on the party proposing insurance:
 - (a) a duty to disclose all material facts to the insurer;
 - (b) a duty not to misrepresent material facts to the insurer.
14. What is a “material” fact? The test of materiality is not what the insured considers material, nor what a reasonable insured would consider reasonable, but whether the fact would be taken into account by a prudent insurer when assessing the risk and determining an appropriate premium.
15. Material non-disclosure or misrepresentation entitles the insurer to avoid the contract *ab initio* if the insurer was induced to enter into the insurance contract by the non-disclosure or misrepresentation: *Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd*³.

¹ [2008] EWHC Civ 2692

² See Tony Reddiford’s article on this litigation in the Summer 2008 of *Guildhall Chambers’ PI News*, p.11.

³ [1995] 1 AC 501

16. In order to establish materiality and inducement, it is necessary for an insurer to adduce evidence from underwriters that the non-disclosure or misrepresentation was material and did induce the contract. The insurer must show at least that, but for the non-disclosure or misrepresentation, the policy would not have been concluded on the same terms. It is not necessary, however, to show that that it was the sole effective cause. The issue is one of fact. Frequently, expert evidence will also be called on the issue of materiality.
17. *Mark Whitlam v. Andrew Hazel*⁴: repudiation of a motor policy for material non-disclosure. At the time of proposing motor insurance, W was working full-time at a golf shop but had applied to train as a golf professional. On his proposal form he stated that he worked as a shop assistant and made no reference to his golfing activities. On his way home from a 5 day residential golf training course, he was involved in a fatal accident. It was accepted that there was no deceit on the part of the insured and that his non-disclosure was innocent, caused by the manner in which his insurance broker had filled in the insurer's electronic form. It was held that the non-disclosure was material because, on the evidence of the underwriters, the proposal of insurance would have been rejected if the word "golf" had appeared in it. The Court of Appeal confirmed that the insurer had been entitled to repudiate the policy of insurance, notwithstanding the fact that the non-disclosure had been innocent.
18. A word of warning. Since January 2005, there has been in force the Insurance: Conduct of Business Sourcebook ("ICOBS") issued by the Financial Services Authority. This requires that when dealing with private individuals, an insurer must not unreasonably reject a policyholder's claim and that rejection is unreasonable where the insurer is relying on non-disclosure of a material fact which the policyholder could not reasonably be expected to disclose or non-negligent misrepresentation. The Financial Ombudsman Service will permit an insurer to avoid the policy in the case of a deliberate or reckless misrepresentation or non-disclosure but will require the insurer to pay the claim in respect of an innocent breach of duty. For the full terms of the ICOBS, go to: <http://www.fsahandbook.info/FSA/html/handbook/ICOBS>.

Late notification

19. Insurance contracts generally require the insured to notify the insurer "immediately" or "as soon as possible" of any occurrence which might give rise to a claim. In what circumstances can an insurer avoid paying a claim due to late notification?
20. The obligation to give notice of a potential claim to the insurer is a term of the contract of insurance. The rights of the insurer upon breach of such a term depend upon the nature of the term itself: is it a condition precedent, a simple warranty or an innominate term?
21. If the term requiring notification is properly classified as a condition precedent, then breach automatically entitles the insurer to refuse payment. The use or absence of the descriptive words "condition precedent" is not determinative of the issue and the term will be construed in the context of the insurance contract as a whole. Experience shows that some policies of insurance ascribe the status of condition precedent to a whole host of obligations, many of which cannot objectively be regarded as points of significant for the insurer. It has been held that "indiscriminate" use of the term "condition precedent" is likely to undermine the contention that a term described as a "condition precedent" is in fact a condition precedent: *HLB Kidsons v. Lloyds Underwriters*⁵.
22. In *Kosmar Villa Holidays PLC v. Trustees of Syndicate 1243*⁶ the Court of Appeal construed a notice provision in an insurance contract as a condition precedent. Kosmar had notified the insurers of a potential personal injury claim 12 months after the injury had occurred. The insurers wrote to Kosmar requesting further information and informed the claimant's solicitors that they were taking over conduct of the claim. Several weeks later the insurers repudiated liability to indemnify Kosmar in respect of the claim due to breach of the condition precedent. Kosmar contended that the insurer had waived the breach by unequivocally stating that they would deal

⁴ [2004] EWCA Civ 1600

⁵ [2007] EWHC 1951

⁶ [2008] EWCA Civ 147

with the claim. The Court of Appeal held that there had been no waiver of the breach of the notification condition since the insurer had requested more information from Kosmar and was entitled to a reasonable time to consider the response before deciding to repudiate liability under the policy.

23. If the notification condition is not a condition precedent, breach may still give rise to a right not to pay the claim. In *Alfred McA Alpine PLC v. BAI (Run off) Ltd*⁷, Colman J held that the obligation to give notice of any occurrence which might give rise to a claim “as soon as possible...in writing, with full details” was not a condition precedent. Insurers did not challenge the finding that the term was not a condition precedent but argued that the failure to comply amounted to a breach of the duty of good faith entitling the insurer to avoid the contract. The Court of Appeal held that mere negligence in supplying details of the claim could not constitute a breach of the obligation of good faith. However, it was held that breach of such a term might in some circumstances be so serious as to give a right to reject the claim. In other words, the notification clause was held to be an innominate term: see *Hong Kong Fir Shipping Co. Ltd v. Kawasaki Kisen Kaisha Ltd.*⁸ A breach which demonstrated an intention not to continue to make a claim, or which had very serious consequences for insurers, should be such as to entitle insurers to defeat the claim.
24. In practical terms, therefore, unless the notification clause is a condition precedent, insurers will have to show prejudice arising from late notification in order to defeat a claim. In *Loyal Trend v. Creechurch Dedicated Ltd*⁹ it was held in the Commercial Court that a claim on a business interruption policy failed because the insured was in breach of the policy condition requiring immediate notice to be given and the delay in giving notification had given rise to insuperable difficulties in assessing what business losses flowed from the material damage.

Third Parties (Rights against Insurers) Act 2010

25. This Act completed its passage through Parliament on 25th March 2010 but has not yet come into force. It is currently awaiting an order of the new Secretary of State by statutory instrument.
26. When it does come into force it will repeal the Third Parties (Rights against Insurers) Act 1930.
27. The aim of the 2010 Act is to simplify the procedure whereby claimants can recover their losses directly from a defendant's insurers in circumstances where the defendant is insolvent.
28. Under the 1930 Act, it is necessary for the claimant to restore a dissolved company to the Register, to establish liability against the company and then to bring a claim against insurers under the Act. The 2010 simplifies the procedure by removing the need to restore the company to the Register and entitling the claimant to bring proceedings directly against the insurer to establish the liability of the insured and the insurer.

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⁷ [2000] 1 Lloyd's Rep 437

⁸ [1962] QB 26

⁹ [2010] EWHC Civ 425