QBE EUROPEAN OPERATIONS

PROPERTY MATTERS

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Made possible QBE

Contents

Introduction

QBE was proud to be nominated for the British Insurance Awards, Major Loss Award, with a joint submission with AIG, Vericlaim and Yorkshire Water Services (YWS). The claim followed very significant and widespread flooding on 26/27 December 2015, causing damage to over 100 YWS facilities and potentially impacting over 3 million local residents. The collaborative approach ensured there was no direct disruption to customers and a successful outcome for all parties. Unfortunately, we did not pick up the award this year. However QBE did walk away with the award for Business Sustainability/Corporate Social Responsibility Initiative of the Year for our ground-breaking Premiums4Good (qbeeurope.com/community/qbe-premiums4good/) programme.

Since the last edition of Property Matters, the final chapter of recent insurance reform has been implemented, in the form of the Enterprise Act. The last 3 years has seen significant legal change for the insurance sector, after 100+ years of very little (Marine Act 1906). QBE welcomes the introduction of damages for late payment - we're known for taking a pragmatic and innovative approach to claims. When you make a claim, our goal is to get our customers back in business as quickly as possible by providing flexible support and prompt payments.

This month we also look at 2 interesting court judgments, the first considers breach of an insured's duty of utmost good faith, whilst the second looks at accidental or inevitable damage. The law regarding an insured's duty of disclosure changed following the introduction of the Insurance Act, so judicial application of the old, and new law, is worth considering. Both cases provide helpful guidance for property claims practitioners.

Finally, we undertake some horizon scanning and look at a recent report, which considered the potential increase for UK insurance losses as a result of windstorm. The correlation between global warming and frequency and intensity of windstorm, leads to some significant percentage point increases for insurance losses. Given the size of insurance losses following storms Desmond, Eva and Frank, the accurate prediction of significant weather events is critical for risk management and loss mitigation.

Enterprise Act 2016

Prior to the Enterprise Act 2016 (the Act) coming into effect on 4 May 2017, an insured would be unable to pursue a claim for damages suffered as a result of late or non-payment of the substantive insurance claim. The unfairness of such an eventuality has now been addressed and appears to conclude the recent tranche of insurance reform.

What's Changed?

The provisions of the Act relating to the late payment of insurance claims apply to policies written or renewed on or after 4 May 2017, where English law applies. The Act will make (re)insurers liable for damages caused by late payment of a valid claim (sums due under the policy), by introducing into every contract of insurance an implied term that the insurer pay valid claims within a "reasonable time" of when a claim is made (by inserting a new section 13A into the Insurance Act 2015).

The legislation is fundamentally aimed at first party claims, which will experience the most significant impact as the insured is pursuing their contractual right to claim (as opposed to an action against the insured in negligence). However, as the Act applies to all contracts of insurance, third party casualty and motor claims could also be affected, but to a lesser extent. The majority of third party claims will inherently involve a payment to a third party, who will have no statutory right under the insured's casualty or motor policy.

Key Aspects

Reasonable time

What is meant by "reasonable time" has not been defined within the Act, but will depend on the specific circumstances of:

- The type of insurance
- The size and complexity of the claim
- Compliance with any relevant statutory or regulatory rules or guidance
- Factors outside the insurer's control

As a valid claim must be paid within a reasonable time, it follows that an insurer will have a reasonable time to investigate and assess a claim based on the above factors. The lack of a specific and defined timescale may lead to some debate and accusations of delay – what's reasonable to one insured, broker or insurer, may well be quite different to another. At the very least, the Act places an increased onus on an insurer to communicate clearly, and regularly, throughout the period of investigation and assessment, particularly where there is some delay.

Whilst large and complex claims are likely to take longer to settle than small and straightforward claims, the question and answer to what is "reasonable", will be fact specific. A multi-million pound claim could be easier and quicker to resolve than a difficult, smaller value claim. If there are complex, technical and detailed investigations that have to be carried out, it is reasonable to expect that the process will take longer.

Compliance with any relevant statutory or regulatory rules or guidance will also be relevant (e.g. FCA Principles for Business, FCA Insurance: Conduct of Business Sourcebook (ICOBS), and Lloyd's Minimum Standards for managing agents). These will cover principles such as providing reasonable guidance to help an insured make a claim, giving appropriate information on the progress of the claim, treating insureds fairly, and communicating information in a clear, fair and not misleading manner.

The relevance and extent, to which factors are outside the insurer's control, will likely encompass situations where the insured delays in providing information or documentation, or the Loss Adjuster cannot get access to a property to make an inspection.

When a claim is made

The Act does not define when a claim is actually made, which could lead to further disagreement between insured and insurer. Simple notification of a loss or incident may not be sufficient to satisfy the Act for the purposes of making a claim, and thus won't be enough to "start the clock ticking" with regard to the "reasonable time" allowed. It is perhaps, more likely that the insurer will have to be provided with enough detail to consider and affirm policy liability, thus moving forwards to investigate causation and quantum. The involvement of a Claims Preparation Team or a Loss Assessor (instructed on behalf of the insured), may influence the determination of when a claim is actually made i.e. whether the claim is properly presented to the insurer (or representative), thus starting of the clock-ticking for when the period of "reasonable time" commences and finishes. It is anticipated that the question of when a claim is made will be the subject of satellite litigation and judicial comment.

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Enterprise Act 2016 (continued)

Key Aspects (continued)

Claims conduct

The conduct of both the insured (or broker) and the insurer will be relevant considerations, should there be an allegation of delay and late payment of the substantive insurance claim. An insurer will have a defence to a claim under the Act, if it can show that genuine grounds existed to dispute a claim or its quantum, during the period of investigation or analysis.

The Act represents an opportunity for the QBE claims team to exhibit our market-leading claims service. It also encourages proactive claims handling, encompassing consistent, timely and clear advice, throughout the lifecycle of the claim.

Damages for late payment

Any claim for damages for late payment will have to overcome the usual hurdles of breach, causation and foreseeability of damages. An insured will have to prove, on the balance of probability, that any loss has a causative link to the insurer's breach of the implied term. Where the delay is relatively short, or the sums due are relatively small, it seems unlikely that an insured will suffer a loss purely as a result of late payment. It will be for an insured claimant to prove their loss/claim, so the same rules of quantum-assessment will apply. The size and complexity of the losses will determine the evidence needed to support the claim i.e. forensic accountancy evidence, annual accounts etc.

Limitation

An insured's claim against an insurer for failing to pay a claim within a reasonable time will be a separate cause of action from the substantive insurance claim against their insurer. A new provision will be inserted into the Limitation Act 1980, providing that a late payment action will be barred one year after payment of all sums that are due in respect of the insurance claim.

Duty of utmost good faith

Dalecroft Properties Ltd v Underwriters Subscribing to Certificate Number 755/BA004/2008/OIS/00000282/2008/005 [2017]

The insured sought an indemnity under its property policy following a fire at its premises in 2009. The insurers avoided the policy on the basis of material non-disclosure/misrepresentation, principally relating to the description and condition of the Property. Alternatively, the insurers argued they had been discharged from liability due to breach of warranty (the proposal form contained a basis of contract clause) relating to the commercial un-occupancy conditions of the policy.

The court judgment set out a number of principles relating to the duty of utmost good faith (the Insurance Act 2015 did not apply in this case):

The duty to disclose arises only before the contract of insurance is formed or varied.

Each renewal is a new contract, so the duty to disclose arises again, but there is no duty to disclose facts which should have been disclosed at inception but which are no longer relevant. There is no duty to disclose a previous failure to disclose a fact, once material to the expiring risk, but no longer material, unless the prior non-disclosure was dishonest (and so raised a real question of moral hazard).

No duty to undertake any special enquiry.

Before the Insurance Act came into force, an insured did not have to undertake any special enquiry and was deemed to know only what he would be expected to know in the ordinary course of his business, making allowance for its imperfect organisation.

Materiality determined by relevance to the disputed fact.

The question of what is material is "not…something that is settled automatically by the current practice or opinion of insurers. Rather the decision rests on the judge's own appraisal of the relevance of the disputed fact to the subject-matter of the insurance". If a statement is one of "expectation or belief", it need only be made in good faith. However, if the statement is one of fact, the law imposes strict liability and it doesn't matter that the insured believed it to be true or had no reason to think it was untrue.

A statement that property is in a good state of repair is a representation of fact, not just a statement of opinion. Here, insurers had been told that refurbishment works were to be carried out, and so the confirmation that the property was in a good state of repair did not relate to the parts of the property which were to be refurbished. On the facts, the statement had been untrue. The insured had also incorrectly confirmed in the proposal form that there had been no "malicious acts or vandalism". Where intruders had ripped out tanks and piping in order to steal them, that amounted to both a malicious act and an act of vandalism.

Dividing the risk and voidance

If, on the true construction of the policy, the risks covered by the insurance are clearly separable into distinct parts, the policy will be voidable in respect only of those risks which are affected by the misrepresentation or non-disclosure. There were no grounds for dividing the risk here. Although certain policy conditions broken by the insured related specifically to the commercial parts of the property, they were directed at risks (including fire) which jeopardise the entire property. There were therefore no grounds for confining the effect of the insured's breaches of warranty to the commercial parts only.

The judge concluded that insurers were not obliged to indemnify the insured and that the same result would have been reached had the Insurance Act 2015 been in force at the time the policy incepted.

"The old law embodied in the 1906 Act is insurer-friendly, and may sometimes operate harshly to the detriment of the insured. Looking at the matter in the round, however, I am satisfied that the application of the pre-2015 Act law works no injustice to Dalecroft in the present case. The evidence satisfies me that Dalecroft made no real effort to make a fair presentation of the risk (as that expression is now defined in the 2015 Act[62]) to the Underwriters at renewal, and thereafter made no real effort to comply with the Commercial Unoccupancy conditions of the insurance. It also satisfies me that Underwriters would have declined the risk (i.e. would not have entered into the contract on any terms[63]) had a fair presentation been made at renewal. It follows that, even under the 2015 Act, Dalecroft's claim would have failed."

Accidental or Inevitable Damage

Leeds Beckett University v Travelers Insurance [2017]

A student accommodation block was built by the claimant in 1996 over an historic watercourse, which ran adjacent to the Leeds/Liverpool canal. In December 2011, large cracks appeared overnight and further investigation revealed that the building's supporting concrete blocks had "turned into mush" and the building was demolished in 2012. The claimant made a claim under its all risks building insurance policy (which was taken out in August 2011) estimated to be in the region of £10m. "Damage" was defined under the policy as meaning "accidental loss or DD destruction or damage" and various exclusions were included in the policy. Travelers declined indemnity, relying on the following exclusion clause:

"The insurance provided under this Section does not cover

1. Damage caused by or consisting of
   a. Inherent vice latent defect gradual deterioration wear and tear frost change in water table level its own faulty or defective design or materials....

But this shall not exclude subsequent Damage which itself results from a cause not otherwise excluded."

Much of the case turns on its facts, but in dismissing the claim, Coulson J summarised some key principles in the decision. He held as follows:

1. **"Accidental Damage"** simply means an event that occurs by chance, which is non-deliberate. Damage can occur due to an inherent vice, or by ordinary wear and tear, and still be accidental. However, to be accidental the event must be non-inevitable. Inevitably will be assessed from the time that cover was taken out. The claimant does not need to prove the exact nature of the accident and foreseeability is irrelevant.

   On the facts of the case, it was held that at the time the policy was taken out the damage was inevitable at some point during the policy period and hence was not accidental. Furthermore, there had been no flood, as argued by the claimant.

2. **"Gradual Deterioration"** was excluded under the policy. The judge rejected the claimant's argument that this meant deterioration of the thing itself (i.e. the building), without any influence from an external source. He accepted the insurer's argument that deterioration inevitably involved an interaction between the property being insured and its environment (i.e. the ground on which it stood). Furthermore, "gradual" meant something which develops over time. Here the damage happened over a period of at least 10 years and so this exclusion would have applied even if the damage had been accidental.

3. **"Faulty/Defective Design"** was excluded under the policy. The judge accepted that accidental damage can be the subject of an operable exclusion for faulty design. The insurer need only show that the design was not fit for its purpose: no negligence need be demonstrated. On the facts, the judge accepted that the design of the groundwater drainage had been defective.

4. **"Subsequent Damage"** The judge rejected an argument that the original damage was damage to the concrete and that the cracking was "subsequent damage". The claimant had sought to rely on an Australian decision (Prime Infrastructure v Vero Insurance [2005]) that an exclusion for damage caused by gradual deterioration or faulty design should not exclude cover for subsequent damage. The judge held that there was no subsequent damage here and, in any event, any subsequent damage was not caused by a cause "not otherwise excluded".

Horizon Scanning:

Climate Change to Increase UK Losses from Windstorm

Climate change will drive-up windstorm losses in the UK in coming years, according to a recent report from the Association of British Insurers (ABI), the Met Office, and catastrophe modeller AIR Worldwide. The report, "UK Windstorms and Climate Change," assesses the impact of global temperature increases on the frequency and intensity of UK windstorms, UK flooding and China typhoons, and the implications for the UK insurance industry.

The full report is available at: abi.org.uk/globalassets/files/publications/public/property/2017/abi_final_report.pdf

The report shows that temperature increases of just a small number of degrees are likely to lead to increased insurance losses for high winds, that could be 11% higher nationwide by mid-century and 25% higher by the end of the century. These temperature changes fall within the long-term projections of what climate change experts expect to happen and are based on Met Office analysis, which shows that even small increases in temperature are likely to shift stronger winds further north.

The report offers a detailed look at how specific areas could be affected. Increased losses are not spread evenly across the country, but are likely to be concentrated in Northern Ireland, northern England and the Midlands, while Southern England could potentially see decreasing losses from storms.

For the UK as a whole, a temperature increase of 1.5 degrees would increase insured losses by 11% percent, while an increase of 3 degrees would more than double the losses to 23%. In London, the losses are predicted to go down as the planet gets warmer. A 1.5 degree rise in temperature would result in 16% fewer losses, while a 3 degree rise would yield an 8% decrease in losses.

Matt Cullen, Head of Strategy at the ABI, said:

"In the midst of all the other global uncertainties, it is important we don't overlook the inevitable long-term impacts of climate change. Concerns about global warming often focus on rising water levels and the threat of flooding but this new research makes it clear the impact of other meteorological events such as high winds must not be overlooked.

"Severe storms result in claims costing billions of pounds. The likelihood of these claims increasing in the future is something the insurance industry, and society, need to start preparing for now. Planners and builders should be aware of the need for more wind-resistant construction in specific areas of the country if claims are to be kept to a minimum and residents spared the distress and expense of higher levels of wind damage."

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