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International risk team

The Evolution of the Remedy of Avoidance

There used to be a side-splitting "joke" amongst the barrister authors of a particular insurance law textbook that its title ought to have been "How to Avoid". This was because twenty-five years ago telephone calls between insurance carriers and their lawyers might often have started with: "We are going to get clobbered. How can we get out of this?". Back then the insurance market was a very different place to what it is now, notwithstanding what is currently going on in the world. It was somewhat fragmented and there was a heady mix of under-capitalisation and LMX spiral business (a hazardous game of "pass the exploding parcel" played through mutual reinsurance). A big loss could spell doom – hence the "joke".

The law of avoidance arguably reached its pro-insurer high-point in 1996 with the case of *Marc Rich v Portman*. An underwriter who wrote a demurrage liability insurance policy for a large oil trader was able to avoid that policy for non-disclosure of the trader's demurrage history – despite not being able to explain what demurrage was during his somewhat excruciating cross-examination!

So what about the remedy of avoidance in 2020?

It is first important to understand why avoidance exists as a remedy and also that the remedy of avoidance is not unique to insurance contract law.

At the risk of stating the obvious, all contract law is based on a "meeting of minds" – because it is founded on obligations that are voluntarily assumed, as opposed to obligations imposed on us by law (such the tortious duty to take care when driving etc). To take a not unusual transaction (that may have been autobiographically inspired), such as a middle-aged man purchasing a 1980s sports car on eBay late on a Saturday night. If the seller describes the car, that is in fact full of rot and filler, as being in excellent structural condition and the purchaser, in reliance on that description, presses "buy it now" and somewhat unwisely immediately transfers the money to the seller's bank account, he can, as a general rule, unwind the contract altogether as if it never happened and recover the purchase money. This is the remedy of rescission or avoidance – as it is called in an insurance contract law context. This remedy exists because the purchaser's agreement to purchase the car has been obtained on a false basis, or to put it more pretentiously, their intention to enter into the contract has been "vitiated" – and so there has been no genuine meeting of minds. In those circumstances, the law assumes the purchaser would not have proceeded with the purchase in the first place

had the false representation not been made. Needless to say, this is hardly quantum theory.

The analysis is substantively the same in an insurance contract law context. However, the key difference between an ordinary contract and an insurance contract is that there is not just a duty on the insured to be accurate when it speaks, but there is also a duty on it to speak to reveal things that are objectively important to the insurer. The primary justification for this in an insurance context is that there is a presumed informational disadvantage on the part of the insurer. There is a presumption that the insurer will tend not personally to undertake an inspection of the insured subject matter to ascertain its true nature. That would substantially increase the transactional costs of providing insurance, which would in turn make insurance, which is socially and economically vital, prohibitively expensive. However, the flip-side to insurance being affordable is that the insurer requires enhanced protection beyond what is provided by ordinary contract law.

The problem with English insurance law (as it previously was) is that it arguably went too far in that it protected some fairly suspect underwriting – as well illustrated by the Marc Rich case – and it was seen to punish insureds by potentially depriving them of cover for objectively minor oversights. The law was not just used to escape the insurance equivalent of being duped into buying a rotten old sports car. Instead, it inspired fragile reconstruction of the underwriting process by rather over-zealous insurance lawyers who, working backwards from the desired outcome, might build a case founded on the non-disclosure of things which might never have crossed the underwriter's mind. This was, of course, fuelled by the fact that it was not necessary for the underwriter to prove that they would not have written the contract at all, just that they would have done something slightly different, such as marginally increasing the premium (assuming that they also satisfied the not particularly onerous requirement of showing objective materiality – for which they may have turned to an expert underwriter who had just "retired" from the LMX spiral game). Consequently, this draconian "one size fits all" remedy was sometimes perceived as being out of all proportion to the actual "wrong" (if any) committed by the insured with potentially devastating consequences for it.

The English courts and arbitral tribunals became increasingly uncomfortable with this. More and more, judges and arbitrators were prepared to find that the non-disclosed information (or the misrepresentation) was either objectively not material or the underwriter was not induced. Consequently, the number of successful avoidance cases diminished significantly during the 2000s. This also coincided with a recognition on the part of carriers that if they kept pulling the pin on the avoidance "grenade" it would end up going off before it left their hand – because habitually declining claims is not particularly great for business.

This general discomfort with the old law resulted in the passing of the **Insurance Act 2015**. The "one size fits all" remedy of unwinding the contract no longer automatically applies. In the absence of fraud, the underwriter now needs to prove that they would not have written the risk at all in order to be able to avoid the contract. Otherwise, the remedy reflects and/or is proportionate to what the underwriter would have done had a fair presentation been made by the insured. For example, if an exclusion would have been applied by the underwriter, the claim will be dealt with as if the exclusion had been written into the policy. If the underwriter only charged 50% of the premium that, but for the breach, would have been charged, the insurer is only liable for 50% of any claims. And so on.

This seems all very balanced and fair. However, the problem now is one of proof and evidence. Not even the most diligent underwriter may have contemporaneously created evidence of what they specifically would have done in a hypothetical situation which they were not actually contemplating at the time, ie "If I had been told x I would have done specifically y". The result is that avoidance cases, or even cases seeking one of the new lesser remedies under the 2015 Act appear rarely to hit the courts. The evidential burden which an underwriter now needs to discharge in order to obtain any remedy at all may explain this.

Moreover, at least as concerns innocent express misrepresentations (as opposed to non-disclosure), insurance contract law is now arguably more restricted as regards the availability of rescission than general contract law.

Does this matter? The short answer is not really. The trigger-happy days of the 80s and 90s were something of an aberration driven, to some extent, by the turbulence of those times. The remedy of avoidance is and should only ever have been a remedy of last resort reserved for bad claims. This is especially important in the current circumstances where the spotlight is on the insurance industry. A bad claim tends to be bad whether you look at it through the prism of the 2015 Act, or not. Furthermore, a bad claim tends to be bad for a number of reasons, the least serious of which may be that the insured has been economical with the truth at placement.

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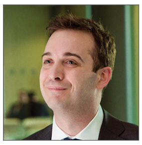

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