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The reform of insurance warranties: a behavioural economics perspective

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J.B.L. 118 **Abstract**
Lawyers, when off duty, recognise that the way in which choices are presented matter to the decisions that people make. A critical leader piece (whether in The Guardian *or* The Telegraph*) on the framing of the question to decide Scottish independence would fit comfortably with this world view, and be considered unremarkable. However, suggest that the manner in which a commercial law statute is presented would have a similar effect on their drafting of a contract, and brows would furl. However, contracting behaviour in key insurance markets cannot be explained by reference to our standard model of economic rationality. This piece applies the behavioural economics of* Nudge *to the default rule for breach of insurance warranty, and in particular to the attempts to mitigate the strict default by means of the "held covered" clause. What emerges is substantial evidence of behavioural influence on contracting and a call for a non-directive statutory design.*

Introduction

In the land of neoclassical economics, commercial parties normally end up with the contract terms that they desire. Mostly, this is because of the permissive nature of contract law, with parties free to displace existing default rules. [1] Where legal rules are not mandatory, the law and economics movement stressed that law's role is to minimise the costs of choosing a replacement. It should not concern itself with the content of the default rule. Put simply, the rule laid down in the case or statute is of little importance if parties can cheaply and easily choose an alternative. Law's mission in such cases is to keep out of the parties' way. Arguments as to the fairness of the default rule are meaningless; the response is always: make it easy for the parties to choose a better rule for themselves. From this comes the central tenet of much of commercial law: that legal certainty is the dominant policy objective in rule design. That way parties are able to rapidly assess the default position, and select an alternative if desired. Thus party autonomy and the free market are protected by clear, simple rules. ***J.B.L. 119***

The example taken for our commercial law default rule is the "promissory warranty" in marine insurance law. The remedy for non-compliance with these terms was codified in s.33(3) Marine Insurance Act 1906:

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

In many marine insurance contracts, the strictness of the default "automatic prospective discharge" rule in s.33 is unwarranted and the parties negotiate an alternative. Commonly, it is added to by a form of "held covered" clause. Such clauses allow for the continuation of cover provided the insured gives notice, and the parties reach agreement on additional premium and/or terms.

The fundamental question is why parties adapted the s.33 warranty with a complex contractual amendment, when simpler models were available. This article argues that the held covered amendment of the s.33 rule is a result of behavioural influences on contracting, in particular, the pull of the "status quo bias" by which contracting parties tend to seek to maintain or amend existing contractual defaults even where this is inefficient. If true, then this is evidence that the foundations of neoclassical economics are built on sand. It would be further evidence that contracting parties are not rational, welfare-maximisers but humans with the cognitive limitations that brings.

Put simply: are we really sure that the manner in which legal choices are presented to us do not tilt our preferences towards certain options? And if it is true that our preferred contractual outcomes are shaped by the content of default rules, what can be done about it?

A brief introduction to behavioural and neoclassical economics

The basis for selecting contractual defaults is not commonly discussed in English contract and commercial law. [2] In this section, we consider the approaches suggested by lawmakers, economists and psychologists in light of the current attention being paid to behavioural economics as a system for state action.

The promise and limits of law and behavioural economics

Historically, the intersection of law and economics rested on the assumption that people behaved in a welfare-maximising fashion. The "rational choice" doctrine developed over time, with the recognition that the costs of obtaining and processing information placed boundaries on rational behaviour. Rightly, Ronald Coase receives credit for his insights into transaction costs in the seminal work "*The Problem of Social Cost*". [3] On this basis, people would make sub-optimal choices ****J.B.L. 120*** because the *costs* of making a better choice outweighed the *benefits* to be obtained. However, neoclassical economics of this type had little to say about irrational behaviour, despite that being an everyday part of human existence. It struggled to explain sub-optimal behaviour in circumstances where a better solution was readily available at no (or minimal) extra cost. This gap in the literature is increasingly being filled by "behavioural economics" by which human behaviour is modelled by reference to psychological theories and observational data. This new model of human behaviour was popularised in *Thaler and Sunstein's Nudge: Improving Decisions about Health, Wealth & Happiness* [4] but is based on a more extensive academic literature to which Thaler and Sunstein are merely two contributors. Many of the case studies discussed in *Nudge* have become legendary:

- the "fly" painted on the urinals at Schipol airport that reduces the amount of urine that misses its intended target and thereby reduces clean up costs [5];
- the converging painted road markings in Chicago that gives the optical illusion of driving faster than is actually true, prompting drivers to brake near accident black spots [6];
- that doctors are more likely to recommend an operation if told that "ninety of 100 patients" are alive after five years, than if the information is stated as "ten out of 100 patients are dead". [7]

Despite these apparent advances in our understanding of human behaviour, it must be underlined that it remains an incomplete model. Given the complexity of human cognition, it is not surprising that even relatively simple activities such as the negotiation of commercial contracts are not totally understood. The decision-making rules of thumb (heuristics) considered in behavioural economics are complicated in the real world by their interaction with each other and with underlying rational behaviour. The position adopted in this article is that the "behavioural economics" model of human decision-making is the best currently available model for mimicking commercial decision making, but for all that, it remains a theoretical model, and is unlikely to perfectly replicate reality. This scepticism is often absent from the behavioural economics literature (indeed from many branches of economics). Thaler and Sunstein derided neoclassical economics as limited to "econs" (fictional "rational choice"

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motivated beings) unlike the "real people" they considered.[8] In reality, many of their examples of contracting behaviour are either derived from observations made in pseudo-laboratory conditions or where neoclassical "bounded rationality" approaches might provide similar predictions. That said, it is much better than the model of human behaviour found in much of the discussion of commercial law in the United Kingdom. As a marine insurance lawyer might put it: "In the land of the Nelsonian blind, you don't need much of a telescope to be King …." ***J.B.L. 121**

The rise of Nudge within political science

It is worth pausing at this moment to note the rapid rise in behavioural economics as a guiding principle for Anglo-American political elites. At a time when the Law Commission is seeking legislative approval for its reform project, it might be useful to peg it to the smart regulation agenda. Richard Thaler advises David Cameron on "smart regulation" in the United Kingdom and Cass Sunstein is President Obama's Regulation Czar.[9] This centrist appeal is predictable. Their "Libertarian Paternalism" agenda appeals to the centre left as a challenge to hegemony of neoclassical law and economics. After all, it is about "real people" and not just economic values. Moreover, to the centre right it can be projected as a form of "soft" paternalism. It seeks to influence people to make the "right" decision without extensive state interference. It smacks less of "nanny state" and more of "small state": promising social improvement without direct government interference. Thus the Coalition Government may use "hard" paternalism to criminalise your cannabis, moderate paternalism in taxing your alcohol, but will employ soft nudges to shift you towards eating more salad.[10]

Behavioural economics, nudges and choice architecture

The attention in this piece is on the nudges inherent in "choice architecture". This is the assumption that the manner in which choices are presented can affect the eventual outcome. This is intuitive, but a challenge to commercial law: many lawyers who would assume that the framing of the Scottish referendum question could affect the outcome would blissfully apply a statute without considering whether the way the statute is framed has a similar subtle influence on the choices they make. This point should not be overstated. It is crucial to recognise that influences are often weak, and may be readily overcome by a firmly minded individual. What will be visible are the effects across a population. Thus the framing of the question is unlikely to alter the voting patterns of committed Scottish Nationalists, but may still influence marginal cases.

Karen Yeung, in her excellent review article, "*Nudge as Fudge*",[11] noted the failure of Thaler and Sunstein to recognise the variable standards on which their proposed nudges operate. Some attempt to shift defaults in favour of a paternalistically favoured option (making organ donation opt out, rather than opt in) whereas others seek to alter our perception of reality (using optical illusions to nudge drivers to slow down own bends). Using behavioural economics to alter choices remains controversial. However, in this piece our focus is different. In high stakes insurance contracts we do not wish to alter parties' preferences in contracting, but to ensure as best we can that their preferences are not altered by the manner in which the choices are presented. This reversal of the normal use of behavioural economics is crucial. We do not need to justify the use of paternalistic behaviour, whether soft or hard in nature, as we wish to leave the parties to choose ***J.B.L. 122** for themselves. Our mission is to remove the unintended nudges that the codification and practice of commercial law has institutionalised.

Put together, this can be represented as resting on two key assumptions:

1. In high value insurance contracts (e.g. much of marine insurance), lawmakers will not wish to use choice architecture in a directive manner (as we might in consumer insurance law) but to ensure that law does not inadvertently direct contracting parties towards a particular outcome.
2. In doing so, there is no claim that such unintended nudges dominate choices made in the marketplace. Such influences can be overcome: it is a weak force. But just as the framing of the referendum question will have effects across a population, so would choice architecture. It should be remembered that in physics terms, gravity is a weak force. It can be readily overcome, but it takes effort to do so.

Nudges, transaction costs and the design of commercial law statutes

Behavioural economics provides a substantial challenge to pre-existing models for the design of commercial law rules and statutes. This is best demonstrated by an investigation of the framing objectives stated by lawmakers. In particular, we are concerned with the purpose of the default rules created by precedent and Parliament. In each case, we will assume that the rule

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stated is subject to contrary party intention, and that law makers intend no "nudge" towards any given outcome. We start with the 18th-century design of English commercial law by the judiciary and the Victorian codification of marine insurance contract law.

Version 1.0: the content of defaults does not matter

"In all mercantile transactions the great object should be certainty: and therefore, it is of more consequence that a rule should be certain, than whether the rule is established one way or the other. Because speculators in trade then know what ground to go upon." [12]

Lord Mansfield's plea for legal certainty above all things in *Vallejo v Wheeler* determines that the framing of the default is immaterial as long as its position is certain, for the parties can then choose their own preferred option. This objective runs as a clear thread through much of the design and partial codification of insurance contract law. In Mackenzie Chalmers's preface to his original digest on marine insurance law (the basis for the Marine Insurance Act 1906), he proclaimed:

"In dealing with rules of law, which may be modified by the stipulations of the parties, it is to be borne in mind that the certainty of the rule laid down is of more importance than its theoretical perfection. ***J.B.L. 123** " [13]

Chalmers was dogmatic that the diffuse nature of judicial precedent frustrated commercial practice. As Ferguson noted, Chalmers' codification ideology is consistent. [14] He was not interested in nuanced complex rules as default positions, but preferred clear rules, even if inefficient:

"The object of the man of business is not to get a scientific decision on a particular point, but to avoid litigation altogether. On the whole, he would rather have a somewhat inconvenient rule clearly stated than a more convenient rule worked out by a series of protracted and expensive litigations pending which he does not know how to act." [15]

Whatever the strengths of Mackenzie Chalmers, he was not a specialist insurance lawyer. Many complex nuanced patterns of commercial behaviour prior to 1906 were not replicated in the statute. Moreover, his view of commercial practice naturally failed to account for transaction cost economics later developed by Ronald Coase and others. In the real world, it will often be expensive to draft and negotiate an express contractual term to replace a statutory default. Policy-makers ought then to choose defaults that reduce the overall expense that contracting parties must incur to contract out of an inefficient default. Commonly, this has been assumed to be solved by picking the default that most contracting parties would have chosen (the "majoritarian default"). That way, the majority need not draft an express clause, they can adhere to the statutory rule. This "transaction cost" analysis shifts us from Victorian Britain to the law departments of American universities in the latter half of the 20th century.

Version 1.1: defaults only matter where transaction costs are high

"Once the costs of carrying out market transactions are taken into account it is clear that such a rearrangement of rights will only be under taken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about." [16]

Under a transaction costs analysis, lawmakers would only be justified in being indifferent to the content of a default rule where the costs of selecting a preferred alternative are low or nil. The development of transaction cost theory would therefore require Mackenzie Chalmers to revisit his method of default rule selection. One way of minimising the magnitude of transaction costs across the market is for the law to mirror what most parties would set as the default (the majoritarian default). However, this is not the only credible method. Just as Karen Yeung described utilising nudges with her two-year-old child, [17] so I employ a range of defaults with my two infant school children. These would include:

- the majoritarian default—where I seek to imagine what they would have consented to before conflict arose (share equally); or ***J.B.L. 124***
- the penalty default: "if you don't settle this dispute quietly, *I will eat the cake* you are arguing about"; or
- the information forcing default: "one of you will cut it in half, the other gets to choose which half she wants", etc. [18]

This is a clear advance on the Mansfield and Chalmers statements that defaults do not matter. With transaction costs included, we see defaults as significant in setting the costs that parties will bear in contracting around the default. The question is how to minimise these costs, not just in individual cases, but across the entire market. Choosing the rule that most people would have selected is a useful starting point, but is incomplete. What if, for example, a substantial minority would incur vastly increased costs in contracting around the default chosen by the majority? As Ayres and Gertner noted in 1989:

"Few academics have gone beyond one-sentence theories stipulating that default terms should be set at what the parties would have wanted." [19]

Ayres and Gertner challenge the assertion that the most efficient default rule is always the majoritarian default (the rule most parties would have chosen). They suggest that in some cases it will be more efficient to impose a "penalty default", a rule which the parties would *not* want, to force them to renegotiate. However, the bases on which they do so have little relevance to a commercial insurance market. They make the prediction that some parties will elect to remain with an inefficient rule, rather than reveal privately held information about the loss allocation under the default. As they put it, I will not increase the overall efficiency of the contract (make it a bigger pie) if in doing so I decrease my personal profit (by substantially reducing my share of the pie). In an insurance market, this would mean an insured not challenging the imposition of an inefficient clause if in doing so it would reveal, for example, its hidden purpose for seeking insurance. That risk, that parties would conceal private information to maximise personal return, is substantially curtailed in the insurance market by the existence of a wide variety of information-shifting rules requiring the sharing of information. Chief among these information-forcing rules would be the duty of pre-contractual disclosure, [20] but this "information sharing" effect is increased by the implied limits on coverage inherent in the doctrines of seaworthiness [21] and fortuity [22] among others. We assume therefore that a Coasean transaction cost analysis of breach of warranty would favour a majoritarian default: the rule that most parties would have chosen for themselves.

Assuming that the selection of a default rule for breach of warranty falls within the general class of majoritarian defaults, what are we to make of s.33 ? Does it represent what most parties would choose? In the absence of data, we need to operate on the basis of a number of informed assumptions: ***J.B.L. 125**

- "Ordinary" transactions costs in the marine insurance market are relatively low. We would expect expert advice to be routinely available to both contracting parties.
- The potential costs of innovating by designing a new default are potentially high. However, underwriters wishing to seek to modify existing statutory default rules have institutional support from the Lloyd's Market Association and others. [23] These support structures provide possible modifications to standard form contracts on a regular basis to adjust to market conditions.
- The duties of disclosure, and other implied terms (such as seaworthiness) force parties to share a considerable amount of private information about the risk.
- The extent to which the underwriter will hold the insured to strict compliance with a risk governing term is a factor in determining the price.

If s.33 were acting as a majoritarian default then we would expect most insureds to be satisfied by the trade-off between reduced coverage under the policy and the reduced price that flows from that. The statutory default would not be normally subject to variation by express term. However, over the last three decades the standard Hull & Machinery and Cargo clauses have seen a shift away from the strict warranty regime towards more nuanced positions, often suspending cover during non-compliance or requiring proof of a causal connection between non-compliance and any subsequent loss. [24] So, even if it represented the majoritarian position in 1906 (and 1976), it probably does not do so now. It has, over time, revealed its nature as a penalty default favouring the underwriter. The difficulty with this is well known: "one side's penalty may be the other side's windfall. One-sided penalties can create incentives for opportunism." [25]

If this analysis is correct, the current statutory default places the insured at a disadvantage. If it wishes to contract away from the maximal level of protection awarded to the underwriter by s.33, it must seek variation of the default. The underwriter, by contrast, has no incentive to move from the default unless market conditions dictate. The shifting patterns in risk governing terms over the last three decades (from automatic discharge of liability to a more balanced regime) suggests that the default term no longer represents what most parties would choose.

If the predictions of neoclassical law and economics are accurate, we ought to see near optimal contracting in high value marine insurance contracts. In particular, the content of the default ought to have a vanishingly small influence on negotiations. Under transaction cost theory, if an alternative rule could be implemented with limited additional cost, the parties would ignore the

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default rule unless it was optimal. Coase would predict that s.33 would be left behind and replaced entirely with a more suitable model. This assumption, "preference exogeneity", is fundamental to the remainder of this article. If neoclassical economics is correct, what the contracting parties want would be entirely unaffected ***J.B.L. 126** by the content of the default rule. Once s.33 was recognised as sub-optimal (and it is often altered by express terms in real life) then the parties' choice of a new rule should ignore s.33. They should look dispassionately at all other possible legal regimes and pick the one that provides the best net improvement in their position. Transaction cost theory would expect them to pick the most efficient replacement, unless the costs of drafting, negotiating and implementing that regime are significantly higher than other rules. If, however, we can show that the default has a lasting impact on the parties' negotiating positions, even where transaction costs are low, then neoclassical economics is flawed. Thus, if parties seem to be drawn to rules close to the default position, where objectively preferable rules are available, then this suggests that the default casts a shadow over the parties' preferences in a manner not predicted by Ronald Coase.

To reiterate: under neoclassical law and economics, the economically rational individual (or "econ") is only interested in the efficiency (or lack thereof) of the default, and the relative cost of implementing an alternative. This is why transaction cost theory tells us to (normally) pick what they would have chosen, so that they do not have to take the trouble to do so. However, if there is evidence that parties are more subtly influenced by the default, then neoclassical economics is an incomplete explanation of human behaviour. It would hardly be a surprise to find that this is the case: it was surely more a mathematical model than a real world simulator. Behavioural economics is then faced with finding a solution to this conundrum.

Version 2.0: Doubts about the limited effect of defaults …

"This is not to say that law and economics scholars did not believe that people's actions deviate at times from the optimization assumption of [rational choice theory]; rather, that this aspect of reality was simply not useful for the purpose of devising legal policy because deviations were random and unpredictable, because competition would drive such errors out of legal markets, or because adding new elements to behavioral models would complicate analysis to the point that prediction would become impossible". [26]

The challenge to the design of contractual default rules under neoclassical law and economics principles has been led by Russell Korobkin, professor of law at UCLA. In his mind, the battle has been won: his most recent article was entitled "*What Comes After Victory for Behavioral Law and Economics?*". [27] The defeated combatants in this battle would be Lord Mansfield, Sir Mackenzie Chalmers and Ronald Coase. An impressive haul!

What Korobkin claims to have established is that the outcomes preferred by parties to contractual negotiations are shifted by the default position adopted by law. In particular, the "status quo bias" established by psychologists has a demonstrable impact on commercial contracting. As a heuristic, this would mean that the default rules that law imposes have a subtle "drag" on our preferences. It would appear that what we want from our contract is as malleable as what we want ***J.B.L. 127** for our birthday. While statutes may not deliberately advertise a state sponsored outcome (at least not in commercial law), they can have an influence on our view of the ideal. This means that when negotiating a contract, parties will favour answers that reflect or are built on the default rule, over models that are more efficient but further removed from the default.

Take our example of marine insurance and risk-related clauses. The statute provides a single default for express terms that govern the insured's risk related behaviour (the s.33 warranty) even though other models of risk regulation exist. [28] If Korobkin is right, then the s.33 warranty will provide the starting point for negotiation even where it is inefficient, *because* it is the default. As noted in the introduction, these subtle influences can be overcome: lawyers do choose models other than the s.33 warranty. However, the effort of overcoming that inertial drag of the default would mean it would have greater influence and prominence than its relative efficiency would merit.

Why does this matter? If we are to redesign the statutory face of (marine) insurance contract law, then we might challenge the s.33 approach of a single clear default. This would run contrary to the counsel of Lord Mansfield and Mackenzie Chalmers, but might improve overall efficiency. Before we accept this challenge to large swathes of commercial law, we ought to examine the evidence that Korobkin and others use to support their theory.

Decision-making, heuristics and the evidence for "sticky" defaults

The general theoretical work that underpins the behavioural analysis of default rules is found in the Nobel prize winning work of Amos Tversky and Daniel Kahneman. [29] In "*Judgment under Uncertainty: Heuristics and Biases*", [30] they detail the types

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of heuristics that individuals use when making decision about certain future events. This is what contracting parties and their agents must do: establish which contractual terms best fit the likely behaviour of the parties in the future. In respect of risk related terms, the insurer is seeking to commit the insured to certain behaviours that will mitigate the level of risk during the policy.[31] Even if the parties are agreed on the behaviour controls that are required (not navigating the vessel into areas of increased risk such as war zones or high risk piracy areas), they need to establish a remedy for non-compliance.

The most likely decision-making heuristic to give rise to error in insurance negotiations is "anchoring". In such cases, estimates of an unknown figure tend to cluster around the suggested starting point. So, when Tversky and Kahnemann asked students: is the percentage of United Nations members that are African nations higher or lower (and how much higher or lower) than *x* ? When *x* is set at 10 per cent, the median guess is 25 per cent. When *x* is set at 65 per cent, the estimate is nearer 45 per cent. The human brain estimates unknowns by reference ***J.B.L. 128** to the initial starting point. Such errors are not merely the preserve of students; empirical evidence suggests that professionals use similar rules of thumb:

"Although the statistically sophisticated avoid elementary errors, such as the gambler's fallacy [hot streaks], their intuitive judgments are liable to similar fallacies in more intricate and less transparent problems."[32]

It is this anchoring behaviour that will encourage contracting parties to start with the default rule provided by law as the basis for agreement and renegotiation. Behavioural theory would predict that even if the default is judged to be unsuitable, they will seek to make amendments to the default to make it fit. This is linked to the human tendency to weight losses caused by positive action more heavily than losses caused by inaction. Contrast this with our "econs" from Ronald Coase's work above. The purely rational would ignore the position adopted by the default, and simply estimate the net benefit of scrapping the default and replacing with a more efficient rule. Humans do not appear to normally solve problems in this way. We do not wish to "reinvent the wheel" even if what we need are skis.

This anchoring technique operates with conjunction with an additional heuristic: herd behaviour. When making decisions, we consider the behaviour of those around us faced with the same decision. This behaviour is often rational, but goes beyond the rational in predictable ways.

The social pressure to conform was found to be substantial in test subjects. Following Asch's work, Sunstein repeated an experiment with audiences from across the globe.[33] In this study, when planted members of the test audience gave public and incorrect answers to simple questions, the number of incorrect answers from neighbouring test subjects jumped from nearly nil to 20 to 40 per cent. So, people often give what they would know to be inaccurate answers because of the responses given by others around them. This clearly goes beyond any rational reliance on other's expertise. We look to others to inform as to what is right, or fashionable, or efficient. As Malcolm Gladwell puts it, these individuals act as "mavens", inspiring others by their accumulation of information from a wide variety of sources.[34] Often, our trust in others is well placed: they have chosen a good restaurant, or nice-looking clothes. However, emulating others can also institutionalise errors.

Any suspicion that this potential irrationality surfaces only in the poorly educated or inexpert needs to be met head on. The best counter example is Sunstein and Thaler's evidence that federal judges' voting patterns are influenced by the composition of the bench.[35] Specifically, Republican appointees voted more liberally when sitting with two Democrat appointees and vice versa. As with all of these heuristics, they are not uniform in their impact on individuals. One might suspect that the voting patterns of Lord Denning M.R. are less indicative of herd behaviour than many others. ***J.B.L. 129**

This herd behaviour is likely to be particularly significant in subscription markets, such as the Lloyd's insurance market. This is a commonly used marketplace for the marine insurance products under consideration. Common practice is for the broker to approach a "lead underwriter" as an expert in the particular risk to be insured for indicative agreement on the terms and price. With this in place, the broker will take the slip around the market seeking other underwriters to contribute to coverage. If successful, each underwriter will undertake an agreed percentage of the risk, for the corresponding portion of the premium. The following underwriters will trust to the judgment of the lead underwriter because of its expertise and reputation.

The decision made by the lead underwriter is publically displayed as part of the contracting process. Generally, following underwriters will have to accept or refuse the contract terms set. This combination of factors means that individual underwriters are very unlikely to challenge the status quo. Rather than undertake an individual assessment of the most efficient term, parties are likely to follow an established norm, where one exists. This will often be entirely rational behaviour, as lead underwriters will normally possess genuine expertise and profitable contracting opportunities can be gained by following its decisions. However, routinely following the lead underwriter's assessment will tend to crystallise views of efficiency.

The combined effect of these heuristics is that contracting parties will tend to make minimal changes to a default in order to improve it. Having done so, others will tend to copy that behaviour (even if inefficient to do so). Not all humans will display these tendencies to the same degree, and strong evidence of inefficiency will trigger reconsideration. Just as the framing of a referendum question, or the use of clever advertising, would not have an identical effect on all recipients, so behaviours across the market will vary, but it will tend towards these norms.

Testing the behavioural explanation: the mystery of the held covered clause

What evidence is there of these heuristics at play in the insurance market? Without controlled experiments on Lloyd's brokers and underwriters, we need to look for evidence elsewhere. Rather than seek experimental evidence, by having law students mimic market players, we can examine the development of modifications to the s.33 rule. In particular, we examine the held covered family of clauses.[36] If there is evidence that parties "clustered" around the default rule, even where it appears to be inefficient, this is preliminary evidence of "sticky" defaults.

Bennett cites cl.10 of the Institute Cargo Clauses (A), (B) and (C)[37] as a "classic" held covered clause: ***J.B.L. 130**

"Where after the attachment of this insurance, the destination is changed by the Assured, held covered at a premium and on conditions to be arranged subject to prompt notice being given to the Underwriters."

This clause removes the normal remedy for a change of destination (immediate loss of cover) and replaces it with an extension of cover to include the new risk providing that prompt notice is given, and the bargain is amended as the underwriter requires.

Bennett then explains the use of held covered clauses in the following terms:

"[T]he doctrine of alteration of risk [of which s.33 is a part] … may be viewed as inflexible and weighted heavily in the insurer's favour, ultimately it serves to provide clear and certain *prima facie* rules and *as a basis for negotiation of terms relaxing the severity of the default position*."[38]

This is Korobkin's point writ large. The default is the basis for renegotiation, even where it is admittedly one-sided. This is behaviouralism, not rational choice theory at play. However, this needs to be tested more fully. Before doing so, the function of insurance warranties, and their amendment by held covered clauses, needs to be explained.

The natural history of the held covered clause

Before we can appreciate the development of the held covered clause, we must understand the warranty and the doctrine of alteration of risk. The function of the promissory warranty codified in s.33 is well established. It makes the insurer's continuing liability conditional on the insured meeting certain standards of conduct. These requirements are normally an attempt by the insurer to keep the insured risk within agreed limits. Otherwise the insured would be indifferent to the occurrence of an insured peril because the insurer would bear the cost of the loss. By requiring the insured to maintain certain risk management standards, or face becoming uninsured, the underwriter can require the insured to continue to invest resources and attention to minimising losses. This is to the advantage of the insurer, and as Abraham argues, in the interest of wider society.[39] Better to invest in advance to avoid a loss than to compensate for it ex post. Moreover, it closely defines the limits of the underwriter's potential liability, and thereby enables accurate pricing of the risk. The express warranties in the insurance contract are supplemented in marine insurance law with a range of implied obligations to keep the risk within the terms of the agreement.

The problem is the rigidity of the mechanism by which the insured is tied to performing its risk management: automatic discharge from liability. As Clarke notes:

"A tension remains between the purpose of promissory warranties, to control the behaviour of policyholders, and one of the very purposes of insurance ***J.B.L. 131** itself, to indemnify policyholders for the consequences of the carelessness which is only too normal among mere mortals."[40]

What is clear is that the extent to which the strictness of the promissory warranty is deemed acceptable has shifted appreciably. Clarke identifies the clear shift from 1802 to 2007: in 1802: "if the insured 'did not mean to perform, he ought not to have bound himself to such a condition'." [41] And in 2007: "From the viewpoint of policyholders and most courts, current law leaves too much unregulated discretion to insurers; and too little certainty of cover for policyholders." [42]

By contrast, relatively little has been written about the origins of the held covered clause, although some light is shed on the matter by Long. He suggests that the initial basis of the clause was to cover inadvertent breaches of risk related terms, where the insured could not be aware of the loss of cover in a timely manner. This would chime with Clarke's view that the insurance warranty as codified does not sufficiently take account of inadvertent breaches. Long's tentative conclusion as to the initial function of the held covered clause was based:

"[S]olely upon a review of the historical conditions and problems that produced the clause originally, i.e., oftentimes a master breached a trading or other warranty under circumstances beyond the control of the assured and without his prior knowledge and, communications being slow or inadequate, in the absence of a 'held covered' clause the policy was avoided and a loss sustained before the owner could procure additional insurance to cover the vessel." [43]

This analysis is consistent with the behavioural economics argument that parties to marine insurance contracts seek to modify the existing default rather than simply replace it with a more efficient express clause. It is the "status quo bias" as predicted by Korobkin. The choice of an express clause in the form of a held covered would only be rational if the costs of drafting and administering the express clause are less than the costs of any other replacement rule (such only discharging liability where the breach and subsequent loss are causally connected). Given the extensive problems with the held covered clause detailed below, it is submitted that this "transaction cost efficiency" explanation is highly unconvincing. This hypothesis is tested in the following sections by seeking to estimate the likely costs of following a held covered regime, in light of the legal issues that arise.

Let us start with a hypothetical scenario: imagine a world in which the s.33 warranty and the held covered clause had not been introduced by the market or statute. Imagine instead that an academic proposed the following proposition as a basis for law reform: What would be the response of fellow academics, and the market?

Proposition A: Risk related terms shall be construed as subject to strict compliance. Non-compliance gives rise to automatic loss of all prospective liability, but is mitigated by an opportunity (duty?) to give notice to the underwriter and negotiate amendments to terms, price, etc. ***J.B.L. 132***

It is likely that this would be immediately rejected on the following bases:

1. the term is unbusinesslike as parties cannot know their respective rights and obligations on breach (lack of legal certainty); and
2. the term gives rise to a number of unresolved legal questions, namely:

    (a) If not carefully worded, the clause might be unenforceable as an "agreement to agree".

    (b) The clause fails to clarify whether the underwriter is obliged to extend the contract or the insured obliged to give notice of breach of existing cover.

    (c) The clause fails to clarify the consequences of a failure to give timely notice.

    (d) Section 31 of the Marine Insurance Act 1906 imposing a reasonable premium in the absence of agreement is of no use when the parties fail to agree terms, or where the market premium is not commercially viable.

    (e) While it is agreed that the duty of utmost good faith applies to the extension of cover, it is unclear what remedy would arise from non-compliance.

These issues require discussion in some detail. Our initial focus is the inherent uncertainty of a legal rule that requires renegotiation on non-compliance. This is followed by consideration of specific legal issues arising out of held covered clauses.

The lack of legal certainty

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The held covered clause seeks to establish markers for the circumstances in which an insurer would rely on a strict legal rule discharging it from liability. It envisages renegotiation (inherently uncertain) following the giving of notice within a reasonable period of time. Where agreement cannot be reached, a reasonable additional premium will be payable, [44] and some commentators have suggested that an obligation on the underwriter to negotiate reasonable variation of the terms limiting cover would be imposed. [45] Taken as a whole it represents an extremely uncertain legal regime, designed to mirror commercial practice (the "spirit of the agreement") rather than provide precise boundaries. I suggest that most commentators seeing this rule for the first time would view it as too uncertain to be efficient. Indeed, it is so uncertain as to be borderline unenforceable. Yet we are expected to believe by Coase that this is the most efficient rule that parties could devise in response to s.33.

This immediate section details the costs of a default rule that fails to clearly identify the legal positions of the parties. This is the costs of uncertainty not of law, but of outcome. The second source of transaction cost: the unresolved nature of some fundamental aspects of the legal nature of the held covered clause is considered in the subsequent section. ***J.B.L. 133**

Given that "legal certainty" has a variable meaning, a definition is required. [46] For these purposes, we mean by "uncertainty" the lack of predictability inherent in adopting "open textured" principles for adjudication (such as "reasonableness"), by contrast to the perceived clarity of set rules. [47] The selection of clear, simple rules over principles (or standards) of behaviour is said to be a founding principle of English commercial law. As noted above, it represented much of the judicial lawmaking and codification strategies of Lord Mansfield and Mackenzie Chalmers. The need to maximise legal certainty is commonly asserted without further proof or comment in commercial law journal papers. [48] Even where considered in depth, most commentators favour certainty. Take for example, Iain MacNeil, writing in the *Edinburgh Law Review*:

"If a default rule is uncertain, it cannot properly fulfil its function as gap filler. This is because uncertain default rules create risks for the contracting parties when they decide what must be expressly agreed and what can safely be left to the general law, with the likely result that increasing use will need to be made of express terms." [49]

Whatever the merits of MacNeil’s arguments, this shows that a default based on a principled measure such as a held covered clause would be likely to be met with resistance. He clearly favours clear rules over amorphous principles. Similarly, the value of legal certainty as a means of reducing the cost of business has been highlighted by those reviewing the Law Commission’s proposals for insurance contract reform. So, Soyer argued:

"They [the Law Commissions] are not only proposing radical changes to restrict the extent of the doctrine but also seriously contemplating varying the range of remedies available when the doctrine is breached … these new parameters are very fact-intensive and have the potential of injecting a considerable degree of uncertainty into law …." [50]

The contention is therefore a simple one: academic commentators reject the dilution of the strictness of the insurance regime on the basis of legal certainty but uncritically accept the held covered clause as a pragmatic market response to a strict default rule. If the held covered clause were the product of academic imagination, rather than market professionals, we would view it as unacceptable. It is deemed acceptable because it is an amendment of the default rule, and *not* because of its own merits. This is because academics, like insurance professionals, are drawn to incremental reform of established defaults rather than starting from scratch. We are all human, and respond to legal problems in a human way. ***J.B.L. 134**

If the lack of legal certainty were not enough in and of itself, the doctrinal difficulties caused by the held covered clause are legion. A representative survey is detailed below, as further evidence of the inefficiency of the current position.

Unresolved legal issues

As evidence of the likely transaction costs of the held covered amendment, we can identify six overlapping areas of substantive legal difficulty. In each case, serious doubts are raised about the legal effect of the clause. In some situations the issues are clause specific, and will not be common to all held covered clauses. However, most arise out of the nature of the clause itself.

The held covered clause as an agreement to agree

The ability of parties to bind themselves to "agreements to agree" or similarly "agreement to negotiate" is considered in depth in *Chitty*. [51] If the "held covered" clause is an agreement to agree or to negotiate, it is of no legal effect, as such clauses have been held too uncertain to be enforced. Moreover, such clauses cannot be saved by implying an additional obligation to negotiate in good faith to agree. That is also unenforceable for lack of certainty.[52] If the held covered clause is merely permissive (cover is extended *if* the underwriter agrees to it) then this adds little to the freedom of the parties to renegotiate a contract, provided consideration is provided. Moreover, it would offer little protection to the insured facing a lapse in cover.

Given the real danger that many held covered clauses would not be legally enforceable on this basis, they must represent the least efficient amendment that could be made. It is little better if the effect of adding enforceability is that the clause becomes merely representative of the general common law right to mutually renegotiate contractual standards. Either way such clauses would appear to be of limited efficiency.

The held covered clause: obligatory or permissive?

While some held covered clauses have sought to clarify the obligations of the underwriter and insured under held covered provisions, this is not universally true. Bennett argues convincingly that this is a matter of interpretation and not a rule of law. As he notes, in a number of modern clauses the position is left unclear. In the most recent Institute Cargo Clauses produced (2009), there appears to be an obligation on the insured to give notice (irrespective of whether it wished to extend cover) but no obligation on insurers to agree to the extension:

"Where, after attachment of this insurance, the destination is changed by the Assured, *this must be notified* promptly to Insurers for rates and terms to be agreed. Should a loss occur prior to such agreement being obtained cover *may be provided* but only if cover would have been available at a reasonable commercial market rate on reasonable market terms. ***J.B.L. 135** "[53]

If we recall the original intended purpose of this clause, to provide seamless cover for insureds following inadvertent breach, we can see the clause has turned 180 degrees. Now, the insurer is provided with valuable information about breach, but has no obligation to extend cover. This is a very odd way of amending the strict breach of warranty (and here, analogous "deviation") rules.

As a notice provision

The requirement of the giving of prompt notice to underwriters is not merely an issue within held covered clauses but arises in many situations giving rise to a potential claim. In the leading decision in the Court of Appeal, Mance L.J. (as he then was), declined to categorise such clauses as conditions precedent to the claim by default, stating: "English insurance law is strict enough as it is in insurers' favour. I see no reason to make it stricter."[54] Despite this, most held covered clauses have been interpreted as making the extension of cover conditional on prompt notice, even in the absence of clear wording.[55] Again, this is an odd attempt to mitigate the strictness of the default rule for breach of warranty, as it reinforces the strictness of the insured's obligations, in a provision which is commonly lacking in a similar obligation on the underwriter.

Where agreement is not commercially or actually possible

The held covered clause is limited by its own nature. Even in routine factual scenarios, it is easily possible for the reasonable additional premium that an insured would have to pay would exceed the benefit payable.[56] And yet in *Mentz Decker*, Hamilton J. stated:

"[I]t is impossible to construe the clause as giving an option to the assured to be covered or not as he chooses, but I think that in the event of the ship arriving safely the assured would be bound to give the notice and the underwriter would be entitled to his premium."[57]

No underwriter would expect the insure to pay additional premium over and above the possible benefit to be gained, but other than by reference to some general principle like commercial practicability, it is hard to see why the insurer could not so demand, if it were minded. Certainly, if "reasonable" premium means reasonable for the increase in risk, rather than commercially reasonable then the insured appears bound to pay, at least in theory.

Can this be worked around with appropriate use of implied limitations on the held covered clause? Certainly, but it shows the inefficiency of the clause that it does not appropriately set the responsibilities of each party. ***J.B.L. 136**

And utmost good faith

When insurance cover is created or renewed, the insured is under a duty of pre-contractual disclosure.[58] This is said to be part of the wider doctrine of utmost good faith that permeates insurance law, often to the disadvantage of the insured.[59] The s.18 duty to disclose extends to all material circumstances and if the insured fails to comply, the insurer may avoid ab intio.

What about when cover is extended under a held covered clause? Is this, like formation or renewal, a new contract requiring full disclosure? And if there is a new contract, is it an entirely new agreement, (replacing the old contract), or merely a new mini-contract adding to the existing clauses? If there is no new contract, and it is merely performance of the contract, does this type of obligation attract post-contractual duties of disclosure under the doctrine of utmost good faith?

The simple answer to these questions is that opinion is divided. This is a fundamental part of marine insurance law, and we do not have an established answer on point. Recall that failing to advise properly on this will not simply provide the underwriter with an insignificant remedy. The entire contract (or perhaps only the extended cover) could be avoided ab initio.

Clarke suggested[60] that risk aggravating behaviour must be disclosed by reference to the first instance judgement of Hobhouse J. in *The Good Luck*.[61] By contrast, Rose considered that the answer may depend on the particular wording of the contract. However, after reviewing five cases other than *The Good Luck* he concluded:

"The general approach in the cases is founded on the proposition that there is a continuing duty of good faith in marine insurance contracts. This may not be universally true."[62]

This distinction between the triggering of s.18 (pre-contractual disclosure) and s.17 is vital. If it is the post-contractual duty only, then the insured will normally only be in breach if fraudulent. By contrast, s.18 provides avoidance for even innocent non-disclosures.

The leading specialist monograph on utmost good faith notes the ongoing lack of certainty. Thus, on general renegotiation of the contract, we get:

"Where the assured wishes to vary the terms of the original contract so that the insurer takes on additional risk, the assured must disclose all circumstances material to that variation. Materiality is judged by analogy with the pre-contractual position, namely that a circumstance is material if it would influence the judgement of a prudent insurer in determining whether to agree the variation and if so on what terms."[63]

And: ***J.B.L. 137**

"If the insurer is being required to hold the assured covered upon the agreement of an additional premium, the insurer is entitled to further disclosure in so far as it is relevant to the fixing of the premium."[64]

This suggests a full disclosure regime, for which even innocent failures to disclose will grant the insurer the right to avoid. But avoid what: the entire contract or merely the extension? In light of the conflicting views expressed in recent case law, Macdonald Eggers et al. suggest a compromise:

"In those circumstances, it is submitted that, if the variation can easily be separated from the remainder of the contract, such as the negotiation of a one-month extension to the risk or an additional voyage, the insurer should only be entitled to avoid the amendment. However, where the variation goes to the root of the insurance and constitutes a fundamental alteration to the cover, the insurer should be entitled to avoid the contract as a whole."[65]

Evidence of inefficiency? Some concluding thoughts

The family of held covered clauses resemble the *Romalpa* clause of sales law. Inspired by an attempt to capture complex commercial behaviour, it is created a tangled web of confusion and uncertainty, much of which defeats the original intention of the clause. So, as lawyers have sought to incrementally adapt to spiralling levels of legal uncertainty, so the clause has become less efficient as a representation of commercial behaviour.

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In light of this evidence, we must ask the fundamental question:

- is the explanation for the held covered clause that it represents the most efficient use of transaction costs in creating an optimal rule?; *or*
- is this an example of parties "anchoring" to a default rule, and seeking to improve it incrementally, rather than rejecting it as inefficient and implementing a novel, efficient clause? Moreover, is its ongoing use an example of "herd behaviour" as clauses are handed down through the market?

The answer is clear. Lawyers have sought to tinker with the default provided in the statute, rather than replace it with a more efficient alternative. Although the nature of held covered clauses have developed, they have not become significantly more certain. Where a clause has been amended to ensure that it is enforceable, it has deprived the insured (the intended beneficiary of the clause according to Long) of any advantage and loaded costs. In the final section, we question what now can be done by the Law Commission and parliamentary draftsmen to minimise this unhelpful behaviour. ***J.B.L. 138**

Cleansing defaults of stickiness: reducing friction in a behavioural economics model

The held covered clause in marine insurance law is fundamentally uncertain in its impact. It may operate as a signalling device to placate policyholders concerned about the strictness of the promissory warranty regime, but as a legally binding contractual obligation it is seriously flawed. Its use in marine insurance contracts is evidence that negotiating parties seek to amend the default provided, rather than contract around the default and impose a substitute rule. While this could be explained by reference to the transaction costs of drafting a new rule, the general availability of alternative models, and the administrative (including potential legal) costs of adhering to the held covered regime suggest the contrary.

Why then is an inefficient amendment made? This is most likely due to a combination of anchoring and herd behaviours. Parties start with the default before them, and seek to improve it, rather than start afresh with an independent assessment of their best interest. Later parties copy the amendments made, until litigation establishes the inefficiency of the rule, forcing further change.

What then are lawmakers to do? Rather than provide parties with a single default rule, lawmakers should attempt to provide a wide diversity of pre-approved rules.[66] At present, law offers a simple choice: our way or design your own. A better model would be to provide the parties with suggested ways of managing risk during the contract, each with a distinct label and remedy for non-compliance.

So:

- **Clause A1:** Condition precedent: non-compliance with the term automatically discharges the underwriter from liability from the date of the breach.
- **Clause A2:** Condition precedent + "simple held covered’": as A1, but the insured is entitled to an extension of cover at its option if timely notice of the non-compliance is given to underwriters, and a reasonable additional premium paid.
- **Clause A3:** Condition precedent + "complex held covered": as A2, but the extended cover is also subject to such additional terms as the "prudent underwriter" would require.
- **Clause B1:** As A1, but liability is only discharged where there is a causal connection between the loss incurred and the non-compliance. ***J.B.L. 139**
- **Clause B2:** As A1, but liability suspended for the period of non-compliance and not permanently discharged.
- **Clause B3:** As A1, but liability is only discharged on the giving of reasonable notice by the underwriter.
- **Clause C1:** "Innominate" condition precedent: the underwriter is discharged from all future liability for any "substantial" breach, but minor breaches merely reduce any future liability to the extent to which the insurer was otherwise prejudiced by the breach, etc.

As lawmakers, it is not our business to estimate which clauses are efficient: that is for the market to decide. But we need to free them from the stickiness of a statute with a single default. The resultant statutory provision ought to resemble a takeaway pizza menu. The simple Margherita is available (as "Original Cheese and Tomato"), but in addition to the 15 set options there is a wide variety of choice of base and toppings. These can be constructed to provide a highly personalised pizza. Similarly,

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the best way to get commercial parties to choose what they want is to ensure that they have no single default choice to which they will become anchored. While this will not free contracting parties from their internal thought processes and turn them into "econs", it will minimise the effects of behavioural economics on the choices they make.

It must now be recognised that Lord Mansfield and Sir Mackenzie Chalmers were wrong. The content of a default rule matters. It matters because it is human nature to seek to make incremental improvements to rules, even when we recognise that they are unsuitable. Until lawmakers accept this reality, law will be stuck in the past.
James Davey

Footnotes

1 "Default rules": the rules supplied by law in the absence of express agreement. For this article, this set of rules is limited to those providing a framework of remedies for non-compliance (akin to the rules governing termination for breach and the measure of damages in contract law). This excludes "implied terms" which are context specific and generally impose duties on parties.

2 There are notable exceptions. See, e.g., *D. Campbell, D. Harris and R. Halson, Remedies in Contract & Tort, 2nd edn (Cambridge University Press, 2005)*; and C. Riley, "Designing Default Rules in Contract Law: Consent, Conventionalism and Efficiency" (2000) 20 O.J.L.S. 367.

3 R. Coase, "The Problem of Social Cost" (1960) 3 Journal of Law & Economics 1.

4 *R.H. Thaler and C.R. Sunstein, Nudge: Improving Decisions about Health, Wealth & Happiness, updated international edn (Penguin, 2009)*.

5 *Thaler and Sunstein, Nudge (2009), p.91*.

6 *Thaler and Sunstein, Nudge (2009), p.41*.

7 *Thaler and Sunstein, Nudge (2009), p.39*.

8 *Thaler and Sunstein, Nudge (2009), p.7*.

9 Discussed in Karen Yeung, "Nudge as Fudge" (2012) 75 M.L.R. 122, 122–123.

10 See http://www.cabinetoffice.gov.uk/resource-library/applying-behavioural-insight-health [Accessed October 19, 2012].

11 Yeung, "Nudge as Fudge" (2012) 75 M.L.R. 122.

12 Lord Mansfield: *Vallejo v Wheeler (1774) 98 E.R. 1012* at 1017.

13 See *Chalmers and Owen, The Marine Insurance Act 1906 (1st ed), p.x*. Chalmers saw this as part of an ongoing judicial project, citing *Lockyer v Offley 1 Term Rep. 252* at 259 and *Sailing Ship Blairmore v Macredie (1898) A.C. 593* at 597.

14 R. Ferguson, "Legal Ideology and Commercial Interests: The Social Origins of the Commercial Law Codes" (1977) 4 Brit. J.L. & Soc'y 18.

15 M. Chalmers, "Codification of Mercantile Law" (1903) 19 L.Q.R. 11, 14–15.

16 R.H. Coase, "The Problem of Social Cost" (1960) 3 Journal of Law & Economics 1, 15–16

17 Yeung, "Nudge as Fudge" (2012) 75 M.L.R. 122, 122.

18 I suspect that my inability to stick to a single default with my daughters is inefficient. I am probably not alone in this.

19 I. Ayres and R. Gertner, "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules" (1989) 99 Yale L.J. 87.

20 Marine Insurance Act 1906 (MIA 1906) s.18.

21 MIA 1906 s.39.

22 H. Bennett, "Fortuity in the law of marine insurance" [2007] L.M.C.L.Q. 315; J. Davey and J. Coggon, "Life Assurance and Consensual Death: Law Making for the Rationally Suicidal" (2006) 65 Cam. L.J. 521.

23 See http://www.lmalloyds.com/ [Accessed October 19, 2012].

24 e.g. the shift in the drafting of navigation warranties in hull policies from promissory warranties to suspensive conditions. See *H. Bennett, The Law of Marine Insurance, 2nd edn (Oxford University Press, 2006), para.18.100*.

25 Ayres and Gertner, "Filling Gaps in Incomplete Contracts" (1989) 99 Yale L.J. 87, 98.

26 Russell Korobkin, "Possibility and Plausibility in Law and Economics" (2004–05) 32 Fla St. U.L. Rev. 781, 782.

27 R. Korobkin, "What Comes After Victory for Behavioral Law and Economics?" (2011) U. Ill. L. Rev 1653.

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28 For example, the statutorily implied terms provide a mixture of different types of regulation, from the warranty in s.39(1) to the complex mens rea and causatively restricted exception in s.39(5).

29 Amos Tversky died in 1996, six years before the award, but in his acceptance speech Daniel Kahneman made clear that the work was produced jointly. See http://www.nobelprize.org/nobel_prizes/economics/laureates/2002/kahnemann-lecture.pdf [Accessed October 19, 2012].

30 A. Tversky and D. Kahneman, "Judgment under Uncertainty: Heuristics and Biases" (1974) 185 Science 1124.

31 *C. Heimer, Reactive Risk and Rational Action: Managing Moral Hazard in Insurance Contracts (University of California Press, 1985)*.

32 Tversky and D. Kahneman, "Judgment under Uncertainty: Heuristics and Biases" (1974) 185 Science 1124, 1130.

33 *Thaler and Sunstein, Nudge (2009), p.60*, discussing *S. Asch, "Opinions & Social Pressure" in E. Aronson (ed.), Readings about the Social Animal (Freeman, 1995)*.

34 *M. Gladwell, The Tipping Point (Little, Brown & Co, 2000), Ch.2*.

35 *Thaler and Sunstein, Nudge (2009), p.59*, discussing results of *C. Sunstein et al., Are Judges Political? (Brookings International Press, 2006)*.

36 The wider family of extension clauses is discussed in *F. Rose, Marine Insurance: Law & Practice (2004), Ch.12*.

37 *Bennett, The Law of Marine Insurance (2006)*, is citing (in 2006) the (then current) 1982 version. The 2009 variant reads: "10.1 Where, after attachment of this insurance, the destination is changed by the Assured, this must be notified promptly to Insurers for rates and terms to be agreed. Should a loss occur prior to such agreement being obtained cover may be provided but only if cover would have been available at a reasonable commercial market rate on reasonable market terms."

38 *Bennett, The Law of Marine Insurance (2006), para.18.111*.

39 Abraham describes the insurer's behaviour here as "surrogate regulator": *K. Abraham. Distributing Risk: Insurance, Legal Theory and Public Policy (Yale University Press, 1986), p.60*.

40 M. Clarke, "Insurance Warranties: the absolute end" [2007] L.M.C.L.Q. 474, 478.

41 Sir *J. Park, A system of the Law of Marine Insurance, 5th edn (1802), p.319*. Cited in Clarke, "Insurance Warranties" [2007] L.M.C.L.Q. 474, 480.

42 Clarke, "Insurance Warranties" [2007] L.M.C.L.Q. 474, 478.

43 S. Long, "'Held Covered' Clauses in Marine Insurance Policies" [1957] Insurance Counsel Journal 401.

44 MIA 1906 s.31.

45 *Bennett, The Law of Marine Insurance (2006), para.18.119*.

46 For a useful introduction to the issue in the commercial context, see I. MacNeil, "Uncertainty in Commercial Law" (2009) 13 Edinburgh L. Rev. 68 and the sources discussed therein. To avoid confusion, this is Glasgow University's Iain MacNeil and not the relational contract theorist formerly at Northwestern University.

47 P. Rubin, "Why is the Common Law Efficient?" (1977) 6 Journal of Legal Studies 51.

48 This tendency is discussed in J. Braithwaite, "Rules and principles: a theory of legal certainty" (2002) 27 Australian Journal of Legal Philosophy 47.

49 MacNeil, "Uncertainty in Commercial Law" (2009) 13 Edinburgh L. Rev. 68, 69.

50 B. Soyer, "Reforming pre-contractual information duties in business insurance contracts — one reform too many?" [2009] J.B.L. 15, 35.

51 *Chitty on Contracts, 30th rev. edn, edited by H. Beale (2011), paras 2-136 to 2.138*.

52 As noted in *Chitty (2011)*, the position of an express agreement to use best endeavours to agree appears unresolved.

53 Emphasis added.

54 *Friends Provident v Sirius International [2005] 2 Lloyd's Rep. 517 CA (Civ Div)* at [33].

55 *Bennett, The Law of Marine Insurance (2006), para.18-120*.

56 *Greenock Steamship Co v Maritime Insurance Co, Ltd [1902] 1 K.B. 367 KBD*.

57 *Mentz, Decker & Co v Maritime Insurance Co [1910] 1 K.B. 132 KBD*.

58 MIA 1906 s.18.

59 MIA 1906 s.17.

60 M. Clarke, "Aggravation of risk during the insurance period" [2003] L.M.C.L.Q. 109.

61 *Bank of Nova Scotia v Hellenic Mutual War Risk Association (Bermuda) Ltd (The Good Luck) [1988] 1 Lloyd's Rep. 514 QBD* at 545.

62 *Rose, Marine Insurance (2004), fn.53*.

63 *P. MacDonald Eggers, S. Picken and P. Foss, Good Faith & Insurance Contracts, 3rd edn (2010), para.10.18*.

64 *MacDonald Eggers et al., Good Faith & Insurance Contracts (2010), para.10.28*.

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65 *MacDonald Eggers et al., Good Faith & Insurance Contracts (2010), para.10.24*.

66 The current Law Commission proposals (in *Discussion Paper 155, "Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (June 2012)*) suggested that traditional warranties would henceforth suspend cover under the policy, and other risk related terms suspend liability for the types of risk affected by non-compliance. This would be mandatory for consumer insurance, and a default rule for commercial insurance.

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