TURKEY

Precautionary Measures

"Clauses requiring the policyholder or the insured, before the insured event occurs, to perform or not to perform certain acts" (PEICL 4:101)

Papers submitted to the AIDA Consumer Protection & Dispute Resolution Working Party meeting held on 13 September 2012 in London by

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December 2012

Publisher: Sigorta Hukuku Türk Derneği

Editor: Samim Ünan

Front Page Design: Ümran Arslan

Printing House: Özdil Basımevi, Galip Dede Cad. 77/1 Beyoğlu 34420 İstanbul, Tel: 0212 251 83 13

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Foreword

At its meeting in London in September 2012 at the occasion of the AIDA Europe Conference, the Consumer Protection & Dispute Resolution Working Party of AIDA discussed one of the most controversial issues of insurance law: The so-called "Precautionary Measures" defined in the PEICL (Principles of European Insurance Contract Law) as the contractual stipulations requiring the policyholder or the insured to perform or not to perform certain acts before the occurrence of the risk.

After the Working Party Chairman's general presentation aimed at highlighting the main problems that needed to be examined, distinguished speakers from different countries -John Habergam (UK), Greg Pynt (Australia), Prof. Anne Pelissier (France), David Hirzel (Switzerland) and Stella Sakellaridou/Dr. Kyriaki Noussia (Greece)- made presentations to reflect the approaches prevailing in their countries (Huseyin Arslan from Turkey also sent a powerpoint presentation but he was unfortunately not able to attend. The minutes take into account his contribution). Dispite some interventions and questions from the floor unfortunately a lengthy discussion was not possible due to the lack of time.

This publication contains the papers prepared by the above-mentioned speakers together with the answers given to the questionnaire drafted by the Chairman. Greg Pynt took notes during the Working Party meeting and wrote the minutes that he finalized later with Dr. Noussia. The minutes being sufficiently detailed give a precise idea of the presentations/speeches made at the Working Party meeting.

It is hoped that the readers find in this publication the main problems encountered in the field of precautionary measures, a topic that will be discussed also in detail at the 2014 AIDA World Congress in Italy. Therefore it is a small contribution while we are on the "Road to Rome".

Dr. Samim Unan

Content

IVth AIDA Europe Conference
13 September 2012, Grange Tower Bridge Hotel, London

Report on, and Minutes of, the Consumer Protection and Dispute Resolution Working Party Session on Precautionary Measures

Greg Pynt and
Dr. **Kyriaki Noussia** *(Secretary to the Working Party)*

The meeting was held on Thursday September 13th 2012 between 9:15 and 11:45 hrs at the Grange Tower Bridge Hotel, 45 Prescot Street, London E1 8GP, UK.

The topic of the session was titled: "'*Precautionary Measures*', defined as 'a clause in the insurance contract whether or not described as a condition precedent to the liability of the insurer, requiring the policyholder or the insured before the insured event occurs, to perform or not to perform certain acts' (PEICL Article 4:101)". The Agenda included various speakers and has been conducted as follows:

Introduction: The PEICL

Professor Dr Samim Unan (Chairman of the Working Party) opened the Session by setting the foundation for a discussion of 'precautionary measures'.

'Precautionary measures' clauses are included in insurance contracts for the purpose of requiring insureds to take or not take steps prior to an insured risk occurring for the purpose of reducing the risk occurring or minimizing the loss if it does happen. Falling into this category are clauses requiring insureds to have activated security or fire alarm systems.

By contrast, 'preventive measures' clauses address conduct before and after an insured event occurs. A prompt notification clause is an example of a 'preventive measures' clause.

The Principles of European Insurance Contract Law ("**PEICL**") define a 'precautionary measure' as a term:

whether or not described as a condition precedent to the liability of the insurer, requiring the policyholder or the insured, before the insured event occurs, to perform or not to perform certain acts: Article 4.101.

There is a distinction between a clause which is regarded as a definition of the risk and a clause which imposes a duty on the insured. A 'precautionary measures' clause falls into the latter category. An insurer cannot sue to enforce it and cannot claim damages for non-compliance with it. However, depending on the context, non-compliance may entitle an insurer to terminate or avoid the contract or be wholly or partly relieved from liability for a loss.

A 'precautionary measures' clause that allows an insurer to refuse to pay all or some of a claim for non-compliance with it is only effective to the extent the loss was caused by the policyholder's or insured's:

a) non-compliance with intent to cause the loss, or reckless non-compliance with knowledge that the loss would probably result: the PEICL, Article 4.103(1); or

b) negligent non-compliance, but only if there is a "*clear clause providing for reduction of the insurance money according to the degree of fault*": the PEICL, Article 4.103(2).

A clause that allows an insurer to terminate a contract for non-compliance with a 'precautionary measure' is only effective if:

a) "*the policyholder or the insured breached its obligation with intent to cause the loss or recklessly and with knowledge that the loss would probably result"*: the PEICL, Article 4.102(1); and

b) the insurer exercises its right of termination in writing "*within one month of the time when the non-compliance with a precautionary measure becomes known or apparent to the insurer. Cover shall come to an end at the time of termination*": the PEICL, Article 4.102(2).

Professor Dr Unan raised a number of questions for discussion, including:

a) how to distinguish between a clause that describes the risk (an insuring clause or an exclusion) and a 'precautionary measures' clause;

b) whether limitations on sanctions for non-compliance with a 'precautionary measures' clause should apply to all contracts, or only to personal lines or consumer contracts;

c) whether sanctions for non-compliance with a 'precautionary measures' clause should only be available if the insurance contract specifically provides for them;

d) what sanctions should be available for non-compliance with a 'precautionary measures' clause (termination, avoidance, discharge from liability for the claim or reduction of indemnity).

Also, whether limitations on sanctions for non-compliance with a 'precautionary measures' clause should depend on:

a) the existence of a causal link between the non-compliance and the occurrence of the insured event or loss;

b) whether the non-compliance was innocent, negligent, wilful or reckless;

c) whether the policyholder, insured or beneficiary was involved in the non-compliance.

Professor Dr Unan said there exists different terminology for `*'precautionary measures*'' (e.g. in the UK it is expressed by the term "*promissory warranties*" whereas in France it is expressed by the words "*preventive measures*"). Hence the variety in the existing wording.

He also stated that their aim is to protect the insurers, work as a condition precedent, and set an exclusion, as well as that specific conduct is required. Prof. Dr Unan stated also that the German Supreme Court has put an emphasis on the wording and the content of these clauses. He made the distinction between duty and obligation and finally raised the awareness issue.

The English position: John Habergham, Myton Law Ltd, lawyers, Hull, England

A promissory warranty is a common law notion and is very similar to a 'precautionary measures' clause. It is a promise or representation by an insured to an insurer about future conduct, or that a state of affairs will continue after the contract is made. It is a condition precedent to liability and must be literally, strictly and exactly complied with. Substantial compliance is insufficient. The insurer is automatically discharged from its liability under the contract from the moment a promissory warranty is not complied with, unless it is estopped from relying on the non-compliance.

A 'basis of contract' clause is a device used by insurers to elevate every item of information in an insurance proposal form to the status of a warranty.

John suggested there is no need to change the law relating to promissory warranties and 'basis of contract' clauses for business insurance as businesses are well able to look after themselves, but there is a pressing need for it to be changed for consumer insurance contracts.

Section 6 of the *Consumer Insurance (Disclosure and Representations) Act 2012* prevents insurers from using 'basis of contract' clauses in consumer insurance contracts. The Law Commissions for England and Wales and for Scotland propose that a similar provision apply to business insurance, whilst preserving the ability of the parties to contract out of the provision of the legislation.

The Law Commissions also suggests the law be changed so that non-compliance with:

a) a warranty would suspend the insurer's liability for the duration of the non-compliance rather than discharge the insurer's liability from the moment of non-compliance. This would mean that the insurer is on risk again as soon as the insured resumes compliance;

b) a term designed to reduce the risk of a particular type of loss in a consumer insurance contract would suspend the insurer's liability for that type of loss for the duration of the non-compliance. For example, non-compliance with a term requiring the insured to maintain fire retardant lagging in kitchen ducting would suspend liability for fire loss for the duration of the non-compliance. In business insurance, an insurer would be entitled to specify that non-compliance with such a term would discharge it from all liability under the contract.

The Australian position: Greg Pynt, Pynt + Partners, lawyers, Perth, Western Australia

Section 54 of the Australian *Insurance Contracts Act 1984* is concerned, amongst other things, with '*precautionary measures*', because it limits an insurer's ability to refuse to pay a claim because of a post-contractual act or omission by an insured or "*some other person*".

Section 54 does not qualify the act or omission by reference to the word "*breach*" or to the nature or characteristics of the relevant contractual term. Accordingly, it is brought into play by acts or omissions relating to all manner of contractual terms, including exclusions, warranties, terms descriptive of risk (suspensive conditions), conditions precedent and subsequent and conditions that are not conditions precedent or subsequent.

Section 54 does not operate if the circumstances that gave rise to the claim on the policy fall outside the insurer's 'core' promise.

Generally speaking, in a 'losses occurring' insurance contract, an insurer's 'core' promise will coincide with the scope of the insuring/operative clause. Accordingly, circumstances falling outside the scope of the clause will usually be regarded as falling outside the insurer's 'core' promise and will

therefore not attract the application of s 54. For example, in the case of an insuring clause in a motor vehicle policy that promises cover for accidental damage to a vehicle:

- during the period 12 September 2011 to 12 September 2012, s 54 will not come into play if the damage occurs on 13 September 2012;
- in Australia, s 54 will not come into play if the damage occurs when the vehicle is in New Zealand.

Section 54 divides post-contractual acts or omissions into those that are:

a) potentially loss-causing ("*could reasonably be regarded as being capable of causing or contributing to*" an insured loss), in which case the insurer can refuse to pay the claim, except to the extent that the insured proves the relevant act or omission did not cause or contribute to the loss (s 54(2));

b) not potentially loss-causing (could not reasonably be regarded as capable of causing or contributing to an insured loss), in which case the insurer cannot refuse to pay the claim, it can only reduce its liability to pay the claim by the extent to which it has been actually financially prejudiced by the act or omission (s 54(1)). Section 54(1) addresses circumstances covered by the PEICL Articles 6.101 and 6.102.

Example of the operation of s 54(2). An insured vehicle with faulty brakes is damaged when the owner unintentionally drives it into the back of another vehicle. The insurer can refuse to pay the owner's claim for the damage to the insured vehicle if:

- the contract excludes cover for a loss that occurs while the vehicle is being driven in an unroadworthy condition; and
- faulty brakes could reasonably be regarded as being capable of causing or contributing to an insured loss.

In these circumstances, the owner will only be able to recover the cost of repairing the damage to the insured vehicle to the extent he or she proves the faulty brakes had nothing to do with the accident: s 54(3) and (4).

Greg said that as far as he is aware, in the 27 years s 54 has been operating no case has reached a superior court on the potential "*practical difficulties in quantifying an insurer's liability*". Presumably, when these issues have arisen, the parties have managed to resolve their disputes without going to trial.

Greg concluded by saying that like s 54, Article 4.103 of the PEICL seeks to accord 'a fair go all round' to insurer and insured arising out of non-compliance with a '*precautionary measure*'. There are differences between

the two approaches, but both are a significant advance on insurance contract law 'in the state of nature'.

The French Position: Professor Anne Pélissier, Montpellier I University, Montpellier, France

In her presentation, Professor Pélissier focused on issues concerning burden of proof, interpretation/validity issues and sanctions.

For a consumer insurance contract, a judge in France is obliged to construe a contractual stipulation most favorable to the policyholder (not a true 'interpretation' because the judge is under a legal duty to safeguard the interests of a consumer). Interpretation is not available to a judge in the case of an exclusion clause because it is only effective if precisely drafted.

An insurer:

a) can draft a 'precautionary measures' clause so that it delimits cover by defining the risk, by excluding cover or by forfeiting cover if the insured does not comply with the clause ("*déchéance*"). It is not clear whether a causal link between non-compliance and the loss is a relevant consideration;

b) can stipulate that cover will only commence if the policyholder implements certain 'preventive measures'. The insured bears the onus of proving compliance with the 'preventive measures';

c) can stipulate for reduction of cover to the extent that the insured's non-compliance with a 'preventive measure' is causally linked to the loss. The insured's innocence, neglect or deliberateness is irrelevant;

d) cannot unilaterally terminate a contract for non-compliance with a 'precautionary measures' clause.

The Swiss position: David Hirzel, Legal Counsel, SCOR Services Switzerland Ltd, Zurich, Switzerland

David focused on the contractual co-operation duties that are described in Swiss law as "*vertragliche Obliegenheiten*" and the sanctions in case of their non-compliance. 'Precautionary measures' are understood in Swiss insurance contract law as contractual co-operation duties that apply before materialization of the risk.

Art. 29 paragraph 1 of the Swiss Insurance Contract Act (ICA) states that the insured may be contractually bound by 'precautionary measures' in

order to minimize the risk or to prevent a risk increase. Furthermore, 'precautionary measures' are often based on statutory co-operation duties which have been modified by agreement of the parties.

A clause in an insurance contract providing for a sanction against an insured's or beneficiary's non-compliance with a 'precautionary measures' clause is only effective if the circumstances of the non-compliance are "*imputable to the insured or the beneficiary":* Article 45, paragraph 1 of the ICA. This provision contains only a fault requirement, but no general causation requirement. However, article 29 paragraph 2 of the ICA regulates an explicit causation requirement which solely applies to the specific 'precautionary measures' as per article 29 paragraph 1 of the ICA.

David concluded his presentation by referring to the completely revised Swiss ICA, which is not yet in effect, but will influence the future regulation of 'precautionary measures'.

The Turkish position: Huseyin Arslan, Legal Counsel ERGO Sigorta AŞ, Istanbul, Turkey

Insurance contract law is the 6th Book of the new Turkish Commercial Code ("**TCC**"), which came into effect on 1 July this year.

By TCC Article 1449 (when read with Article 1412), a termination clause in an insurance contract is only effective:

a) to the extent that a policyholder or insured (or their representatives or beneficiaries) has negligently, wilfully or recklessly not complied with a 'precautionary measures' clause;

b) to the extent that non-compliance contributed to the materialization of the risk; and

c) if the insurer exercises its right to terminate (wholly or partially) within 1 month of becoming aware of the non-compliance.

The Greek position: Stella Sakellaridou (post-graduate student) and Dr Kyriaki Noussia, Lexarb, Athens, Greece

A 'precautionary measures' clause that allows an insurer to refuse to pay all or some of a claim for non-compliance with it is only effective to the extent that the non-compliance was negligent, wilful or reckless and there was a causal link between the non-compliance and the loss: Greek Insurance Act, Article 3, Law 2496/1997, § 5.

An insurer can unilaterally terminate an insurance contract or vary it within 1 month of becoming aware of negligent, wilful or reckless non-compliance with a 'precautionary measures' clause: Greek Insurance Act, Article 3, Law 2496/1997, § 3.

If an insured event occurs before the variation or termination takes effect, the insurer is entitled to reduce payment by the extent to which the insured's negligent, wilful or reckless non-compliance caused the loss.

The most innovative rule introduced by the Greek regime is the element of the principle of proportionality which applies to reduce the sum to be indemnified by the insured in ratio to the extent to which the insured's negligent, wilful or reckless non-compliance caused the loss.

Conclusions

All of the jurisdictions discussed during the Session (apart from France) are doing, or have done, something towards limiting an insurer's right to refuse payment or terminate an insurance contract for non-compliance with a 'precautionary measures' clause, and the solutions broadly head in the same direction (in favour of policyholders, insureds and beneficiaries). However, they are all well short of being uniform or of matching the relevant PEICL Articles.

Precautionary Measures in General

Dr. **Samim Unan** *(AIDA Turkey)*

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Prof. Dr. Helmut HEISS (in BRUCK/MÖLLER Versicherungsvertragsgesetz, 9 Auflage Erster Band, 2008, § 28).

Principles of European Insurance Contract Law (PEICL) prepared by the Project Group Restatement of European Contract Law- Chairman: Helmut HEISS (edited by the Drafting Committee: BASEDOW/ BIRDS/ CLARKE/ COUSY/ HEISS in cooperation with LOACKER), 2009, Articles 4:101, 4:102 and 4:103.

1. Introduction

The insurer effects payment upon materialization of the risk. Thus it has an obvious interest to avoid this fact to happen or to impose limitations in that respect. As a basic principle, the parties to the insurance contract are free to determine the risk(s) that will be covered and to define these. This task can be made in different methods.

Often the insurer thinks that the behaviour of the policyholder (or the persons whose acts are assimilated to those of the policyholder) is of relevance for the insurance cover. Then it drafts the insurance contract accordingly. It may provide exclusions, conditions precedent or duties. If the insurer chooses to insert a duty to perform or refrain from certain acts, a number of questions arise. We will examine them below.

The aim of this paper is to make a general description of the problem and put forward the questions that one will face in this connection.

The duty to perform or not to perform certain acts is described as the "precautionary measures".

"Preventive measures" is a broader concept. Preventive measures mean all kind of measures destined for avoiding the risk or the loss to happen (or the resulting economic burden for the insurer) before or after the occurrence of the risk. In that sense

- measures aimed at avoiding the risk to occur (for instance diligent behaviour)
- measures aimed at averting or minimising the loss when the risk has been materialised (for instance intervention in order to extinguish a fire or to take the movable property out of the burning building)
- measures aimed at calculating the loss accurately (for instance provision of documents, invoices etc.)

may all be qualified as preventive measures since from the standpoint of the insurer, they all serve to safeguard his legitimate interest (not to pay more than necessary).

"Precautionary measures" form part of preventive measures.

2. Definiton

The precautionary measure is defined in the PEICL 4:101 as follows:

> "A clause in the insurance contract, whether or not described as a condition precedent to the liability of the insurer, requiring the policyholder or the insured, before the insured event occurs, to perform or not to perform certain acts"

3. Characteristics

Does a precautionary measure clause in the insurance contract constitute a duty or an obligation? The difference between duty and obligation lies in the fact that performance of the duties cannot be claimed (no right to sue). Breach of duty does not entitle the other party to request indemnity (nor to set off) but will cause the loss of the rights under the insurance contract or a diminution thereof.

The qualification (as duty or obligation) will depend on the legal provision or the wording. Often national laws define a precautionary measure clause as a duty.

Mostly (depending on the legal provisions of the country concerned) the breach of the duty has (or may have) the following consequences:

- the policyholder/insured may lose entirely or partly his rights attached to the materialisation of the risk (relief from liability of the insurer)
- the insurer can terminate the insurance contract (for the future, ex nunc)
- or the insurer can avoid the insurance contract (with retroactive effect, ex tunc)

The legislators prefer providing "duties" and not (accessory) obligations taking into account especially the following:

- Although the policyholder transfers the economic burden of the risk to the insurer
- It stays closer to the risk and may influence its occurrence or at least can be expected to be diligent.

Thus the insurance law must establish a balance: Normally the average policyholder/insured will be diligent enough to refrain from materialising the risk. If the careless behaviour would not have any adverse impact on the entitlement to the insurance indemnity, the diligent policyholders would have paid more premiums.

4. Legal Character

Under PEICL and in certain countries (Germany, Turkey) precautionary measures are "duties".

Is it a statutory duty or a contractual duty? Precautionary measures as defined in the PEICL constitute a contractual duty (Obliegenheit = incombance).

National legislations often don't give a definition and leave the issue to jurisprudence and scholars (solution in favour of future developments of the concept).

The following definition seems appropriate:

"Duties are rules of conduct imposed by law or by contract to a contracting party, performance of which cannot be sued and breach of which does not entitle to compensation but generates various disadvantages as regulated by the legal or contractual provisions".

(The insurer may also be under certain duties but mostly duties are imposed to the policyholder).

5. Function

Duties may be imposed from the sunrise (or even before = pre-contractual duties) until the sunset (post-contractual duties: after a total loss, safeguarding the recourse possibility of the insurer against the third party liable for the occurrence of the risk).

Before the occurrence of the risk, they help establishing a balance between the risk transferred to the insurer and the premium. After the occurrence of the risk, they help to avoid or minimise the loss and to bring the insurer in a position to evaluate correctly his liabilities.

Duties are not aimed at penalising (relief of liability is sufficient).

Duties have a general preventive function. Especially the bad faith behaviours (intentional acts, frauds) may be avoided as a result of the dissuasive effect of the sanction that would apply in case of breach of the duty.

6. Relief of the Insurer as A Result of Fraudulent Behaviour

The relief of the insurer may be due not only to the violation of the contractual or legal provisions about duties but also due to the violation of general principle of good faith (though the latter is exceptional). Here we face competing legal institutions.

7. Contractual Duty

The duty to take precautionary measures is a duty of contractual character. In the absence of stipulation in the insurance contract to that effect, the policyholder will not be under such a duty.

8. When to Fulfil?

The duty to take precautionary measures has to be accomplished before the occurrence of the risk. The aim here is the avoidance of the risk. Therefore the measure has to be taken before its materialization.

9. How to Differentiate A Contractual Duty from the Description of the Risk (Exclusions)?

Drawing a borderline between precautionary measure and risk definition (exclusion of cover) is certainly amongst the most important and difficult problems of the insurance law.

Duties are defined as "norms of conduct". But the risk definition may also refer to certain acts to be (or not to be) accomplished by the policyholder. The insurer's will is decisive: It may choose to restrict its liability by stating "exclusions" or, instead, "duties". Hence risk definition and duty are "alternative" solutions.

[Each of those solutions generates different consequences: For risk exclusions there is no protective norm proper to insurance law. The clause decides alone whether a conduct of the policyholder is of relevance, the causality is required or the fault is constitutive. However for duties the

situation is totally otherwise. In that area mandatory provisions apply to protect the policyholder. On the other hand the burden of proof is not the same: In case of risk definition the first step must be made by the policyholder who will have to prove that the risk occurred within the scope of cover (primary risk limitation). If the policyholder succeeds in that task, thereupon the insurer will have to evidence that the event falls within the ambit of an exclusion clause (secondary risk limitation). If the policyholder alleges that it is question of an "exception to the exception" (tertiary risk limitation) the burden of proof will be again transferred to him). In case of duty however normally the insurer will have to prove the breach].

How to know which one (i.e. duty or risk definition) should prevail in a concrete case? This issue will be ascertained by way of "interpretation". The understanding of a diligent policyholder (with regards to the insurance concerned) without special knowledge of insurance is to be taken into account.

(German Supreme Court –BGH- emphasizes in its standard formula that the place and wording of a clause is not the only factors to consider when it comes to make a distinction between duties and exclusions. Decisive is the content of the clause. Is the clause describing a risk that the insurer does not wish to cover or is the insurance cover depending on a specific conduct of the policyholder? If the cover is granted from the outset in a defined extent it is question of risk limitation; if the cover depends on the subsequent conduct of the policyholder, it is question of a duty).

In case of doubt, it seems more appropriate to opt for the duty. This is justified not only by the "contra proferentem" rule but also falls conform to the aim of protecting the consumers[1].

It may happen that a duty is disguised in an exclusion clause: If from the material content of the clause it appears that it has to be qualified as a duty (despite its appellation and formula), it will not be regarded as a risk definition.

A clause will be regarded as "risk definition" if its centre of gravity

- is not a conduct of the policyholder or a person whose acts are assimilated to those of the policyholder
- but is a conduct of a third person or objective situations (such as the

[1] The protection of the consumers encompasses in some countries also small and medium size businesses in the field of insurance and the expression "consumer insurance law" is used to define the policyholders who concluded insurance contracts for mass risks protected by mandatory rules (see Helmut HEISS, General Report (presented to the XVIIIth Congress of Comparative Law 2010) in Insurance Contract Law between Business Law and Consumer Protection, 2011, p. 32-34.

insured place, the state of the insured asset, the timeframe within the cover).

In cases where the policyholder knows or ought to know the intention of the insurer to exclude from cover at the outset certain risks (because they are for example not reinsurable under the market conditions or because the insurer desires to overcome the difficulties of proof etc.), the provision will be regarded as exclusion.

10. How to Differentiate A Contractual Duty from the Causation of the Risk (With Negligence)?

In case the risk is caused with intent the insurer will not be liable.

Often national laws provide that the materialisation of the risk as a result of the policyholder's negligence will not adversely influence the insurance indemnity (no decrease = no sanction).

However, gross negligence may give rise to a decrease of the insurance money.

Under PEICL, there is practically no difference between

- violation of a precautionary measure, and
- causation of the risk with negligence

However with regards to causation of the risk with negligence, the onus of proof will lie with the insurer who will be required to evidence that the conduct of the policyholder has generated the risk.

If the violation of a precautionary measure is at the same time one of the causes of the risk, it will fall also within the rule about the causation of the risk with negligence.

11. How to Differentiate A Contractual Duty from A Time Limitation?

Contractual provisions may provide that the policyholder/insured have to accomplish certain acts within a defined period (otherwise the benefit of the insurance cover extinguishes). So when the policyholder has to make regular declarations of the quantity of fish–feed given to the tuna fishes in the marine farm before harvest (otherwise it will lose the benefit of insurance) , it is more convenient to conclude that in that case it is question of a "disguised" duty.

However the current tendency is to consider

- the clauses stating claim conditions (such as medical examination within a certain period of time following the accident to determine the invalidity)
- the clauses stating claim forfeiture (such as the notification of the occurrence of the risk, or the invalidity, within a certain period of time)

as risk definition provided that the aim of the insurer (for instance the avoidance of severe problems of proof) is (or might be) known to a diligent policyholder. The qualification as risk definition is detrimental to the policyholder in that non-negligence would not be helpful. However the good faith and fair dealing requirement may lead in some cases to preclude the insurer to invoke the forfeiture.

12. Prohibition to Elude the Legal Provisions About Contractual Duties By Way of Contractual Requirements (The Violation of Which Would Generate An Obligation to Indemnify or to Pay Penalty)

Sometimes the insurer provides instead of contractual duties (in the sense of insurance law) civil law contractual requirements (the violation of which would entitle the insurer to ask for penalties or indemnities). Those contractual requirements shall not be valid to the extent they are violating the mandatory rules about duties, the circumvention not being allowed (assuming that in the concrete case it is question of duties and not risk definition).

However, those civil law responsibilities normally will be valid for large risks that are excluded from the scope of mandatory provisions. But even in that case in countries where the rules about unfair contract terms apply also to B2B transactions a control of the content will be possible.

It is important to underline that rules of conduct may be provided freely as contractual obligations (giving rise to indemnity or penalties) when they are aimed at premium calculation.

13. Contractual Duties and Bad Faith/Fraud Clauses

The insurance contract may contain clauses stating that the policyholder will lose his rights in case of bad faith/fraudulent conduct.

Those clauses reflect the civil law principle (rule) that any bad faith/fraudulent behaviour will have the consequence that rights (under the contract) will be lost. In so far as the clause reproduces the civil law rule, it can be held valid.

14. Who Will Comply with the Duty?

The policyholder (and under the PEICL the insured) must comply with the duty.

- POLICYHOLDER as the contract partner
- INSURED as the person whose interest is protected under the insurance contract.

It seems open to debate whether the insured being required to accomplish the duty is a good solution[2].

14.1. Policyholder

As policyholder will be regarded

- The (total) substitutes (subrogees) of the policyholder
- In case of continuation of the policy with a third person that third person (for instance the spouse or the descendants or the beneficiary)

But if the policyholder assigns its right under the insurance contract, the assignee will not be charged with the duty (the policyholder shall remain responsible).

14.2. Persons Whose Acts or Knowledge Can Be Attributed to the Policyholder

In case of plurality of policyholders the solution would be as follows:

- If there is "one policy that covers different risks": Normally there will be no attribution of one's acts or knowledge to the other(s) (except in case of "representation")
- If the policy covers only one risk (for example co-property): Attribution is possible.

In case of contract to the benefit of a third party (INSURED) it seems that the best solution would be as below:

[2] It is important to bear in mind that imposing on the insured the duties incumbent to the policyholder is not the same thing as the attribution of the insured's acts or knowledge to the policyholder. In a concrete case the policyholder may be under the duty of taking a defined precautionary measure but the Insured (for example due to its lower skills or incapability) may not be under the same duty. However the acts or knowledge of such an insured may be attributed to the acts or knowledge of the policyholder (i.e. acts or knowledge of the insured may be considered as the act or knowledge of the policyholder and lead to the same result) regardless of whether the conditions for the imposition to the insured of the duty under which the policyholder is, are fulfilled.

- Attribution to the policyholder of the acts or knowledge of the Insured, when the law attaches a consequence to the acts or knowledge of the policyholder
- Attribution only and not duty imposed on the insured
- Contractual widening being possible (imposition through contractual stipulation of the duties incumbent to the policyholder, on the insured).

14.3. Attribution of the Acts or Knowledge of the Auxiliary Persons to the Policyholder (Assimilation of the Acts or Knowledge of Auxiliary Persons to the Acts or Knowledge of the Policyholder).

It is obvious that the policyholder, by leaving to a third person the accomplishment of a duty, cannot

- bring himself in a better or
- put the insurer in a worse situation.

There is no doubt that a "representative" of the policyholder will bind the policyholder by declaration of will (made on behalf of the policyholder). What about the conduct or the knowledge of a third party or when a third party shares his knowledge with the insurer? Will the policyholder be bound (i.e. bear the consequences of third persons act or knowledge) also in those cases?

If legal provisions regulate clearly the issue, obviously those legal provisions shall apply. But if there is no specific legal provision, where to find the solution?

To answer this question, the theory of "representative" was developed in German law. *(Another possible solution would consist in applying the civil law norms regulating contractual liability for the acts or omissions of auxiliaries to whom the performance of the contractual obligations are entrusted. Alternative application of the representation theory and the rules about civil law norms about contractual liability for auxiliaries entrusted with the task of performance in lieu of the policyholder seems open to discussion*).

Attribution of third parties negligence or knowledge to the policyholder means that the situation would be as if the policyholder itself acted negligently or possessed the knowledge.

To what extent will the acts or knowledge of a third party will be attributed to the policyholder and will the policyholder itself be under the duty (accomplishment of which is left to the third party)?

In case of representation:

- The policyholder has to
  - choose the representative with due diligence and
  - duly instruct him
- The policyholder will be required to let the representative know of the events occurred and facts discovered after the entrustment (or notify these directly to the insurer).
- If the policyholder violates the duty by his proper act after the entrustment, he will have to bear the consequences provided for the breach of duty.

If the conditions of representation (as will be seen below) are not fulfilled, decisive will be whether the policyholder itself may be regarded as having violated the duty.

Definition of "representation": The German Supreme Court (BGH) since 1993 uses the following definition:

> *"Representative is who, within the business to which the insured risk belongs, on the basis of representation or similar relationship takes the place of the policyholder and is empowered by this fact to behave alone, within a certain not totally meaningless extent, as policyholder".*

Therefore

- The policyholder must have appointed the representative consciously. The actual involvement of the third party with the consent of the policyholder is sufficient, a legal appointment as representative is not necessary.
- The policyholder must have entrusted entirely (and waived to perform) the behaviours falling within the ambit of the duty so that it is not anymore the boss (otherwise it would be alone under the duty).
- The policyholder may have entrusted the representative
  - the task of behaving on its behalf in respect of the risk (the so-called "risk administration"), or
  - the task of taking care of his rights and obligations under the insurance contract (the so-called contract administration).

  There is no necessity to entrust a representative for both. If a representative is entrusted only with the task of risk administration, only his behaviour falling within the scope of risk administration

(or having a close connection with the risk administration) will be attributed to the policyholder (the notification of the loss to the insurer will probably not fall under the risk administration, but a number of duties to be fulfilled when the risk occurs such as protective measures in order to avert or minimise the loss, or gathering of evidences may be seen as belonging to risk administration).

- What will be the "representative's sufficient (or meaningful) extent of behaviour"? This issue will be depending on the particularities of the concrete case.
- However in property insurances generally, a representative will not be regarded as entrusted with risk administration, if it is not possessor on the subject matter insured for a long period.

  • The mere direct possession is not sufficient: The representative must have been transferred the entire possession for a lasting period

  • The often use by a third person of the property insured is not sufficient.
- For contract administration it is not necessary to entrust the entire administration of the contract. It will be sufficient that with respect to the part of the contract the administration of which is entrusted, the extent is so meaningful that the representative has to be blamed instead of the policyholder because of a negligent breach).

There is also a dissenting view according to which

- it is not necessary for the representative to be entrusted totally or in a meaningful extent,
- being entrusted only with the unaccomplished task would suffice.

But this view does not seem to be broadly shared.

The representative's involvement should not have the consequence that the policyholder's duty is consequently enlarged: A behaviour that is allowed to the policyholder would not lead to breach of duty when accomplished by the representative.

The intentional or fraudulent behaviour of the representative would also be attributed to the policyholder (even if they are committed only to make harm to the policyholder).

15. Burden of Proof

The national laws may contain different rules on the onus of proof. For instance

- The policyholder may be under the duty to prove that it did not acted with intent or with gross-negligence to avoid a sanction (for example the termination of the contract) before the occurrence of the risk
- The insurer who alleges upon the materialisation of the risk that it is totally or partly relieved of liability as a result of the policyholder's breach may be requested to submit evidence of all the conditions of that breach (normal case)
- But the law may provide that the policyholder shall be under the duty to demonstrate that the breach was not causal for the occurrence of the risk (onus again returned to the policyholder)

16. Sanctions

The possible sanctions are the termination or the partial or total loss of the benefit of insurance.

16.1. Termination

The normal sanction appears to be the termination (with ex-nunc effect).

The problem to know whether in case of non-negligent breach, the insurer shall be entitled to terminate remains debatable.

16.2. Partial Relief From Liability

If the risk has been materialised in connection with the violation of the contractual duty to take precautionary measures will the insurer be entitled to make a reduction in the insurance money in case of negligence or will it be entitled to reduce only in case of gross negligence? This issue must be decided by the legislator and in the lack of express legal provision, contractual stipulations would be decisive.

16.3. Total Relief From Liability

The release of the insurer from liability in case the duty is violated should it be applicable only when the policyholder acted with intent? Again this issue will be dependent on the legislator's choice.

16.4. Prohibition of Avoidance

For contractual duties in general and the duty to take precautionary measures in particular, is it convenient that the insurer be vested the right to avoid the contract (with effect ex-tunc) for non-compliance? Some national legislations prohibit the avoidance on the ground that this sanction is excessively to the detriment of the policyholder.

17. Causation

In case the risk is materialised, will the insurer incur liability if the violation of the duty is not relevant for the materialisation of the risk or the calculation of the insurance money? Is it appropriate in that context to make a difference between intentional breach and other breaches? The answers will depend here too on the legislator's preferences. It seems that the policyholder deserves protection and legal solutions not permitting relief when causation is lacking or relieving the insurer only in case of intentional breach seem more appropriate.

Another question consists to know who will bear the burden of proof? Will the insurer benefit from the assumption that a causal link exists between the breach and the occurrence of the risk or the loss calculation? If such presumption exists, should we maintain it also when the policyholder acted with bad faith? In the absence of legal or contractual solutions, the courts will decide in accordance with the "lex fori".

18. Awareness

Should a duty to warn be imposed to the insurer about the existence of the precautionary measure duty and the eventual sanctions in case of its breach? Such a solution seems convenient.

19. Competition

Should the rules about statutory (legal) duties compete with contractual duties?

Should the provisions about relief of liability of the insurer as a result of causing the occurrence of the risk, compete with the contractual duties? In at least some countries the general rule is that contractual and statutory claims compete and the claimant is free to invoke one or the other in its sole discretion. Where the legislator did not provide a provision exclusively applicable, competition will be admitted.

20. German Law (VVG § 28)

The German law as it stands today seems to bring adequate solutions. The German provision is given below for comparative purposes:

> **VVG (2008) § 28 "Non-observance of an incidental obligation"**
>
> *(1) In the event of the non-observance of an incidental obligation which the policyholder must fulfil vis-à-vis the insurer prior to the occurrence of an insured event, the insurer may terminate the*

contract without prior notice within one month after learning of the non-observance, unless the non-observance was not intentional or based on gross negligence.

(2) Where the contract provides that the insurer is not obligated to effect payment in the event of the non-observance of an incidental obligation on the part of the policyholder, he shall be released from the liability if the policyholder intentionally breached the obligation. In the case of grossly negligent non-observance of the obligation, the insurer shall be entitled to reduce any benefits payable commensurate with the severity of the policyholder's fault; the burden of proof that there was no gross negligence shall be on the policyholder.

(3) Notwithstanding subsection (2), the insurer shall be liable insofar as the non-observance of the obligation neither caused the occurrence or the establishment of the insured event nor the establishment or the extent of the insurer's obligation to effect payment. The first sentence shall not apply if the policyholder fraudulently breached the obligation.

(4) The condition on which the insurer's entire or partial release from liability in accordance with subsection (2) is based shall, in the event of a violation of an existing duty to provide information or duty of disclosure after the occurrence of an insured event, be the fact that the insurer instructed the policyholder in separate correspondence and in writing of this legal consequence.

(5) An agreement based on which the insurer is entitled to withdraw from the contract in the event of the non-observance of an incidental obligation shall be void.

The main points of German law are as follows

- It is not drafted as a type of "all or nothing rule".
- Sanctions are the termination and discharge of liability.
- Termination is possible only in case of intent or gross negligence
- Discharge of liability occurs only in case of intent. If the duty is breached by gross negligence, the insurer may diminish the sum payable in accordance with the degree of fault
- Causality is required. In case the breach had no effect on the materialisation of the risk or the insurer's performance the insurer remains liable save when it acted fraudulently.
- Avoidance is excluded.
- VVG § 28 is mandatory.

AIDA Consumer Protection & Dispute Resolution Working Party
London 13 September 2012

IV AIDA Europe Conference London
Consumer Protection - Warranties and Reform

Precautionary Measures

John Habergham, *Solicitor/Director, Myton Law*

Introduction

The Law Commission for England and Wales and Scotland has carried out a joint consultation which started in 2006.

When starting the process, the Commission said,

"Insurance contract law has been criticised as outdated and unduly harsh to policy holders".

A representative of the Law Commission, speaking at the Leeds Marine Insurance Association workshop November 2007, described the Act as "not fit for purpose".

In 2008 I wrote a paper to the Law Commission headed,

"The Marine Insurance Act 1906: Warranties, Non-disclosure & Brokers - is it time for a change?"

My representations to the Law Commission were these.

In my opinion, I thought there was a pressing need for a separate legislation for consumer insurance law.

I make no apologies for the 1906 Act. I am, unashamedly, an admirer of it. I do not think that the case has been made out for major reform of the Act, so far as business insurance is concerned. Businesses, above all, desire certainty and with the history of the Act extending back for some 100 years, they have it. This isn't to say that there is never change. Courts interpret legislation in accordance with contemporary business practice.

Insurance law generally gets a bad press as a result of consumer cases.

And I accept that a consumer is a wholly different creature to a large PLC

who might have complicated insuring requirements and have the financial wherewithal to compete on equal terms with the insurer. But I thought that a well respected piece of legislation was being tainted by the bad press associated with consumers. My opinion was and always has been that there should be separate legislation for consumers.

The Law Commission agreed.

They published the Consumer Insurance (Disclosure and Representations) Bill which became an Act of Parliament on receipt of Royal Assent in March of this year. It is to come in to force in March 2013.

As it's title suggests, it's focus is the law with regard to the disclosure obligations (briefly the Act (a) abolishes the insured's duty to volunteer information (b) replaces that with a duty to take reasonable care not to misrepresent matters and (c) provides a graded remedy for the insurer depending on the state of mind of the insured when breaching the duty) but one particular section is relevant to the subject to warranties and we will discuss it later.

The Law Commission work continues.

This conference is opportune.

In June of this year they published Consultation Paper 204, "Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties".

Warranties - background

As I understand it, there is no direct equivalent to the common law concept of warranties in civil law, the nearest being "a precautionary measure" .

For example the German Insurance Code, (the Versicherungsvertragsgesetz (VVG)) provides that

1.an underwriter can impose a term requiring that the insured to observe an obligation as a condition to liability for the insured risk , of liability of the underwriter to pay a claim in and breach of which permits the underwriter to terminate the contract; ,and

2. contains a duty on the insured not to aggravate the risk during the lifespan of the policy.

Warranties in English law go back a long way. The law with regard to warranties was eventually codified, after the input of influential judges such as Lord Mansfield, in the Marine Insurance Act 1906. Despite its title, so far as warranties are concerned, it is applicable to all species of insurance policies, marine and non marine.

As a first point, it may be prudent to clarify some confusion from the outset. In general contract law, a warranty is considered to be a fairly minor term. If breached, it simply gives rise to a right in damages and no other remedy. Contrast this with a condition which is said to be a term of such importance that it does to the root of the contract. Insurance law is the exact opposite. A warranty in insurance law is an important contractual term.

There is further confusion – compare and contrast a warranty with a suspensive condition and with an exception from cover.

For example consider the following in a policy of motor insurance:

"It warranted that all drivers will be 25 or over"

"Cover only whilst being driven by drivers 25 or over"

And

"It is an exception from cover if the driver is under 25"

Warranty in the true sense, suspensive condition and exception?

They all have the same objective – to try and marshal the risk that the insurer is taking on. But it is the consequences that are important from the insured point of view.

The current law

There is a statutory definition contained in Section 33(1) of the Marine Insurance Act 1906.

33.— Nature of warranty.

(1) A warranty, in the following sections relating to warranties, means a promissory warranty, that is to say, a warranty by which the assured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts.

On the face of it, therefore, it contains two types of warranties - warranties of past or present fact - the insured "affirms or negatives the existence of a particular state of facts" ;or future warranties, warranties of future conduct, "the insured undertakes that some particular thing shall or shall not be done".

Creating a warranty

A warranty can be express or implied. The vast majority are created

expressly by the parties. No particular form of words is required. Section 35(2) of the Act states that an express warranty "must be included in, or written upon, the policy, or must be contained in some document incorporated by reference into the policy".

35.— Express warranties.

(1) An express warranty may be in any form of words from which the intention to warrant is to be inferred.

(2) An express warranty must be included in, or written upon, the policy, or must be contained in some document incorporated by reference into the policy

The effect of a warranty

Section 33(3) of the Act states that a warranty "must be exactly complied with, whether it be material to the risk or not".

Exact compliance means just that - partial or substantial compliance is insufficient.

The state of mind of the insured when breaching the warranty is immaterial – whether done innocently, carelessly or deliberately, the effect is the same.

(3) A warranty, as above defined, is a condition which must be exactly complied with, whether it be material to the risk or not.

Examples

A stove pipe 3 feet long does not comply with a warranty that requires a pipe to be 2 feet long (Newcastle Fire v Macmorran (1815).

In a life policy a warranty that the applicant was 30 was breached when it was shown that applicant was 35.

But it could work to the insured's advantage.

Marine insurance - a warranty that there was 20 guns was not breached when the insured employed insufficient crew to man them. That is not what the warranty required – strict and literal compliance was 20 guns. (Hide v Bruce (1783))

Not that the breach does not have to be material to the risk or loss.

So breach of a warranty that a fire alarm should be installed and kept in good working order would be a good defence to a claim under the same policy for a claim for flood damage.

The remedy if breached

See Section 33(3)

(3) ….If it be not so complied with, then, subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him before that date.

You can see that if the warranty is not complied with, the insurer is discharged from liability from the time of the breach. The insurer is not liable for any claim which arises after the breach. This is automatic. It occurs as a matter of law.

Note that it is the insurer has bears the burden of proving that a) the clause is a warranty and b) it has been breached.

It matters not that the insured later remedies the breach. See Section 34(2) which reads,

34.

….

(2) Where a warranty is broken, the assured cannot avail himself of the defence that the breach has been remedied, and the warranty complied with, before loss.

So say the insured warrants that he will have the fire alarm system inspected every 6 months; it does not help the insured if after the 6 month period has elapsed he has the inspection carried out. Once breached it can't be put right.

Compare and contrast with the suspensive condition or exception we looked at earlier. For both the suspensive condition and the exception the policy remains alive and once remedied the insured is back on cover. By contrast breach of warranty is terminal. The policy remains alive but of no practical utility.

Get out for the insured

The only way out for an insured, if he has breached a warranty, is to throw himself upon the indulgence of the underwriter which is given statutory footing in Section 34(3) which is clear on its face

(3) A breach of warranty may be waived by the insurer

But this is not as promising as it seems.

Suffice it to say that English law with regard to waiver and estoppel is

relatively esoteric and it is now clear that when the Act talks about waiver what it means is waiver by estoppel. It requires a representation, by the insurer, in words or conduct, which has to be unequivocal, and has to be relied upon by the assured otherwise the insured will be prejudiced, that the insurer promises not to rely upon the breach of warranty.

A bleak picture

So not much comfort there. Objectively, can anyone stand up and defend a species of a term in a contract which, if breached, relieves the insurer of all liability, even if the breach wasn't causative of the loss and even if the breach has been successfully remedied before any loss.

A bit of balance

Firstly there is already some protection for consumers in the form of the Financial Ombudsman Scheme (FOS), the Insurance Conduct of Business (ICOB) rules issued by the Financial Services Authority (FSA) and the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR).

FOS

This scheme has jurisdiction to hear complaints from consumers (and micro businesses). It is not bound by the strict letter of the law. It will resolve matters according to what is fair and reasonable. It would be unlikely for the FOS to allow reliance on a non causative breach of warranty.

ICOB

See ICOB 8.1.2.:

"… rejection of a consumer policyholder's claim is unreasonable, except where there is evidence of fraud, if it is for:

(3) breach of warranty or condition unless the circumstances of the claim are connected to the breach."

Note that this is not the strict law. A consumer could not rely on ICOB in court. Rather it applies in the regulatory context. Insurers who repeatedly breach it can be fined or have their authorisation withdrawn.

UTCCR

These allow the court to assess the fairness of non negotiated terms.

Their utility is questionable.

Certain issues are immune form assessment by the court, so long as they are in plain and intelligible language.

One is "the definition of the main subject matter of the contract", another is "the adequacy of the price" Call them core terms.

Is a warranty a core term?

Probably - if it goes to define the scope of cover or measures the indemnity, I guess they would have to be.

Therefore the only get out for the consumer is to attack the language used.

A bit of balance continued.

Secondly go back to Lord Mansfield in 1786. He laid down the rule that the validity of an insurance contract depends upon the policy holder's strict compliance with the terms of a warranty. The policy holder is in a position of power. He knows more about the proposed adventure than the underwriter; he can alter the risk once cover has been incepted. See the House of Lords in The Good Luck,

"If a promissory warranty is not complied with, the insurer is discharged from liability as from the date of the breach of warranty, for the simple reason that fulfilment of the warranty is a condition precedent to the liability of the insurer. This, moreover, reflects the fact that the rationale of warranties in insurance law is that the insurer only accepts the risks provided the warranty is fulfilled".

The underwriter contracts on the basis of what the assured has told him in terms of the present state of the risk and what he can do or will refrain from doing to prevent the alteration in that risk, to prevent a change in the circumstances as the underwriter saw it when he entered into the bargain. If it is not complied with, then it is simply not the bargain that the underwriter thought he was getting.

So, in short, say the underwriter says as follows,

"You own this building, it's worth this amount to you, you have told me that you have taken the following measures to ensure that the risk of loss or damage by fire has been minimised by the installation of the following system to prevent fires, you have promised me that this is in good working order at the moment, and you have promised me that you will ensure that it remains in good working order throughout the term of the contract. On this basis, I am prepared to contract with you and underwrite the risk of further or greater losses through fire on this basis".

It goes to the root of the contract. If it is not as the assured has said or promised it will be, it is simply not the bargain that the underwriter thought he was getting and, in these circumstances, is entitled to walk away from that contract.

In this respect, as a condition precedent, is there any reason why they are so frowned upon when such conditions precedent are present in other contracts?

For example, a clause in a construction industry norm (JCT Trade Contract Terms 2002) that a loss / expense claim must be made within a specific time in the absence of which there is no liability on the other party.

Or a clause in a design / build contract requiring the provision of notice by the contractor of the discovery of asbestos as a consequence of which the contractor would have no liability for delay, that the contractor may claim relief from other obligations in the contract and recovery of compensation - held to be a condition precedent requiring strict compliance before becoming operative.

Or in an agreement for the sale and lease of commercial properties that compliance of certain conditions were conditions precedent requiring compliance before the buyer was obliged to complete the transactions.

Or, in an employment contract, compromise agreement, a warranty that there were no other repudiatory breaches of the employment was held to be a condition precedent to the right to recover compensation from the employer.

Or in a lease, compliance with various conditions were found to precedent to the exercise of the option in a break clause.

Basis of contract clauses

The problem is that underwriters have wanted to have their cake and eat it.

They have abused the protection given to them at law by raising every piece of information to the status for warranty by the "basis of contract clauses".

Remember that a warranty can be written on the policy or incorporated into it by reference to some document which is incorporated into the policy.

Underwriters fell into the practice of making sure that every item of information given to them in a proposal form was elevated to the status of a warranty by asking the insured to sign a statement to the effect that all the answers "form of basis of the contract".

This has led to the cases which provide insurers and insurance law with a bad press. It has led to the cases where the insurer has been relieved of all liability in respect of a breach of a warranty on a subject which is non causative, may have been remedied, and the subject matter of which is trivial.

The proposals for reform

In consumer insurance, the proposed consequences of breach of warranty could not be excluded by a contract term. In business insurance, the parties would be able to contract out of these provisions, provided they did so in clear, unambiguous terms and the term was brought to the attention of the other party.

Proposal 1: Abolishing basis of the contract clauses

The Consumer Insurance (Disclosure and Representations) Act 2012, section 6 prevents insurers using basis of the contract clauses in consumer insurance contracts. (This Act has received Royal Assent and is likely to com into force in March 2013)

6 Warranties and representations

(1) This section applies to representations made by a consumer—

(a) in connection with a proposed consumer insurance contract, or

(b) in connection with a proposed variation to a consumer insurance contract.

(2) Such a representation is not capable of being converted into a warranty by means of any provision of the consumer insurance contract (or of the terms of the variation), or of any other contract (and whether by declaring the representation to form the basis of the contract or otherwise).

The Commission proposes that a similar provision should apply to business insurance. It should not be possible for an insurer to use a contract term to convert the answers in a proposal form into warranties. If the insurer wishes to include specific warranties, they would need to be spelled out in the contract.

Proposal 2: Treating warranties as suspensive conditions

Section 33(3) of the 1906 Act states that a warranty must be exactly complied with. If not, "the insurer is discharged from liability as from the date of the breach of warranty". Remedy of the breach by the policyholder before loss is of no effect as section 34(2) provides that the policyholder cannot rely on that fact as a defence.

They think that this wrong. Should an insurer be allowed to refuse a claim for delay in inspecting a sprinkler system when, at the time of loss, the sprinkler had been inspected and was working perfectly.

They therefore propose to change the law to the effect that if a warranty is not complied with, the insurer's liability is suspended for the duration of the breach. If the breach is remedied, liability would be restored.

The proposal treats warranties and other exclusion clauses in the same way: liability would be suspended.

Proposal 3: Terms to reduce particular risks

Proposal 3 would apply to any term which has the purpose of reducing particular risks. Where a term is designed to reduce the risk of a particular type of loss, a breach of that term would only suspend liability in respect of that type of loss. Thus, for example, failure to comply with a requirement to maintain fire retardant lagging in kitchen ducting should suspend liability for fire loss but not theft loss.

The same would apply where the term is designed to reduce the risk of loss at a particular time or in a particular location. A failure to employ a night watchman, therefore, should suspend the insurer's liability for losses at night, but not for losses during the day.

Proposal 3, unlike Proposal 2, would not apply solely to warranties as traditionally defined. Instead it would apply to any term which had the purpose of reducing the risk of a particular type of loss, or of loss at a particular time or in a particular place. Some of these terms may well be warranties, while others might not.

This is a default rule. In business insurance, if an insurer wished to specify that the failure to employ a night watchman would discharge it from all liability under the contract, it would be entitled to do so – but the term that provided for this would need to be in clear, unambiguous language and specifically brought to the attention of the policyholder.

NO CAUSAL CONNECTION TEST

In 2007, the Commission proposed that policyholders should be entitled to be paid claims if they could prove that the event or circumstances constituting the breach of warranty did not contribute to the loss. It was said that many consultees feared this would introduce unnecessary complexity and uncertainty.

So they are no longer proceeding with this proposal. They accept that a causal connection test is unsuited to many terms (such as those which define the purpose of the insurance, or the geographical area covered). It would also be difficult to apply the test to warranties and not to suspensive conditions.

They think that their current proposals protect policyholders against unfairness in a simpler and more straightforward way. They treat warranties in a similar way to suspensive conditions, removing unnecessary distinctions between the two.

IVth AIDA Europe Conference
13 September 2012, Grange Tower Bridge Hotel, London

AIDA Consumer Protection and Dispute Resolution Working Party

Precautionary Measures and Section 54 of the Australian Insurance Contracts Act 1984 (Cth): Ensuring 'A Fair Go All Around'

Greg Pynt, Pynt + Partners, Perth

The Occupiers' Liability Act, 1957 (UK) has been very beneficial. It has rid us of those two unpleasant characters, the invitee and the licensee, who haunted the courts for years, and it has replaced them by the attractive figure of a visitor, who has so far given no trouble at all.[3]

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[3] *Roles v Nathan* [1963] 2 All ER 908 (Lord Denning).

AUSTRALIA: LAND OF 'A FAIR GO'

'A fair go all round': Background

1. The demographer Bernard Salt, writing in the Murdoch owned newspaper 'The Australian' on Australia Day this year (26 January), characterised Australians as:

   laid back with a love of the outdoors and a fervent belief in a fair go for all.

   In Australia, to give someone 'a fair go' means to give them a fair opportunity to obtain or achieve something, no matter what their background or circumstances. Australians shy away from using long words when short ones will do. In this context, 'a fair go' has roughly the same meaning as 'egalitarian', in particular, the notion that everyone should be treated equally.

2. When an Australian says "*fair enough*", he is saying he thinks someone has been given 'a fair go'. On the other hand, when he uses any of the following expressions, he is saying he thinks someone has not been given 'a fair go' (sometimes depending on how he says it):

   Fair go mate; *Fair dinkum; Fair suck of the sav* (saveloy sausage); *Fair suck of the pineapple doughnut*; *Fair shake of the sauce bottle*

3. Perhaps the most memorable public protest about not being given 'a fair go' was that of former Prime Minister Gough Whitlam on Remembrance Day, 11 November 1975. That morning, the Governor-General Sir John Kerr, the Queen's representative in Australia, informed Whitlam he had terminated his commission as Prime Minister. Later that day, Kerr's Official Secretary, David Smith, stood on the front steps of Parliament House and proclaimed the dissolution of both Houses of Parliament.

Smith concluded with "*God save the Queen*". Whitlam then said to the crowd:

Well may we say 'God save the Queen', because nothing will save the Governor-General!

4. The term 'a fair go' first appeared in print at the end of the 19th century in an Australian story about a shearer's dispute:

   … on the prisoners leaving the train [Inspector Ahern] *told Taylor and Stewart he had warrants for them. "What for?" asked both men with a laugh. "For conspiracy," was the reply, and in a twinkling the handcuffs were out. Both men turned pale, but struggled, calling out, "Read the warrants to us first." Inspector Ahern said, "You can hear them later," and the police seized the prisoners. Both appealed to Mr. Ranking, crying out, "Do you call this a fair go, Mr. Ranking?"* …[4]

5. In *J Loty and Holloway v Australian Workers' Union*,[5] Sheldon J described the notion of 'a fair go' in the context of Australian industrial relations:

   Mr Commissioner Manuel [a former Broken Hill boilermaker] *in a recent* [unfair dismissal] *case put it in a nutshell and in language readily understood in the industrial world when he conceived his duty to be to ensure 'a fair go all round'.*

6. At the inaugural sitting of Fair Work Australia in Sydney on 1 July 2009, Stephen Smith[6] said the "*central tenet*" of the Australian industrial relations system over the previous 100 plus years is "*the notion of a 'fair go all around'*".

   This is reflected in one of the objects of the Australian *Fair Work Act 2009* (Cth), which is to establish a framework for dealing with unfair dismissal that balances the needs of business and the needs of employees: s 381(a). Section 381(1) states that other objects of the Act are:

   (b) to establish procedures for dealing with unfair dismissal that:

   (i) are quick, flexible and informal; and

   (ii) address the needs of employers and employees; and

   (c) to provide remedies if a dismissal is found to be unfair …

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4 The Brisbane Courier, Queensland, 25 March 1891, page 5.

5 [1971] AR (NSW) 95.

6 Director, National Work Place Relations, Australian Industry Group.

Section 381(2) then provides:

The procedures and remedies referred to in paragraphs (1)(b) and (c), and the manner of deciding on and working out such remedies, are intended to ensure that a 'fair go all round' is accorded to … employer and employee … .

'A fair go all round': The Australian *Insurance Contracts Act 1984* (Cth)

7. The Australian *Insurance Contracts Act 1984* (Cth) ("**ICA**") came into effect more than 25 years ago (1 January 1986). It is almost identical to the bill recommended by the Australian Law Reform Commission (ALRC) in its Report No 20, *Insurance Contracts* (1982).

8. Subject to s 9, the ICA applies to insurance contracts "*the proper law of which is or would be the law of* [an Australian] *State or … Territory …*": s 8(1).

   Section 9 excludes the application of the ICA to contracts or proposed contracts:

   (1) …

   (a) of reinsurance; or

   (b) of insurance … by a private health insurer … in respect of its health insurance business …; or

   (c) of insurance … by a friendly society; or

   (ca) of insurance … by the Export Finance and Insurance Corporation …; or

   (d) … in relation to which the Marine Insurance Act 1909 applies; or

   (e) … for the purposes of a law … that relates to:

   (i) workers' compensation; or

   (ii) compensation for the death of a person, or for injury to a person, arising out of the use of a motor vehicle.

   (2) … in the course of State insurance or Northern Territory insurance …

9. The ICA also applies to "*provisions of insurance*" in a contract that would not ordinarily be regarded as an insurance contract: s 10(2).

   An indemnity clause in a non-insurance arrangement, such as a lease or a sale of goods or supply of services agreement, is a 'provision of

insurance' because the risk transfer effected by such a clause is an essential characteristic of an insurance arrangement.[7] The ICA therefore applies to indemnity clauses in such arrangements.

10. As explained in the Long Title, the ICA was enacted to:

    … *reform and modernise the law relating to certain contracts of insurance so that a fair balance is struck between the interests of insurers, insureds and other members of the public and so that the provisions included in such contracts, and the practices of insurers in relation to such contracts operate fairly* …

    In short, the ICA changed the existing 'insurer-skewed' law relating to insurance contracts so as to accord "*a fair go all round*" to insurers and insureds.

11. Two of the ICA's most significant reforms preclude an insurer, in a wide range of circumstances, from refusing to pay all or some of a claim because of an insured's:

    a) pre-contractual non-disclosure or misrepresentation: Pt IV – Disclosures and misrepresentations;

    b) post-contractual non-compliance with, or breach of, a contractual term, or failure to exercise a right, choice or liberty available under an insurance contract: Pt V – The contract, s 54.

    This presentation is only concerned with that part of the reform of insurance law effected by s 54, as it covers ground similar to that traversed by Article 4.103 of the Principles of European Insurance Contract Law ("**PEICL**"), which initiates its own 'fair go all round' by limiting an insurer's ability to refuse to pay a claim for non-compliance with a '*precautionary measures*' clause.

[7] *R v Cohen; Ex parte Motor Accidents Insurance Board* [1979] HCA 46 at [24]; (1979) 141 CLR 577; *Bayswater Car Rental Pty Ltd v Hannell* [1999] WASCA 34; (1998-9) 10 ANZ Ins Cas 61-437.

INTRODUCTION TO SECTION 54 OF THE ICA

'Preautionary measures'

12. Today's topic is '*precautionary measures*', which the PEICL defines as a term:

    whether or not described as a condition precedent to the liability of the insurer, requiring the policyholder or the insured, before the insured event occurs, to perform or not to perform certain acts: Article 4.101.

13. Under the PEICL, a '*precautionary measures'* clause that allows an insurer to refuse to pay all or some of a claim for non-compliance with it is only effective to the extent the loss was caused by the policyholder's or insured's:

    a) non-compliance with intent to cause the loss, or reckless non-compliance with knowledge that the loss would probably result: Article 4.103(1); or

    b) negligent non-compliance, but only if there is a "*clear clause providing for reduction of the insurance money according to the degree of fault*": Article 4.103(2).

Section 54

14. Section 54 is concerned, amongst other things, with '*precautionary measures*', because it limits an insurer's ability to refuse to pay a claim because of a post-contractual act or omission by an insured or "*some other person*".

    Section 54 does not deal with an insurer's ability to cancel an insurance contract in reliance on an insured's breach or non-compliance with a contractual term. That is addressed by ss 59 to 63 of the ICA. I do not touch on those sections in this paper.

15. Sections 54 and 55 appear in the ICA Part V (The contract) Division 3 (Remedies). They are in the following terms:

    54 Insurer may not refuse to pay claims in certain circumstances

    (1) Subject to this section, where the effect of a contract of insurance would, but for this section, be that the insurer may refuse to pay a claim, either in whole or in part, by reason of some act of the insured or of some other person, being an act that occurred after the contract was entered into but not being an act in respect of

which subsection (2) applies, the insurer may not refuse to pay the claim by reason only of that act but the insurer's liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act.

(2) Subject to the succeeding provisions of this section, where the act could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract, the insurer may refuse to pay the claim.

(3) Where the insured proves that no part of the loss that gave rise to the claim was caused by the act, the insurer may not refuse to pay the claim by reason only of the act.

(4) Where the insured proves that some part of the loss that gave rise to the claim was not caused by the act, the insurer may not refuse to pay the claim, so far as it concerns that part of the loss, by reason only of the act.

(5) Where:

(a) the act was necessary to protect the safety of a person or to preserve property; or

(b) it was not reasonably possible for the insured or other person not to do the act;

the insurer may not refuse to pay the claim by reason only of the act.

(6) A reference in this section to an act includes a reference to:

(a) an omission; and

(b) an act or omission that has the effect of altering the state or condition of the subject matter of the contract or of allowing the state or condition of that subject matter to alter.

55 No other remedies

The provisions of this Division with respect to an act or omission are exclusive of any right that the insurer has otherwise than under this Act in respect of the act or omission.

16. Section 54 divides post-contractual acts or omissions into those that are:

a) potentially loss-causing, in which case the insurer can refuse to pay the claim, except to the extent that the insured proves the relevant act or omission did not cause or contribute to the loss (s 54(2));

b) not potentially loss-causing, in which case the insurer cannot refuse to pay the claim; it can only reduce its liability to pay the claim by the extent to which it has been prejudiced by the act or omission (s 54(1)).

17. At this point, it is worth noticing three things about s 54.

Firstly, the word 'act' in s 54(1), (2), (3) and (4) includes an 'omission': s 54(6)(a).

Secondly, s 54 does not qualify the act or omission by reference to the word "*breach*" or to the nature or characteristics of the relevant contractual term. Accordingly, it will be brought into play by acts or omissions relating to all manner of contractual terms, including exclusions, warranties, terms descriptive of risk (suspensive conditions), conditions precedent and subsequent and conditions that are not conditions precedent or subsequent.

Thirdly, a contractual term that purports to limit or exclude the operation of s 54 to the prejudice of a person other than the insurer, is void: s 52.

WHEN IS SECTION 54 IN PLAY?

Introduction

18. With the PEICL Article 4.103, the first issue is whether the term in question is a '*precautionary measures'* clause or a definition of risk. If the latter, Article 4.103 does not apply. Similarly, the first issue in relation to s 54 is whether it applies to the claim. That can be addressed by asking three questions.

First question

19. But for s 54, does the contract allow the insurer to refuse to pay all or some of the claim? If the answer is 'no', s 54 has no work to do.

Second question

20. If, but for s 54, the contract allows the insurer to refuse to pay all or some of the claim, is the insurer's ability to refuse to pay the claim by reason of a post-contractual act or omission by the insured or "*some other person*"? If the answer is 'no', s 54 has no work to do.

21. This question arose in *Johnson v Triple C Furniture and Electrical Pty Ltd*.[8]

[8] [2010] QCA 282; (2010) 243 FLR 336.

Mr and Mrs Johnson had a family company: Triple C Furniture and Electrical Pty Ltd. They were its only directors and shareholders. Triple C owned a Cessna 206 aircraft, which crashed on take-off as a result of pilot error. The pilot, Mr Johnson, died. Mrs Johnson and the other passenger were seriously injured.

Mrs Johnson sued Triple C on the basis that the pilot's negligence caused her injuries and as the pilot's employer, it was vicariously liable for his negligence. Triple C sought indemnity from Rural & General Insurance Ltd under an aviation insurance policy for any liability it had to Mrs Johnson.

By the insuring clause in the policy, Rural & General promised to:

indemnify [Triple C] *for all sums for which* [it] *become(s) legally liable to pay … in respect of; … (a) accidental bodily injury ... to passengers whilst ... on board ... the aircraft ... .*

The relevant exclusion provided that:

... this policy does NOT apply whilst the aircraft, with the knowledge of [Triple C] *or* [its] *agent ... is; … (a) operated in breach of; … (ii) an Appropriate Authority's, … 'communications'*.

The relevant "*communication*" was Regulation 5.81 of the *Civil Aviation Regulations 1988* (Cth), which provided:

Private (aeroplane) pilot: regular flight reviews required

(1) A private (aeroplane) pilot must not fly an aeroplane as pilot in command if the pilot has not, within the period of 2 years immediately before the day of the proposed flight, satisfactorily completed an aeroplane flight review.

22. Rural & General denied indemnity in reliance on the exclusion, in particular, because the aircraft crashed when, to Triple C's or its agent's (Mr Johnson's) knowledge, it was operating (flying) in breach of the Regulation, in that Mr Johnson had not "*satisfactorily completed an aeroplane flight review*" in the 2 years prior to the crash.

23. In the Queensland Court of Appeal, Chesterman JA, for the purpose of determining whether s 54 applied to Triple C's claim for indemnity under the policy, identified (at [69]) the "*act here* [as] *an omission: Mr Johnson's not having satisfactorily completed an aeroplane flight review within two years of the flight the subject of the claim*". His Honour continued (at [70]):

There is an immediate problem in characterising the prohibition on Mr Johnson's flying as an omission. The word carries with it an

implication or connotation that the thing omitted, the thing not done, was something which was within the power of the omitter to have done. An omission may be deliberate or inadvertent, but whatever its cause one cannot, I think, be said to omit to do something which is beyond one's capacity to do. A candidate for an examination who fails is not ordinarily described as having omitted to pass. An athlete beaten in a contest does not omit to win.

His Honour concluded (at [72]–[73]) that Mr Johnson not satisfactorily completing a flight review within the previous two years:

… was not an omission as the word is ordinarily understood and as it is, in my opinion, used in s 54. He may have omitted to undergo the review but what was required was that he complete the review to someone else's satisfaction. Obtaining that satisfaction was something Mr Johnson might achieve, or fail to achieve, but it was not something he could omit.

24. Did the Queensland Court of Appeal get it right?

For the purpose of the exclusion, Rural & General was only interested in whether Triple C incurred a liability to pay damages to a passenger injured on board an operating Triple C aircraft whilst it was in the charge of a pilot who had not satisfactorily completed the required flight review. It is the operation of the aircraft in those circumstances that triggered the exclusion (enabled Rural & General to refuse to pay the claim, subject to s 54), not simply that a Triple C pilot had not satisfactorily completed the required flight review. If this is correct and if Triple C's claim on the policy fell within the 'core' of the insurer's 'promise' (see below), the Court of Appeal was dealing with an act that but for s 54, would have allowed Rural & General to refuse to pay the claim.

Third question

25. If, but for s 54, the policy allows the insurer to refuse to pay all or some of a claim by reason of a post-contractual act or omission by the insured or "*some other person*", do the circumstances that gave rise to the claim fall within the insurer's 'core' promise? If not, s 54 has no work to do.

26. Generally speaking, in a 'losses occurring' policy an insurer's 'core' promise will coincide with the scope of the insuring/operative clause. Accordingly, circumstances falling outside the scope of the clause will usually be regarded as falling outside the insurer's 'core' promise and

will therefore not attract the application of s 54. For example, in the case of an insuring clause in a motor vehicle policy that promises cover for accidental damage to a vehicle:

- during the period 12 September 2011 to 12 September 2012, s 54 will not come into play if the damage occurs on 13 September 2012;
- in Australia, s 54 will not come into play if the damage occurs when the vehicle is in New Zealand.

Sometimes it is not so easy to determine whether circumstances giving rise to a claim fall within or outside an insurer's 'core' promise. That is illustrated by *Johnson v Triple C Furniture and Electrical Pty Ltd*[9] and *Highway Hauliers Pty Ltd v Matthew Maxwell (The authorised, nominated representative on behalf of various Lloyds underwriters)*[10].

Johnson v Triple C (for the facts of this case, see paragraph 21 above)

27. Did Triple C's incurring of a liability to Mrs Johnson fell within Rural & General's 'core' promise?

    The Queensland Court of Appeal concluded that even if Mr Johnson not having satisfactorily completed the required flight review could be regarded as an omission, it was not an omission for the purpose of s 54 because it was outside the scope of Rural & General's 'core' promise, as defined by the insuring clause when read with the exclusion ([83]).

28. Arguably, the exclusion was not part of Rural & General's 'core' promise. Rather, it simply suspended Rural & General's 'core' promise whilst a Triple C aircraft operated in breach of the Authority's "*communications*".

    If this is right, Triple C's liability to Mrs Johnson clearly fell within the scope of Rural & General's 'core' promise and but for s 54, the exclusion allowed Rural & General to refuse to pay the claim by reason of a post-contractual act by the insured or "*some other person*", in particular, the aircraft being flown by a pilot who had not satisfactorily completed the required flight review.

Highway Hauliers v Maxwell

29. Various Lloyds underwriters ("**Insurers**") insured Highway Hauliers under a Commercial Vehicle Policy for the risk of damage to a fleet of prime movers and trailers it used to transport freight between Perth and the eastern states.

[9] [2010] QCA 282; (2010) 243 FLR 336.

[10] [2012] WASC 53.

Two of Highway Hauliers' prime movers and trailers were damaged in separate accidents during the period of insurance. The Insurers rejected Highway Hauliers' claims for the cost of repairing or replacing the damaged vehicles on the grounds that the Policy contained exclusions which provided that Highway Hauliers was not indemnified if the driver of a prime mover:

(a)had not achieved a minimum score on a driver test known as the 'PAQS test';

(b)was a non-declared (not an Insurer-approved) driver.

30. Corboy J concluded (at [86]) that:

it was the act of Highway Hauliers operating the vehicles by allowing them to be driven by drivers who were nondeclared and who did not satisfy the PAQS endorsement or the act of those drivers driving the vehicles in those circumstances that entitled the Insurers to refuse the claims under the policy.

And:

[101]… the substance of the policy was the provision of cover for vehicle damage or loss and third party liability arising out of the use of an insured vehicle. The PAQS endorsement conditioned the Insurers' obligation to meet a particular claim that otherwise fell within the scope of cover; it did not form part of the way in which the scope of the policy was defined.

[102] the [non-declared driver] *exclusion did not form part of the scope of the policy. The insured could submit a driver declaration after an occurrence and the Insurers could impose an additional excess if they concluded that they would have provided cover had the declaration been submitted prior to the occurrence.*

Accordingly, the circumstances of the two accidents fell within the scope of the Insurers' 'core' promise and that brought s 54 into play.

Can *Johnson v Triple C* and *Highway Hauliers v Maxwell* be reconciled?

31. Can *Johnson v Triple C* and *Highway Hauliers v Maxwell* be reconciled? Not on this issue. It is suggested the later decision is correct and that the circumstances giving rise to the application of this type of exclusion will usually fall within an insurer's 'core' promise.

WHEN SECTION 54 IS IN PLAY, HOW DOES IT OPERATE?

Introduction

32. If engaged, the relief allowed by s 54 depends on whether the relevant 'act or omission':

    - was potentially loss-causing ("*could reasonably be regarded as being capable of causing or contributing to*" an insured loss), in which case it is dealt with by s 54(2); or
    - was not potentially loss-causing (could not reasonably be regarded as capable of causing or contributing to an insured loss), in which case it is dealt with by s 54(1).

Section 54(2)

33. If an act or omission "*could reasonably be regarded as being capable of causing or contributing to*" an insured loss (s 54(2)), the insurer can refuse to pay the claim, except to the extent that the insured proves the act or omission did not cause or contribute to the loss. Below is an example of how s 54(2) operates.

    An insured vehicle with faulty brakes is damaged when the owner unintentionally drives it into the back of another vehicle. The insurer can refuse to pay the owner's claim for the damage to the insured vehicle if:

    a) the policy excludes cover for a loss that occurs while the vehicle is being driven in an unroadworthy condition; and

    b) faulty brakes could reasonably be regarded as being capable of causing or contributing to an insured loss.

    These circumstances fall into the category described by s 54(2), so that the owner will only be able to recover the cost of repairing the damage to the insured vehicle to the extent he or she proves the faulty brakes had nothing to do with the accident: s 54(3) and (4).

34. In *Johnson v Triple C,* Chesterman JA concluded that if, contrary to his view, s 54 was in play, Mr Johnson not satisfactorily completing a flight review within the previous 2 years fell within s 54(2) rather than s 54(1) because not satisfactorily completing a flight review within the previous 2 years "*could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract*". That is because a flight review:

    … *is a defence against pilot error which might cause an aircraft to*

crash. Its function is to ensure pilots have an appropriate level of skill and apply that skill to the task of flying. It is performed by qualified instructors whose responsibility is to observe practices or habits of a pilot that might affect flight safety, even in those pilots who endeavour to conceal their shortcomings.

Section 54(1)

35. If an act or omission could not reasonably be regarded as being capable of causing or contributing to an insured loss (s 54(1)), the insurer cannot refuse to pay the claim; it can only reduce its liability to pay the claim by the extent to which it has been prejudiced by the act or omission. Below is an example how s 54(1) operates.

    An insured vehicle is damaged when the owner unintentionally drives it into the back of another vehicle. The insurance contract contains a term that requires the insured to promptly notify the insurer of any accident involving the insured vehicle. The insured breaches the term by taking 3 months to notify the insurer of the accident.

    As the insured's breach of the term requiring it to promptly notify the insurer of the accident could not reasonably be regarded as capable of causing or contributing to an insured loss, the insurer cannot refuse to pay the claim; it can only reduce its liability to pay the claim by the extent to which it has been prejudiced by the late notification of the accident.

    Prejudice is measured by reference to the "*actual financial damage*" suffered by the insurer by reason of the act or omission.

36. Amongst other things, s 54(1) addresses circumstances covered by the PEICL Articles 6.101 and 6.102, which allow an insurer to reduce a claim on a policy by the extent to which it has been prejudiced by a policyholder's, insured's or beneficiary's failure to:

    a) give notice of the occurrence of an insured event "*without undue delay*";

    b) "*cooperate with the insurer in the investigation of the insured event by responding to reasonable requests*", unless the failure was "*committed with intent to cause prejudice or recklessly and with knowledge that such prejudice would probably result*", in which case the insurer can refuse to pay the claim altogether.

SECTION 54: IN SUMMARY

37. In summary, s 54 works in the following manner:

Question 1

But for s 54, can the insurer refuse to pay a claim? If the answer is 'no', s 54 has no work to do.

Question 2

But for s 54, can the insurer refuse to pay a claim because of a post-contractual act or omission by the insured or "*some other person*"? If the answer is 'no', s 54 has no work to do.

Question 3

If the answer is 'yes' to the first two questions, does the act or omission fall within the insurer's 'core' promise? If it does not, s 54 has no work to do.

Question 4

If s 54 is engaged, does the act or omission fall within s 54(1) or within s 54(2)? If the act or omission falls within:

a) s 54(2), the insurer can refuse to pay the claim, except to the extent the insured proves the act or omission did not cause or contribute to the loss;

b) s 54(1), the insurer cannot refuse to pay the claim, but can reduce it by the extent to which the act or omission actually financially prejudiced it.

CRITICISM OF SECTION 54

38. In its Report 46 entitled "*Some Insurance Law Problems*" (May 1998), the New Zealand Law Commission said ([46]) that one of the reasons it recommended New Zealand not adopt s 54 of the ICA was because the:

application of the notion of proportionality in s 11 circumstances can only be a matter of guesswork.

39. In similar vein, in its 2001 Review of the *Marine Insurance Act 1909* (Cth), the Australian Law Reform Commission said about s 54 of the ICA:

9.120 … While the insurer's liability may be reduced to the extent of the prejudice it suffers, even to zero, the room for dispute

over whether or not a particular marine insurance claim is payable, and the extent to which it is payable, would be greatly expanded.

9.121 A related objection to the ICA model is the element of proportionality it introduces. … This approach may lead to practical difficulties in quantifying an insurer's liability. Concerns have been expressed about resultant uncertainty and the cost of litigating disputes about quantification of liability under a proportionality principle.

40. In their October 2003 *Review of the Insurance Contracts Act 1984 (Cth): Report into the Operation of Section 54*, the authors said (p 7):

Generally, stakeholders were pleased with section 54, agreeing that the rights and obligations it confers upon parties to an insurance contract increases contractual fairness.

41. As far as the author is aware, in the 27 years s 54 has been operating, no case has reached a superior court arising out of the potential "*practical difficulties in quantifying an insurer's liability*". Presumably, when these issues have arisen, the parties have managed to resolve their disputes without going to trial.

PEICL ARTICLE 4.103 AND SECTION 54 OF THE ICA: COMPARE AND CONTRAST

42. PEICL Article 4.103:

a) applies if the parties agreed that the PEICL would govern their insurance contract: Article 1.102. Subject to sections 8 and 9 of the ICA, s 54 applies whether the parties like it or not;

b) applies to private insurance, but not reinsurance. Subject to sections 8 and 9 of the ICA, s 54 applies to all insurance contracts and to provisions of insurance in non-insurance contracts: s 10(2);

c) is limited to 'precautionary measures'. Section 54 is not; its application does not depend on how a contractual term is characterised;

d) applies if the circumstances giving rise to the claim fall within the coverage promised by the insurer and specific conduct by the policyholder or the insured would otherwise reduce coverage. Section 54 applies if the circumstances giving rise to the claim fall

within the insurer's 'core' promise and but for s 54, the effect of the policy is that the insurer could refuse to pay all or part of a claim because of a post-contractual act or omission by the insured or "*some other person*";

e) is arguably limited to post-contractual acts or omissions. Section 54 is limited to post-contractual acts or omissions. So, for example, s 54 does not assist an insured:

(i) in relation to pre-contractual non-disclosure or misrepresentation; or

(ii) under a 'claims made' policy in relation to breach of, or non-compliance with, a policy term that occurred prior to inception of the policy;

f) is only triggered by acts or omissions of the policyholder or the insured. Section 54 is not; it is triggered by the acts or omissions of anyone (other than the insurer);

g) prevents an insurer from refusing to pay a claim, except to the extent that the loss was caused by the policyholder's or insured's non-compliance. Section 54(2) allows an insurer to refuse to pay a claim if the act or omission could "*reasonably be regarded as being capable of causing or contributing to a loss"*, except to the extent the insured proves the act or omission did not cause the loss;

h) does not allow an insurer to refuse to pay a claim if the non-compliance is innocent or if it is negligent and there is nothing in the contract expressly allowing the insurer to reduce a claim for the policyholder's or insured's negligence. Section 54 applies whether the act or omission is innocent, negligent, deliberate or reckless;

i) applies, unless its application has been excluded in relation to certain classes of risks in circumstances where the:

(i) "*policyholder is engaged professionally in an industrial or commercial activity or in one of the liberal professions, and the risks relate to such activity*": Article 1.103(2)(b);

(ii) policyholder's financial position meets certain criteria: Article 1.103(2)(c).

Section 54 applies whatever the policyholder's activity or financial position.

CONCLUDING OBSERVATIONS

43. To paraphrase the quotation from Lord Denning's judgment in *Roles v Nathan* that begins this paper:

    The ICA has been very beneficial. It has almost rid us of those two unpleasant contractual terms, the 'promissory warranty' and the 'condition precedent', that haunted insureds for hundreds of years, and it has replaced them with the attractive s 54, which has so far given us no trouble that we couldn't handle.

44. Like s 54 of the ICA, Article 4.103 of the PEICL seeks to accord 'a fair go all round' to insurer and insured arising out of a breach or non-compliance with a '*precautionary measures*' clause. There are differences between the two approaches, but both are a significant advance on insurance contract law 'in the state of nature'.

Working Party Consumer Protection and Dispute Resolution
Jeudi 13 septembre 2012

The Preventive Measures

Anne Pélissier, *Professor, Montpellier I University (France)*

The subject of this working party, "the preventive measures", is a particularly good choice for a French lawyer. It raises one of the most difficult questions of qualification about insurance contract law. Thanks to Samim Ünan who gave me this hard task: explaining in a few minutes, what generations of lawyers and judges have tried, are still trying and will keep on trying to understand.

First, what is meant by "preventive measures" or "precautionary measures" as they are called by the restatement of European insurance contract law? The restatement defines them as *"a clause in the insurance contract, whether or not described as a condition precedent to the liability of the insurer, requiring the policyholder or the insured, before the insured event occurs, to perform or not to perform certain acts* (Article 4:101). From that definition it's possible to draw two conclusions:

On the one hand, this definition circumscribes the preventive measures at the period before the insured event occurs. I think this is too restrictive because it's also possible to stipulate preventive measures to be taken after the insured event occurs, especially to avoid claim aggravation or to minimize the losses. At this point, we must underline that in French law, the duty of minimizing the loss is not yet well established although the Court of Cassation seems to have admitted the insured's duty to avoid claim aggravation in a recent decision ([11]). In any case, contractual freedom allows including in the policy wording a clause requiring diligence from the insured to try to minimize the loss. I hope this broad subject will constitute the program of a future working party meeting. Therefore, today I will restrict my presentation to the period before the insured event occurs.

On the other hand, the definition given by the PEICL targets a "clause",

[11] Civ. 2ème, 24 novembre 2011, n° 10-25635 : D. 2012, p. 141, note H. Adida-Canac, RGDA 2012, p. 426, note A. Pélissier ; JCP G 2012, 530, n° 1, obs. P. Stoffel-Munck.

so a contractual stipulation. However it is possible to imagine also a legal duty for the insured to take preventive measures though it is not the case in French law. Or, more precisely, this legal duty exists only in marine insurances ([12]). So, in French Law, as far as non marine insurances are concerned the agreement of the parties is the only way to impose on the policyholder the duty to act diligently in order to prevent the insured event.

And, in practice, these clauses are very frequent. For example, closing the door, the windows and the shutters when the insured has left the house, not leaving the keys in the car, marking the vehicle's windows, maintaining equipment, or installing a protection device… Contractual freedom allows a large diversity of stipulations. Diversity, yes, but what about their efficiency?

The confrontation of the general law of contracts with special rules governing the insurance law creates confusion about the meaning and interpretation of those clauses. A lot of doubts surround the clause's nature (I) and its potential sanction (II).

I / Nature of the Contractual Stipulation About Preventive Measure

Taking an example will allow to understand different possible qualifications when the insurer stipulates a duty to take preventive measures for the insured. Professor Jérôme Kullmann ([13]) gives the example, in theft insurance, of the duty to engage an alarm system (A) and raises the importance of the qualification task (B).

A / What qualifications are possible?

The possible qualifications depend on the policy wording which can provide:

- "The policy guarantees theft when the alarm system is on". This wording can be regarded as the definition of the risk covered.
- "Does not guarantee theft when the alarm system isn't on", so it is an exclusion.
- "The insurance cover operates only if the alarm system is on", so it is a condition of the cover.

[12] Article L. 172-19 2° du Code des assurances : *« L'assuré doit : [...] 2° Apporter les soins raisonnables à tout ce qui est relatif au navire ou à la marchandise »* : The insured has to : [...]2° bring the reasonable cares to all is about the ship or the wares.

[13] J. Kullmann, Lamy Droit des assurances 2012, n° 191.

- "The insured declared that the alarm system will be on during his absence". If the insured omitted to precise that the alarm system could be offline (and did not put the alarm system before leaving) there is a risk aggravation.
- "The insured will lose the benefit of the cover if the alarm system is offline". This wording refers to the sanction called "déchéance" in French law, forfeiture can be an equivalent in English.
- Finally, "The insured undertakes to put the alarm system on". Here, it's simply an obligation according to the general law of contracts.

In the light of this very pedagogical example, one would think that the qualification task is not so difficult. However, we must bear in mind that the judicial interpretations may differ (the so called "judge's power of requalification"). Sometimes, despite a similar wording in similar situations, judges have different interpretations. Following examples illustrate this phenomenon:

- the engagement to turn on the protection system in the vehicle was qualified as an exclusion ([14]),
- but the clause imposing to use an alarm system was qualified as condition of the cover ([15]). We are searching for some logic but in vain ([16]).

When a clause is interpreted as providing an exclusion of the cover the judge may go beyond the policy wording and make a (second) qualification which may lead to the non validity of the clause.

B / Why the qualification is so important?

When a clause is qualified, the rules about the proof, the rules on interpretation and the conditions of validity have to be taken into account. Let's try to explain with examples:

As far as the **proof is concerned,** if the clause in question is regarded as a definition of the risk, or an obligation or a condition of the insurance cover the burden of proof shall lie with the insured. He will have to demonstrate that

[14] Civ. 1er, 26 novembre 1996, n° 94-16058 : RGDA 1997, p. 132, note J. KULLMANN.

[15] Civ. 2ème, 3 février 2005, n° 03-19624 : resp. civ. et ass. 2005, comm. 140, obs. H. GROUTEL.

[16] G. DURRY, La distinction de la condition de la garantie et de l'exclusion de risque (une proposition de réforme pour trancher le nœud gordien, *in* Etudes offertes à H. Groutel, LexisNexis 2006, p. 129 et s. ; L. MAYAUX, La distinction des exclusions et des conditions, *in* Les grandes questions du droit des assurances, LGDJ, 2011, p. 91 et s.

- the event falls within the scope of the risk defined in the insurance contract, or
- his obligation was performed, or
- the condition was fulfilled.

On the contrary, if the clause is qualified as exclusion, the insurer will have to prove that the event constitutes an excluded case.

And lastly, with regards to the aggravation of the risk, the insured will be requested to prove that the necessary declarations were made or must be considered made.

The burden of proof is an important consequence resulting from the qualification of a clause as a preventive measure. But this is not the most important so far.

More dangerous is the **interpretation issue**. In the general law of contracts, the judge has the power to interpret the contractual stipulation if its wording appears to be obscure and/or ambiguous. He has to find out the parties' common volition without favoring any of them. When the insurance contract is a "consumer contract", there is only one rule of interpretation: The Judge shall choose the interpretation most favorable to the policyholder. (In fact it is not a true interpretation since the Judge is under the legal duty to safeguard the interest of the consumer).

In case the analysis of the clause leads to an "exclusion", no interpretation shall take place (in other words interpretation shall be forbidden) as the Court of Cassation decided that an exclusion clause missing clearness can't be effective ([17]).

Obviously, **the validity** of the clause about preventive measure is the most important issue when it comes to qualification. In insurance law the rule is that the consumer must be widely protected. If the clause is qualified as an exclusion clause, the form requirement (writing the clause with very apparent print), and the condition as to the substance (defining the exclusion with enough precision) have to be complied with. However, in the case of a clause qualified as an obligation, there will be no applicable particular rules.

The efficiency of the preventive measures will be depending on their qualification. Unfortunately, as the last word belongs to the judge, it's very difficult for the redactor of a contract to anticipate what the outcome

[17] Civ. 1re, 22 mai 2001, n° 99-10849 : *D*. 2001, p. 2778, note B. Beigner ; *Resp. civ. et ass*. 2001, n° 241, chron. n° 17 par H. Groutel ; *RGDA* 2001, p. 944, note J. Kullmann ; *D*. 2002, somm. p. 2116, obs. J. Bonnard.

will be. It is in a large scale detrimental to the principle of "certainty in contractual relationships" but for the time being it is very difficult to find a way to settle this problem. Perhaps the solution can be found in defining precisely the sanctions to apply in case of violation of a clause generating a preventive measure duty.

II / Sanctions of the Contractual Stipulation About Preventive Measure

Some of the different sanctions applicable to a contractual relationship may not be fit for being applied to the breach of a preventive measure duty incumbent on the insured. We must determine first the authorized sanctions (A). But, between the various sanctions allowed in insurance law, one of them may seem more appropriate and could even solve the qualification issues, as will be seen below.

A / Authorized sanctions

In the first place, the insurer can stipulate that the commencement of cover will take place only if the policyholder implements the preventive measures. In this case, the sanction of non-observance of these measures will be the non-commencement of cover. The contract exists (it was validly concluded) but the cover cannot be effectively used. We must underline that it is not this type of clauses which raises the worst problems (provided however that the policy wording properly marks the link between the accomplishment of the preventive measure and the commencement of cover).

In the second place and on the opposite, the non-compliance with a preventive measure is not serious enough to justify the extinction of the contract. So, the contract shall remain in force. In French Insurance law the insurer is not entitled to terminate unilaterally the contract, except in cases explicitly stated by the insurance code ([18]) and the non-compliance with a preventive measure is not part of those cases. Contrary to the article of the restatement providing that the insurer shall be entitled to terminate the contract if the policyholder or the insured has breached its obligation with intent to cause the loss or recklessly and with knowledge that the loss would probably result ([19]), in French law the termination of the contract is not an option. So, the contract survives.

Accordingly, there remain the sanctions affecting the indemnity: Either a

[18] Civ. 1re, 7 mars 1989, n° 87-12034 : RGAT 1989, p. 526, note H. Margeat et J. Landel.

[19] Article 4 :102.

total or a partial exemption of the insurer from liability. But we have to precise that these sanctions bring about more qualification problems than they solve as explained below:

- A clause leading to a complete discharge of the insurer's liability in the case of non-compliance with a preventive measure shall be either a clause defining the risk, or an exclusion clause or a clause providing a special sanction called in French "déchéance" (forfeiture). It is question of the same effect (the insurer's discharge) for each of those (three) qualifications (each with its specific requirements). In addition, we must underline the judge's requalification power that creates the very important risk of non validity (for the said clauses).

  It's necessary to point out that if the insurer is exempted from liability due to exclusion or definition of the risk, it isn't strictly speaking a sanction but a delimitation of the insurance cover. So, normally, it is not necessary to prove a causal link between the non-compliance with a preventive measure duty and the loss. However, the French Supreme Court, changing its previous position, with two disruptive decisions ([20]), decided that a causal link was necessary. Professor Jean Bigot describes this development as the reintroduction of causality requirement ([21]), but it's difficult to appreciate with only two decisions. In the same manner, where the insurer's discharge follows from a forfeiture, the question to know if a causal link has to be proven is being discussed in France ([22]); again an incertitude.

- On the other hand, if the non-observance causes only a reduction of the insurance money according the requalification, in that case the risk will be less important. The clause will be analyzed most of the time as a simple obligation incumbent on the policyholder. So its non-compliance would mean that the insured was to blame for the occurrence of the event, which justif**ies** a reduced indemnity. In that context, the proof of a causal link between the non-compliance with a preventive measure and the loss is indispensable but it isn't necessary to proof the intent to cause the loss or that the loss was caused recklessly and with knowledge that it would probably result, as stated in the restatement. In classical contract law, the simple non-observance, with or without intention to cause the loss or

[20] Civ. 2ème, 8 juillet 2004, n° 03-15045 : RGDA 2004, p. 928, note J. KULLMANN.– Civ. 2ème, 12 mai 2011, n° 10-17256).

[21] J. BIGOT, La recommandation de la Commission des clauses abusives et l'assurance multirisques habitation des particuliers : RGAT 1986, p. 29.

[22] Cf. J. KULLMANN, Lamy Droit des assurances 2012, n° 685.

negligence, leads to the liability provided that a prejudice exists.

This proportionality is to be found also in the case of a preventive measure appearing as a circumstance of risk aggravation, hence leading to a reduction of indemnity. In this case the insurer must prove that the undeclared circumstance has affected his perception of risk, even if the insured event is not caused by that circumstance. So, the aggravation of risk must have an influence on the conclusion of contract but not on the occurrence of the insured event.

In conclusion, it's possible to see that the reduction of the indemnity is certainly the sanction which brings about less problems both at the level of qualification and at the level of sanction. For these reasons, and others, it's in my opinion the most appropriate sanction.

B / Appropriate sanction

The compliance with a preventive measure duty is not a fundamental obligation under an insurance contract. Therefore, it is not appropriate to give the insurer the right to deny totally his liability. This sanction, the cessation of the insurer's liability, would cause a significant imbalance in the respective rights and obligations of the insurer under the insurance contract to the detriment of the insured. It is very much like an abusive clause. Furthermore, it's this sanction which raises most the qualification problems and triggers a requalification risk. The treatment of exclusions in French law is an important negative factor for the validity of the clause. This can lead to the exoneration of the insurer on the ground of forfeiture. Therefore, this sanction raises more problems than solutions. For the time being, in French law, we don't even know if the forfeiture can constitute an valid sanction applicable to an obligation to be fulfilled before the insured event occurs. Some authors think that this sanction is reserved only for non-observance of obligations to be acquitted posterior to the insured event ([23]).

For all these reasons, the total discharge of the insurer's liability shall be abandoned and a more measured sanction will be adopted.

The reduction of indemnity appears as the most appropriate sanction. First because it gives the possibility to avoid the qualification difficulty. This sanction applies under two qualifications:

[23] Y. LAMBERT-FAIVRE, L. LEVENEUR, Droit des assurances, Dalloz, 12ème éd., 2005.– A. D'HAUTEVILLE, Plaidoyer pour une réforme des clauses de déchéance en droit des assurances : RGDA 2004, p. 299. There is also a decision of the Supreme Court : Civ. 3ème, 17 octobre 2007, n° 06-17608 : RGDA 2008, p. 66, note L. Mayaux ; JCP G 2008, I, 134, n° 1 et s., obs. J. Kullmann ; JCP G 2008, II, 10199, note J-P. Karila ; Resp. civ. et ass. 2007, comm.. 375, note H. Groutel.

- a classical obligation incumbent on the insured, or
- an aggravation of the risk.

As the qualification of aggravation depends on the wording of the declaration, there isn't any difficulty for the redactor of the policy to take the preventive measures out of this declaration. The better is to provide a sanction for the breach of the preventive measures duty during the stage of contractual performance. So, if the sanction is the reduction of the indemnity and if the declaration of risk doesn't mention the preventive measures, only one qualification remains possible: a contractual duty.

On the other hand, we have to make sure that the sanction applicable in case of non-compliance with an accessory obligation of the insured is proportionate to the impact that this faulty behaviour has on the insured event. The contractual balance depends on this. The insurer will have to prove the influence of the non-observance of the preventive measures duty on the materialization of the risk. This solution would protect the insured and the said influence will determine the extent of the reduction to be made. The causal role of the insured justifies the regulation of the indemnity.

We have here a very good example that the general law of contract offers a more balanced solution than the protective insurance law.

Thanks for your attention.

Precautionary Measures - *Swiss Law Aspects*

David Hirzel, *SCOR Switzerland*

1) Should we have in Insurance Contract Acts special provisions about "precautionary measures?

The Swiss insurance contract law differentiates between two types of co-operation duties ("Obliegenheiten"), the statutory co-operation duties ("gesetzliche Obliegenheiten") which are governed by the Swiss Insurance Contract Act ("Swiss ICA") and the contractual co-operation duties ("vertragliche Obliegenheiten") which are agreed upon by the parties in the respective insurance contract. Both types of co-operation duties may occur before or after the occurrence of the insured event. The term precautionary measures as per Swiss insurance contract law solely comprises the contractual co-operation duties requiring the policyholder or insured to perform or to omit certain acts before the insured event occurs. Precautionary measures often elaborate on particular statutory co-operation duties on the basis of the specific type of insurance contract. In drafting precautionary measures, the parties have to observe the principle of freedom of contract. However, article 29 paragraph 1 of the Swiss ICA provides for a minimum legal framework of dealing with particular co-operation duties (so-called risk-preventive co-operation duties) respectively precautionary measures in conjunction with risk minimization or prevention of risk increase. The Swiss ICA governs, furthermore, certain requirements that must be met in order to trigger the stipulated legal consequences in case of breach of precautionary measures (articles 29 paragraph 2 and 45 paragraph 1 of the Swiss ICA). The revised Swiss Insurance Contract Act, which is not yet in effect, will entail further legal provisions in this respect (e.g. article 41 paragraph 6 of the draft of the revised Swiss ICA).

2) If yes should those provisions be mandatorily applicable
   - To all insurance contracts?
     - to loss insurances only or to personal insurances as well?
   - To consumers only? Or to business as well?
   - To insurance consumers only?

Article 45 paragraph 1 as well as article 29 paragraph 2 of the Swiss ICA are mandatorily applicable, which means that they cannot be modified to the detriment of the insured or beneficiary (see article 98 paragraph 1 of the Swiss ICA). The parties are thus bound by these minimum legal standards when drafting insurance contracts.

Both provisions are regulated in the section of the general provisions (articles 1 – 47a of the Swiss ICA) and apply to all insurance contracts. There are no statutory provisions regarding precautionary measures in the Swiss ICA which refer to particular lines of business (e.g. personal insurances). Moreover, the afore-mentioned mandatory provisions apply to any type of insured party, whether consumer or not.

3) Should the application of sanctions (in case of violation) be possible only if the insurance contract explicitly provides those sanctions? (=no legal sanctions, only contractual sanctions)

In principle, there are no legal sanctions applicable as per the Swiss ICA in case of violation of precautionary measures. The insurance contract must thus explicitly provide the applicable sanctions. However, the general principle of article 97 of the Swiss Code of Obligations ("Swiss CO") regarding the duty to pay damages is also applicable to Swiss insurance contract law, although the provision is too generic to directly apply with respect to breaches of precautionary measures as it does not deal with specific circumstances of insurance contracts and only relates to the requirements that must be met in case of violation of the respective contractual duty. In case of a clear loss or proof of causation, this may, though, provide a remedy.

4) What should be the sanctions?
   - Termination or avoidance?
   - Discharge of liability
   - Reduction of the insurance indemnity

The following contractual sanctions are frequently stipulated in Swiss insurance contracts: Reduction of insurer's liability, discharge of insurer from liability, termination of insurance contract, suspension of insurer's duty to indemnify, contractual penalty or premium increase imposed on the insured.

5) Should the sanctions be applied also in case of innocent breach? Or should fault be necessary?

Article 45 paragraph 1 of the Swiss ICA states that if a sanction was stipulated for the insured or the beneficiary violating an obligation respectively a precautionary measure, that sanction will not be imposed if the violation resulted from circumstances which are not imputable to the insured or the beneficiary. This provision includes a fault requirement which is mandatory for all contractual sanctions. Therefore, such sanctions will not apply if the insured has caused the breach innocently. For the sake of completeness, it is worthwhile to mention that certain statutory co-operation duties regulate legal sanctions, which do not require fault of the insured.

6) If fault is necessary, should the applicable sanction depend on the degree of fault?
   - Intent (including "Dolus Eventualis")
   - Wilful misconduct? Gross negligence
   - Negligence

The legal provision of article 45 paragraph 1 of the Swiss ICA includes no differentiation of the degree of fault. The contracting parties often stipulate in the insurance contract that the insurer may reduce his duty to indemnify according to the degree of fault of the insured or beneficiary.

The draft of the revised Swiss ICA explicitly states in its article 41 paragraph 6 that the insurer may refuse his performance in case of wilful breach, or reduce its performance in case of negligent breach or dolus eventualis as per the degree of fault of the insured or beneficiary. Consequently, the breach of precautionary measures will newly cause a fault-based quotation of the insurer's performance.

7) Causation? Should there be a causal link between the occurrence of the risk and the violation (of the duty/obligation to take precautionary measures?)

Article 29 paragraph 2 of the Swiss ICA contains an explicit causation requirement. It states that if the violation of a risk-preventive co-operation duty respectively precautionary measure as per article 29 paragraph 1 of the Swiss ICA had no influence on the occurrence of the insured event and the extent of the insurer's performance, the insurer must accomplish its duty to indemnify the insured in case of a loss.

In contrast to article 29 paragraph 2 of the Swiss ICA, the mandatory provision of article 45 paragraph 1 refers solely to the fault requirement and does not contain any regulation of causation. Therefore, there are often clauses in the general conditions of insurance, out of the scope of article 29 paragraph 1, which explicitly exclude the requirement of causation. Furthermore, the general conditions of insurance may also allow the insured to prove that there is no causation between the loss and the breach of the precautionary measure.

The revised Swiss ICA will prescribe a general causation requirement stating that reductions of the insurer's performance without a causal link between the breach of precautionary measures and the occurrence of the loss will not be possible anymore.

8) Whose acts and/or omissions would give rise to the application of sanctions against the policyholder/insured for violation of a precautionary measure?

- Civil law solution (vicarious liability?)
- Solution proper to insurance law

The policyholder/insured who delegates the accomplishment of certain precautionary measures to a third party (auxiliary person) is liable for the conduct of this auxiliary person in carrying out such task (see article 100 of the Swiss ICA referring to article 101 of the Swiss CO). The policyholder/insured is bound by the acts and/or omissions performed by the auxiliary person and must bear the legal consequences in case of violation of a precautionary measure, unless he is able to prove that he could not be alleged of negligence if he acted in his own. As there is no specific provision in the Swiss ICA, the general civil law solution of article 101 of the Swiss CO is also applicable in Swiss insurance contract law.

9) How a precautionary measure would be distinguished from
   - an exclusion (risk definition)
   - a condition precedent

   Do we need special provisions for that purpose?

In order to exclude coverage in particular circumstances, the insurer has to clearly and unambiguously define an exclusion in the respective insurance contract referring to individual events (cf. article 33 of the Swiss ICA). Exclusion clauses deal with the definition of risk and differ from precautionary measures as they apply irrespective of the insured's specific conduct. The remedy of exclusion depends on whether the particular case falls within the scope of exclusion and is thus excluded from coverage.

The Swiss ICA does not provide any provisions about condition precedents. However, they are regulated in article 151 et seq. of the Swiss CO which states that a contract is conditional if its binding nature is made dependent on the occurrence of a future event that is uncertain to happen. The contract takes effect as soon as this condition precedent occurs. Condition precedents do, contrary to precautionary measures, not require a specific conduct of the insured. They are based on the presence or the absence of particular facts.

10) Should rules about precautionary measures be applicable exclusively (lex specialis) or should they compete with other legal institutions? For example

- With discharge of the insurer's liability in case of fraudulent behaviour?
- With rules about aggravation of risk?

Precautionary measures do not differentiate the degree of fault. However, fraudulent behaviour of the insured entails that the insurer is not bound to the insurance contract anymore and entitled to reject his duty to indemnify (cf. article 40 of the Swiss ICA). If fraudulent behaviour is equally unlawful, then this may further lead to a compensation claim of the insurer.

Precautionary measures may compete with other additional obligations or statutory co-operation duties. The Swiss ICA regulates in its articles 28 and 30 statutory co-operation duties in respect of the aggravation of risk caused with and without the influence of the insured. These rules differ from the provisions of article 29 of the Swiss ICA with regard to precautionary measures as they pursue not the same purpose. However, the contracting parties may stipulate that the legal consequences of articles 28 and 30 of the Swiss ICA also apply in case of breach of the precautionary measures of article 29 paragraph 1.

Furthermore, the breach of a precautionary measure as per article 29 paragraph 1 of the Swiss ICA competes with the rule of the gross negligent causation of the insured event according to article 14 paragraph 2 of the Swiss ICA. The same action of the insured may accomplish both rules. However, the precautionary measure referring to a specific risk fact is in this case regarded as lex specialis.

IV AIDA Europe Conference
London 13-14/9/2012, Consumer Working Party Session

Precautionary Measures Under P.E.I.C.L. - Art. 4:101 & The Position Under Greek Law

Ms **Stella Sakellaridou &** Dr. **Kyriaki Noussia**

Introduction

The traditional continental European Insurance Contract Acts (ICA) that regulate the obligation of the insured (and the applicant) to inform the insurer of circumstances which he knows or ought to know, in particular when concluding the contract but also during the life of the insurance contract and after the occurrence of the insured event, was under critic the last years. The critic was focused in particular on the extent of the sanctions which were allowed by the law to be stipulated against the po-licyholder for the breach of its obligation, but also on the extent of the disclosure duties and the circumstances which such duty should be fulfilled.

The Project Group "Restatement of the European Insurance Contract Law", - a project held of academics from several EU countries has published the first part of its work on December 2007. The work contains the PEICL which deals *inter alia* with the so-called "Precautionary Measures".

During the discussions of the Project Group "Restatement of the European Insurance Contract Law", it appeared that this subject was definitely one of the most controversial ones. The result of the discussions is a regulation, based on the following three articles:

Article 4:101. Precautionary Measures: Meaning

A precautionary measure means a clause in the insurance contract, whether or not described as a condition precedent to the liability of the insurer, requiring the policyholder or the insured, before the insured event occurs, to perform or not to perform certain acts.

Article 4:102. Insurer's Right to Terminate the Insurance Contract

(1) A clause which provides that in the event of non-compliance with a precautionary measure the insurer shall be entitled to terminate the contract, shall be without effect the loss or recklessly and with knowledge that the loss would probably result.

(2) The right to terminate shall be exercised by written notice to the policyholder within one month of the time when the non-compliance with a precautionary measure becomes known or apparent to the insurer. Cover shall come to an end at the time of termination.

Article 4:103. Discharge of the Insurer's Liability

(1) A clause that non-compliance with a precautionary measure totally or partially exempts the insurer from liability, shall only have effect to the extent that the loss was caused by the non-compliance by the policyholder or insured with intent to cause the loss or recklessly and with knowledge that the loss would probably result.

(2) Subject to a clear clause providing for reduction of the insurance money according to the degree of fault, the policyholder or insured, as the case may be, shall be entitled to insurance money in respect of any loss caused by negligent noncompliance with a precautionary measure.

According to Article 4:101 PEICL a precautionary measure means a clause in the insurance contract, whether or not described as a condition precedent to the liability of the insurer, requiring the policyholder or the insured, before the insured event occurs, to perform or not to perform certain acts.

The Issue of the Discharge of the Insurer's Liability

Article 4:103 shows that the PEICL not only adopt the principle of causation as a condition precedent to the discharge of the insurer's liability, but adds to it the requirement of fault at the side of the insured.

Re causation Article 4:103 is clear, i.e. non-compliance with a precautionary measure shall only have effect to the extent that the loss was caused by the non-compliance by the policyholder or insured.

The text of the clause is also clear in so far the onus of proving a causal link between the non-compliance and the loss is on the insurer.

The PEICL introduce a second requirement for the discharge of the insurer's liability: the loss should be caused by the non-compliance by the policyholder or insured with intent to cause the loss or recklessly and with

knowledge that the loss would probably result. The policyholder or the insured shall be entitled to insurance money in respect of any loss caused by merely negligent non-compliance with a precautionary measure. Without any requirement of fault the rule was felt to be unjust and incomplete

Right to Terminate the Contract

Article 4:102 implies that the right to terminate the contract in the event of non-compliance with a precautionary measure is limited to cases wherein the policyholder or the insured has breached its obligation with intent to cause the loss or recklessly and with knowledge that the loss would probably result. The right to terminate shall be exercised by written notice to the policyholder within one month of the time when the non-compliance with a precautionary measure becomes known or apparent to the insurer. Cover shall come to an end at the time of termination.

Critique

The Basic philosophy for the majority of the PEICL Group was that without any requirement of fault, the rule felt to be unjust and incomplete. Freeing the insurer from covering the loss can generally not be legitimized if the fault on the insured's part is only "slight" negligence.

The Greek Law Position

According to position of the general law, the breach of a contractual precautionary measure cannot lead to loss of cover, unless the insured is liable for the breach and there is a causal relation with the damage suffered. More specifically, art. 3 of Law 2496/1997 § 5, i.e. Greek Insurance Act (ICA), states that in case of a negligent breach of duty, the insurer has all of the rights of art. 3 §3 (i.e. he has the right to terminate or vary the contract in one month), he is not liable to indemnify and can terminate terminates and the insured is also liable for the loss suffered. In addition, if the insured event occurs before the insurance contract is changed or before the insurance contract termination produces its effect, there is also proportional reduction of the indemnity sum. The Greek law art. 3§ 5 is revolutionary in that it followed the rationale expressed in the schedule for Dir. 78/473/EC, and in that it has introduced the proportionality rule for sanctions due to negligent breach by the insured. Greece was first to introduced the rule and thereafter its example was followed by other countries (Germany, Holland etc.).

Conclusion

The PEICL in case of breach of the precautionary measures encompasses that the insurer is discharged provided there is a justified causation element (condition precedent) and the fault of the assured. With regards to the causation issue for non-compliance with the precautionary measures, the insurer has the burden of proof. Under Greek law's regime, the legal sanctions for non-negligent breach of precautionary measures are strict since the insurer is not liable to indemnify and may terminate the contract (with immediate effect). In addition, the policyholder is also liable in damages for the loss suffered. It is clear that the PEICL, in providing rules for precautionary measures in Article 4:101-103, secures a high level of protection on behalf of the policyholder and the insured. Their choice should be respected however it remains to see in practice whether they will be highly and widely chosen. In effect, PEICL takes into consideration the modern EU insurance contract law regulations which include new tendencies, aiming towards the more efficient protection of the policyholder. The rules which have been introduced on precautionary measures, have introduced in order to set up a framework which will restrict the insurer from introducing heavy & draconian sanctions for breach by the policyholder. Overall as a general conclusion it should be stressed out that their ratio is in fact the protection of the policyholder.

Precautionary Measures in Turkish Law

Dr. **Samim Unan** *(AIDA TURKEY)*

Turkey has enacted in 2011 a new Commercial Code (TCC) in which the Fifth Book is dedicated to the insurance contract.

TCC Article 1449 relating to the contractual duties of the policyholders/ insured reads as follows:

> **e) Violation of the Duties Stipulated in the Contract**
>
> **Article 1449-** (1) Provisions to the effect that the insurer will be discharged from its obligation of performance by terminating the contract entirely or partly in the event that the policyholder is in breach of a contractual duty towards the insurer shall be ineffective if the breach was not negligent, unless otherwise provided by this Code or other legislation.
>
> (2) If the breach was negligent, the right to terminate, which is not used within one month from the date of awareness, is lost, unless a different period is provided in this Code.
>
> (3) The insurer cannot terminate the contract where the violation had not any effect on the materialisation of the risk or the extent of the insurer's obligation to be fulfilled.

This legal provision, inspired partly from German law as it stood when TCC was first drafted, does not seem to bring happy solutions. We begin by stating what is positive first:

- Previous Turkish law did not contain any rule about "contractual duties". Only legal duties were regulated (precontractual information duty; duty to refrain from aggravating the risk, duty to notify the materialised risk, duty to take preventive measures at the stage of materialisation of the risk).
- In practice insurance contracts provided often contractual duties and uncertainty existed on the provisions applicable to these

- Therefore this issue had to be regulated. The new TCC remedied to this gap.

Before we criticise the new provision, we must beforehand state what solutions it brings:

- In case of breach of the contractual duty, the insurer will be entitled to escape payment if the insurance contract contains a stipulation to that effect.
- The way to escape payment is the termination of the contract wholly or partly, based on the abovementioned contractual stipulation
- If the insurer terminates the contract wholly or partly, it will be relieved of its obligation to pay the insurance money
- However if the breach was innocent (i.e. not negligent) the insurer will not be relieved.
- If the breach was committed with negligence, the insurer must use its right to terminate within one month from awareness
- Termination is excluded where the breach was not effective on the materialisation of the risk or on the extent of the insurers' performance.

The rules above are not appropriate for following reasons:

- First of all, we must clarify one point that may lead to misunderstanding: Termination will not by itself discharge the insurer. Termination means that the contract comes to an end for the future (not retroactively= ex nunc). Upon termination there will be no new obligations generated by that contract. But obligations already arisen would remain intact. In other words if the contract is terminated by the insurer after the occurrence of the risk that caused some damage to the subject matter insured (the parties to the insurance contract- insurer as well as the policyholder- are entitled to terminate ex lege upon partial loss TCC 1428(2)) the use of the right of termination will not remove the obligation of the insurer to compensate the damage.
- Therefore, the discharge of the insurer will occur as a result of a special clause in the insurance contract to that effect. The special clause may provide the discharge directly (for example through the wording "the insurer shall be discharged of liability in case of negligent breach") or leave it to the discretion of the insurer (it may for instance stipulate that "the insurer will be entitled to terminate in case of negligent breach").
- The right to invoke the discharge pursuant to a clause in the insurance contract may be subordinated to the termination of the insurance

contract. We think that is what the Turkish legislator wanted to achieve. But we must confess that the formulation is far from clarity.

- It is not convincing to oblige the insurer to "terminate" the contract whenever it wishes to apply a sanction for the breach of the contractual duty. The sanction should not be dependent on another sanction. The aim of this "bundling" is certainly the need to restraint the rights conferred to the insurer. However its rights are already sufficiently restricted by the requirements of "fault" and "causality".
- The "bundling" will have an unduly dissuasive effect on the insurer. On the other hand such a burden could sometimes be detrimental to the policyholder (it may lose the cover and not replace it adequately or in due time).
- A similar solution existed in Germany under the old law. But nowadays Germany does not insist anymore on the "termination" as a condition precedent for the "discharge" of the liability. Turkish rule is born "old".
- The fault is a key requirement. As a fundamental choice it is certainly most convenient. However Turkish law did not provide different solutions for different "degrees" of fault.
  - The insurer will then be free to stipulate the heaviest sanction for the slightest breach.
  - Escalation would be a good solution: Heaviest sanction for intentional breach; less severe sanction for gross negligence and slightest sanction for minor negligence. This is what the German ICA 2008 did.
- TCC does not seem to be consistent: Although it renounced to the "all or nothing rule" in many areas (for example in respect precontractual information duty or the duty to refrain from aggravating the risk), it finally maintained this –nowadays broadly abandoned- rule with regards to the contractual duties.
- Turkish law does not bring answers to a number of questions that are left to scholars (to whom judges are not very keen to listen) and to judiciary. In that context we must underline especially the points below:
  - The persons whose conduct is assimilated to the conduct of the policyholder are in Turkish law the insured, the representative and the beneficiary. The article 1412 TCC on "the behaviour and knowledge of persons other than the policyholder" reads:

    > *Where this Code attaches any legal consequence to the policyholder's behaviour or knowledge, the same consequence shall attach also to the behaviour or knowledge*

of the insured, of the representative or in cases of personal insurances of the beneficiary, provided that they were aware of the insurance contract.

- What is meant by the word "representative" here does not look very clear. If this term is understood as referring to a legal representative (i.e. a person vested in with the power to bind the policyholder) it will not be sufficient to respond to the needs. A broader concept of representative is needed and has to be defined. German law can inspire a lot.
- On the other hand the reason why the "beneficiary" is also amongst the persons whose conduct creates detrimental consequences is not apparent. The beneficiary is only entitled, but in principle not obligated. Although it is possible via stipulation to assimilate beneficiary's certain conducts to those of the policyholder, a general legal attribution of any conduct of the beneficiary to the policyholder does not seem to be an appropriate solution. PEICL 1:206 proposes a solution more balanced: The knowledge (only) of another person is imputed to the policyholder, insured or the beneficiary if that person was entrusted by the policyholder, insured or beneficiary with responsibilities essential to the conclusion or performance of the contract. PEICL does not contain any express rule as to the imputation of the beneficiary's conduct or knowledge to the policyholder.

– Turkish law is silent as how to distinguish exclusions of cover from contractual duties. There is no rule neither on the competition (whether the sanctions provided by the legal rule about contractual duty are exclusively applicable).

The positive aspects of the new law can be briefly summarised as follows:

– Turkish provision about contractual duties is mandatory. This is a positive step forward to protect the policyholders. At this point we must also emphasize that Turkish law does not make any distinction between large risks and mass risks. Any policyholder, be it a consumer, professional or trader is protected to the same extent.

– The rule about contractual duties is amongst the provisions applicable to all contracts of insurance. Therefore personal insurances (life, accident, health) are also encompassed.

– The application of sanctions (in case of violation) is excluded if the insurance contract does not explicitly state those sanctions. Therefore the insurer should take care to mention in the contract not only the contractual duty, but also the sanction to apply in case of its breach.

Questions and Answers

Precautionary Measures

John Habergham, *Solicitor/Director, Myton Law*

1) Should we have in Insurance Contract Acts special provisions about "precautionary measures?

Yes

2) If yes should those provisions be mandatorily applicable

- To all insurance contracts?
  - to loss insurances only or to personal insurances as well?
- To consumers only? Or to business as well?
- To insurance consumers only?

At the present the Marine Insurance Act defines a warranty and the consequences if breached. Leaving aside certain warranties implied as a matter of law and which are only applicable to policies of marine insurance, there is no mandatory requirement for a policy to contain any such warranty. Neither is there any suggestion to alter this in the Law Commission proposals. I would imagine that the reason for this is that insurers have never been slow in including warranties in policies.

3) Should the application of sanctions (in case of violation) be possible only if the insurance contract explicitly provides those sanctions? (=no legal sanctions, only contractual sanctions)

At present a warranty can be included in the policy or incorporated into it by reference in another document. This lead to the practice of incorporating all information included in the application for insurance into the policy and with the status of warranties (basis of contract clause).

This practice will be abolished for consumer policies in 2013.

For business insurance the Law Commission recommends that if an insurer wants to rely upon a specific warranty it should be explicitly recorded in the policy.

Further, if the Commission recommendation 3 is adopted, and the insurer wants to retain the non-causative warranty (i.e. failure to maintain a burglar alarm defeats a flooding claim) then clear unambiguous wording will be necessary.

In fairness this reflects the courts approach to the incorporation and construction of warranties, ameliorating the potential harshness of the strict law; and the general approach to try and align the remedies at law with what the parties shave agreed in the contract.

See also 10) below.

4) What should be the sanctions?

- Termination or avoidance?
- Discharge of liability
- Reduction of the insurance indemnity

At present the sanction is discharge of liability from the point of breach and the insured cannot remedy the breach . The policy remains alive but of no practical use to the insured.

The Commission proposal that breach of warranty would be suspensive would alter the current law. There would be no liability upon the insurer if the releavant loss occurred whilst the warranty was being breached but the policy remains alive to respond to any other perils.

There are no suggestions for any other remedy e.g. termination.

5) Should the sanctions be applied also in case of innocent breach? Or should fault be necessary?

At present the mind set of the insured is irrelevant – a warranty requires strict and literal compliance. The breach can be innocent, careless or deliberate. There is no suggestion that this is to be changed.

6) If fault is necessary, should the applicable sanction depend on the degree of fault?

- Intent (including "Dolus Eventualis")
- Wilful misconduct? Gross negligence
- Negligence

Not applicable – see 5) above.

7) Causation? Should there be a causal link between the occurrence of the risk and the violation (of the duty/obligation to take precautionary measures?)

At present there is no requirement for the insurer to show causation between the breach and loss.

Commission proposal 3 would alter this albeit by the back door rather than expressly.

Where a term is designed to reduce the risk of a particular type of loss, a breach of that term would only suspend liability in respect of that type of loss.

The same would apply where the term is designed to reduce the risk of loss at a particular time or in a particular location.

It seems to me that this is introducing an element of causation into the equation.

8) Whose acts and/or omissions would give rise to the application of sanctions against the policyholder/insured for violation of a precautionary measure?

- Civil law solution (vicarious liability?)
- Solution proper to insurance law

Although a warranty requires strict and literal compliance, the law does not currently specify who has to comply. İt has rarely been an issue. If the policy says that the fire alarm system should be inspected every six months, it would be a difficult for an insured to argue that the warranty had been complied with, it's purpose served if he or she had inspected the alarm when they held no sufficient technical qualification.

Generally, I think it can safely be said that the acts or ommissions are not personal to the insured.

9) How a precautionary measure would be distinguished from

- an exclusion (risk definition)
- a condition precedent

Do we need special provisions for that purpose?

Whether a provision in a policy is an exception, a condition precedent or a warranty is a matter of construction by the court.

The only real issue is the effect or consequences of breach. See 4) above. Breach of exception means the policy is still available to be called upon to respond to other claims or perils to which the exception does not apply.

But this will be rendered redundant if Commission proposal 3 is accepted making warranties suspensive in nature.

10) Should rules about precautionary measures be applicable exclusively (lex specialis) or should they compete with other legal institutions? For example

- With discharge of the insurer's liability in case of fraudulent behaviour?
- With rules about aggravation of risk?

Although there has been a judicial trend to align the parties remedies to what has been agreed between them and evidenced by the policy, for public policy reasons, it is unlikely that the wider common law principles such as "no man shall profit from his own wrongdoing" will be totally excluded.

Consumer Protection and Dispute Resolution Working Party Session on 'Precautionary measures' Australian response to 'Precautionary measures' questionnaire

Greg Pynt, Pynt + Partners, Perth

1) Should we have in Insurance Contract Acts special provisions about 'precautionary measures'?

Section 54 of the Australian *Insurance Contracts Act 1984* limits an insurer's ability to refuse to pay a claim for breach of, or non-compliance with, a 'precautionary measures' clause.

Sections 59 to 63 of the ICA deal with an insurer's ability to cancel a contract.

2) If yes, should those provisions be mandatorily applicable to:

a) all insurance contracts?

b) loss insurances only or to personal insurances as well?

c) consumers only? Or to business as well?

d) insurance consumers only?

Subject to sections 8 and 9 of the ICA, s 54 applies to all insurance contracts.

3) Should the application of sanctions (in case of violation) be possible only if the insurance contract explicitly provides those sanctions? (= no legal sanctions, only contractual sanctions)

Section 54 is only engaged if the effect of an insurance contract would, but for s 54, "*be that the insurer may refuse to pay a claim, either in whole or in part …*".

4) What should be the sanctions:

a) termination or avoidance?

b) discharge of liability?

c) reduction of the insurance indemnity?

Section 54(2) allows an insurer to refuse to pay a claim if the post-contractual act or omission that would otherwise allow the insurer to refuse to pay the claim could "*reasonably be regarded as being capable of causing or contributing to a loss*", except to the extent the insured proves the act or omission did not cause the loss.

Section 54(1) prevents an insurer from refusing to pay a claim if the post-contractual act or omission that would otherwise allow the insurer to refuse to pay the claim could not "*reasonably be regarded as being capable of causing or contributing to a loss*", except to the extent the insurer proves it has been actually financially prejudiced by the act or omission.

Sections 59 to 63 of the ICA deal with an insurer's ability to cancel a contract.

5) Should the sanctions be applied also in case of innocent breach? Or should fault be necessary?

6) If fault is necessary, should the applicable sanction depend on the degree of fault?

a) Intent (including "Dolus Eventualis")

b) Wilful misconduct? Gross negligence

c) Negligence

Section 54 does not distinguish between innocent, negligent, wilful or reckless breach or non-compliance with a 'precautionary measures' clause.

7) Causation? Should there be a causal link between the occurrence of the risk and the violation (of the duty/obligation to take precautionary measures?)

See the *Answer* to Question 4.

8) Whose acts and/or omissions would give rise to the application of sanctions against the policyholder/insured for violation of a precautionary measure?

a) Civil law solution (vicarious liability?)

b) Solution proper to insurance law

Section 54 is engaged if the effect of the insurance contract would, but for s 54, "*be that the insurer may refuse to pay a claim … by reason of some* [post-contractual] *act* [or omission] *of the insured or of some other person, …*". Ie., the operation of s 54 is not limited to acts or omissions of the policyholder, the insured or the beneficiaries.

9) How a precautionary measure would be distinguished from:

a) an exclusion (risk definition)

b) a condition precedent

Do we need special provisions for that purpose?

Section 54 does not distinguish between 'precautionary measures' clauses, risk definition or conditions precedent.

Section 54 is engaged if:

a) the circumstances that gave rise to a claim on the policy fall within the 'core' of the insurer's contractual promise; and

b) but for s 54, the effect of the contract is that the insurer could refuse to pay the claim because of a post-contractual act or omission of the insured or of some other person.

Generally speaking, in a 'losses occurring' insurance contract, an insurer's 'core' promise will coincide with the scope of the insuring/operative clause. Accordingly, circumstances falling outside the scope of the clause will usually be regarded as falling outside the insurer's 'core' promise and will therefore not attract the application of s 54. For example, in the case of an insuring clause in a motor vehicle policy that promises cover for accidental damage to a vehicle:

- during the period 12 September 2011 to 12 September 2012, s 54 will not come into play if the damage occurs on 13 September 2012;
- in Australia, s 54 will not come into play if the damage occurs when the vehicle is in New Zealand.

Section 54 does not qualify the act or omission by reference to the word 'breach' or to the nature or characteristics of the relevant contractual term. Accordingly, it applies to acts or omissions relevant to all types of contractual term, no matter how characterized.

10) Should rules about precautionary measures be applicable exclusively (lex specialis) or should they compete with other legal institutions? For example, with:

a) discharge of the insurer's liability in case of fraudulent behaviour?

b) rules about aggravation of risk?

Section 54 also deals with aggravation of risk. The ICA deals separately with fraudulent claims (s 56).

Precautionary Measures

Anne Pélissier, *Professor, Montpellier I University (France)*

1) Should we have in Insurance Contract Acts special provisions about "precautionary measures?

There is a legal duty for the insured to take preventive measures only in marine insurances (article L. 172-19 2° Insurance Code).

So, the agreement of the parties is the only way to impose on the policyholder the duty to act diligently in order to prevent the insured event.

2) If yes should those provisions be mandatorily applicable

- To all insurance contracts?
  - to loss insurances only or to personal insurances as well?

In French law, the mandatory character exists only in respect of marine insurances (that are loss insurances).

- To consumers only? Or to business as well?

In these insurances (i.e. marine insurances), the insured is most of the time a professional.

Where the duty to act diligently derives from the contract, it can be imposed to consumers or to business, in application of the contractual freedom.

- To insurance consumers only?

3) Should the application of sanctions (in case of violation) be possible only if the insurance contract explicitly provides those sanctions? (=no legal sanctions, only contractual sanctions)

Yes, only contractual sanctions.

4) What should be the sanctions?

- Termination or avoidance?
- Discharge of liability
- Reduction of the insurance indemnity

The possible sanctions are:

- non-commencement of cover in case of non-observance of the preventive measure.
- discharge of liability
- reduction of the insurance indemnity

The termination of contract is not an option.

5) Should the sanctions be applied also in case of innocent breach? Or should fault be necessary?

It depends on the sanctions.

For the non-commencement of cover, the sanction is applied also in case of innocent breach.

For the discharge of liability, there is incertitude. If the insurer is exempted from liability due to exclusion or definition of the risk, it isn't strictly speaking a sanction but a delimitation of the insurance cover. So, normally, it is not necessary to prove a causal link between the non-compliance with a preventive measure duty and the loss. However, the French Supreme Court, changing its previous position, with two disruptive decisions ([24]), decided that a causal link was necessary, but it's difficult to appreciate with only two decisions. In the same manner, where the insurer's discharge follows from a forfeiture clause, the question to know if a causal link has to be proven is being discussed in France ([25]).

For the reduction of indemnity, the clause will be analyzed most of the time as a simple obligation incumbent on the policyholder. So its non-compliance would mean that the insured was to blame for the occurrence of the event, which justifies a reduced indemnity. In that context, the proof of a causal link between the non-compliance with a preventive measure and the loss is indispensable but it isn't necessary to prove the intent to cause the loss or that the loss was caused recklessly and with knowledge that it would probably result, as stated in the restatement. In classical contract law, the simple non-observance, with or without intention to cause the loss or negligence, leads to the liability provided that a prejudice exists.

[24] Civ. 2ème, 8 juillet 2004, n° 03-15045 : RGDA 2004, p. 928, note J. KULLMANN.– Civ. 2ème, 12 mai 2011, n° 10-17256).

[25] Cf. J. KULLMANN, Lamy Droit des assurances 2012, n° 685.

6) If fault is necessary, should the applicable sanction depend on the degree of fault?

- Intent (including "Dolus Eventualis")
- Wilful misconduct? Gross negligence
- Negligence

No

7) Causation? Should there be a causal link between the occurrence of the risk and the violation (of the duty/obligation to take precautionary measures?)

Cf. Answer 5

8) Whose acts and/or omissions would give rise to the application of sanctions against the policyholder/insured for violation of a precautionary measure?

- Civil law solution (vicarious liability?)
- Solution proper to insurance law

Both. It depends on the qualification of the clause requiring the preventive measures:

If the clause is qualified as a definition of the risk covered, a condition of the cover, an obligation according to the general law of contracts, civil law solutions are applicable.

If the clause is qualified as an exclusion, a risk aggravation, a forfeiture, solutions proper to insurance law are applicable.

9) How a precautionary measure would be distinguished from

- an exclusion (risk definition)
- a condition precedent

Do we need special provisions for that purpose?

It's a very important problem in French law. Despite the redaction of the clause, judges may have different interpretations. So, when a clause is interpreted as providing an exclusion of the cover the judge may go beyond the policy wording and make a (second) qualification which may lead to the non-validity of the clause.

The reduction of indemnity appears as the most appropriate sanction because it gives the possibility to avoid the qualification difficulty. This sanction applies under two qualifications:

- a classical obligation incumbent on the insured, or

- an aggravation of the risk.

As the qualification of aggravation depends on the wording of the declaration, there isn't any difficulty for the redactor of the policy to take the preventive measures out of this declaration. The better is to provide a sanction for the breach of the preventive measures duty during the stage of contractual performance. So, if the sanction is the reduction of the indemnity and if the declaration of risk doesn't mention the preventive measures, only one qualification remains possible: a contractual duty.

10) Should rules about precautionary measures be applicable exclusively (lex specialis) or should they compete with other legal institutions? For example

- With discharge of the insurer's liability in case of fraudulent behaviour?
- With rules about aggravation of risk?

For the moment, there is competition between special insurance rules and civil rules.

Precautionary Measures - Swiss Law Aspects

David Hirzel, *SCOR Switzerland*

1) Should we have in Insurance Contract Acts special provisions about "precautionary measures?

Precautionary measures are based on the principle of freedom of contract. However, art. 29 and art. 45 para. 1 of the Swiss Insurance Contract Act ("Swiss ICA") provide for a minimum legal framework.

2) If yes should those provisions be mandatorily applicable

- To all insurance contracts?
  - to loss insurances only or to personal insurances as well?
- To consumers only? Or to business as well?
- To insurance consumers only?

Art. 45 para. 1 as well as art. 29 para. 2 of the Swiss ICA are mandatorily applicable to all insurance contracts and to any type of insured party.

3) Should the application of sanctions (in case of violation) be possible only if the insurance contract explicitly provides those sanctions? (=no legal sanctions, only contractual sanctions)

The insurance contract must explicitly stipulate the applicable sanctions. Besides, the general principle of art. 97 of the Swiss Code of Obligations ("Swiss CO") dealing with the duty to pay damages needs to be considered as regards the requirements that must be met in case of non-compliance.

4) What should be the sanctions?

- Termination or avoidance?
- Discharge of liability
- Reduction of the insurance indemnity

In Swiss insurance contract law the most common sanctions are the termination and the reduction or discharge of the insurer's liability.

5) Should the sanctions be applied also in case of innocent breach? Or should fault be necessary?

Art. 45 para. 1 of the Swiss ICA includes a fault requirement for all contractual sanctions.

6) If fault is necessary, should the applicable sanction depend on the degree of fault?

- Intent (including "Dolus Eventualis")
- Wilful misconduct? Gross negligence
- Negligence

There is no differentiation between the degree of fault in art. 45 para. 1 of the Swiss ICA. However, the parties often contractually agree upon a reduction of the insurer's duty to indemnify as per the degree of fault of the insured.

7) Causation? Should there be a causal link between the occurrence of the risk and the violation (of the duty/obligation to take precautionary measures?)

Art. 29 para. 2 of the Swiss ICA contains a causation requirement which only refers to the precautionary measures of art. 29 para. 1. Beyond the scope of this provision, causation is not a necessary element and often explicitly excluded in the general conditions of insurance.

8) Whose acts and/or omissions would give rise to the application of sanctions against the policyholder/insured for violation of a precautionary measure?

- Civil law solution (vicarious liability?)
- Solution proper to insurance law

As there is no specific provision in the Swiss ICA, the general civil law solution of art. 101 of the Swiss CO applies which states that the insured is liable for the conduct of a third party (auxiliary person) who was entrusted by him with a particular task.

9) How a precautionary measure would be distinguished from

- an exclusion (risk definition)
- a condition precedent

Do we need special provisions for that purpose?

Exclusion clauses differ from precautionary measures as they apply irrespective of the insured's specific conduct, depending on whether the case falls within the scope of exclusion (cf. art. 33 of the Swiss ICA). Condition precedents are regulated in art. 151 et seq. of the Swiss CO and based on the presence or the absence of particular facts.

10) Should rules about precautionary measures be applicable exclusively (lex specialis) or should they compete with other legal institutions? For example

- With discharge of the insurer's liability in case of fraudulent behaviour?
- With rules about aggravation of risk?

Precautionary measures may compete with other additional obligations or statutory co-operation duties, e.g. co-operation duties dealing with the aggravation of risk (art. 28 and 30 of the Swiss ICA) or art. 40 of the Swiss ICA concerning the fraudulent behaviour of the insured.

Precautionary Measures

Ms **Stella Sakellaridou** & Dr. **Kyriaki Noussia** *(Greece)*

1) Should we have in Insurance Contract Acts special provisions about "precautionary measures?

Yes

2) If yes should those provisions be mandatorily applicable

– To all insurance contracts?

Yes

- to loss insurances only or to personal insurances as well?

Yes

– To consumers only? Or to business as well?

To consumers

– To insurance consumers only?

Yes

3) Should the application of sanctions (in case of violation) be possible only if the insurance contract explicitly provides those sanctions? (=no legal sanctions, only contractual sanctions).

There should exist contractual sanctions (e.g. termination of ins. contract and/or variation of ins. contract)

4) What should be the sanctions?

– Termination or avoidance?

– Discharge of liability

– Reduction of the insurance indemnity

Termination or variation of the ins. contract. In case of termination the insurer is not liable. If variation is chosen then there should also exist reduction of the ins. indemnity.

5) Should the sanctions be applied also in case of innocent breach? Or should fault be necessary?

In my opinion the sanctions should be applicable only if fault is found and proven. Should there be the case of innocent breach and the insurer who has the burden of proof proves so, then a proportional sum reduction of the indemnity should occur. This proportional sum reduction can be specified in the contract if not by law already.

6) If fault is necessary, should the applicable sanction depend on the degree of fault?

– Intent (including "Dolus Eventualis")

Yes

– Wilful misconduct? Gross negligence

Yes

– Negligence

Yes

7) Causation? Should there be a causal link between the occurrence of the risk and the violation (of the duty/obligation to take precautionary measures?)

Yes, causation is a necessary element.

8) Whose acts and/or omissions would give rise to the application of sanctions against the policyholder/insured for violation of a precautionary measure?

– Civil law solution (vicarious liability?)

I support the civil law solution.

– Solution proper to insurance law

9) How a precautionary measure would be distinguished from

- an exclusion (risk definition)
- a condition precedent

The elements of causation and negligence allow such a distinction. A precautionary measure moreover operates also at the post contractual drafting phase when a claim also arises.

- Do we need special provisions for that purpose?

Some legal regimes encompass in their law provisions covering precautionary measures throughout the ins. contract's operation (e.g. Greek ICA art. 3 para.1-5)

10) Should rules about precautionary measures be applicable exclusively (lex specialis) or should they compete with other legal institutions? For example

- With discharge of the insurer's liability in case of fraudulent behaviour?
- With rules about aggravation of risk?

The operation of rules on precautionary measures should not depend on the operation of other legal rules (e.g. rules re the discharge of the insurer's liability in case of fraudulent behaviour or rules re aggravation of risk). In that sense, and by definition, they constitute *lex specialis* and hence should take precedent over more general rules of e.g. general contract law. However, and not in a sense of competition, rather in a sense of complementing each other, other rules such as. Rules re the discharge of the insurer's liability in case of fraudulent behaviour or rules re aggravation of risk should exist and be complimentarily applied alongside the rules on precautionary measures, so as to give the chance for a better legal protection regime.

Precautionary Measures

Dr. **Samim Unan**, *(AIDA Turkey)*

1) Should we have in Insurance Contract Acts special provisions about "precautionary measures"?

Yes, otherwise it will be difficult to reach adequate solutions that would be uniformly applicable and to avoid conflicting practices statutory regulation is a good remedy

2) If yes should those provisions be mandatorily applicable

- To all insurance contracts?
  - To loss insurances only or to personal insurances as well?
- To consumers only? Or to business as well?
- To insurance consumers only?

In our opinion the best solution would consist to provide mandatory provisions for "mass risks". The "large risks" should be excluded. In other words, the "insurance consumer" (including also small and medium size enterprises) should be protected through mandatory norms.

3) Should the application of sanctions (in case of violation) be possible only if the insurance contract explicitly provides those sanctions? (=no legal sanctions, only contractual sanctions)

We believe that it is better to require the provision of the sanction in the contract in order to better protect the insurance consumers. The mere provision of the duty in the insurance contract (without indication of the applicable sanction in case of breach) would not be sufficient then to trigger any sanction (even of lowest severity).

4) What should be the sanctions?

- Termination or avoidance?
- Discharge of liability
- Reduction of the insurance indemnity

Termination should be available in any case (i.e. when breach is detected before the materialization of the risk and also after the materialization of the risk in case of partial loss – relevant especially where the law does not allow the termination upon occurrence of the risk).

Discharge of liability should be possible in case of intentional breach, "dolus eventualis" or willful misconduct (reckless conduct with conscience that the risk would probably occur)

Reduction of the insurance money should apply in case of gross negligence or "culpa levis"

5) Should the sanctions be applied also in case of innocent breach? Or should fault be necessary?

If the breach was not faulty, no sanction should apply.

6) If fault is necessary, should the applicable sanction depend on the degree of fault?

- Intent (including "Dolus Eventualis")
- Wilful misconduct? Gross negligence
- Negligence

Please see answer to the question nr. 4.

7) Causation? Should there be a causal link between the occurrence of the risk and the violation (of the duty/obligation to take precautionary measures?)

Yes. If the breach was not causal for the materialisation of the risk, no sanction should apply (save termination upon detection of the breach before the occurrence of the risk)

8) Whose acts and/or omissions would give rise to the application of sanctions against the policyholder/insured for violation of a precautionary measure?

- Civil law solution (vicarious liability?)
- Solution proper to insurance law

Solution proper to insurance law should prevail. The insurance law should develop a concept to that effect ("representative" in the sense of insurance law as shaped by German law can be a good choice).

9) How a precautionary measure would be distinguished from

- an exclusion (risk definition)
- a condition precedent

Do we need special provisions for that purpose?

For the sake of clarity and avoidance of doubt it would be appropriate to have special rules.

10) Should rules about precautionary measures be applicable exclusively (lex specialis) or should they compete with other legal institutions? For example

- With discharge of the insurer's liability in case of fraudulent behaviour?
- With rules about aggravation of risk?

Competition would be a better solution.