University of Southampton

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Southampton Law School

Applied Contract Theory and the Legal Regulation of Marine Insurance Contracts: The Case of Risk Control Terms and Contracting Out under the Insurance Act, 2015

by

Livashnee Naidoo

Thesis for the degree of Doctor of Philosophy

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Abstract

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Insurance contract law is in a state of flux, having undergone a period of substantial reform. The English and Scottish Law Commissions commenced the period of reform in 2006 and this resulted in two core statutes: the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015 ('the 2015 Act'). The former is applicable to consumer insurance, the latter to consumer and non-consumer insurance. The focus of this thesis is on commercial marine insurance contract law and therefore the 2015 Act. Both statutes sought to amend various aspects of the law of insurance, but this thesis is limited to the reforms pertaining to warranties, risk control terms, and contracting out in the 2015 Act.

Contemporary scholarship has focused primarily on the substantive changes to the law. This thesis goes further by grounding the substantive law analysis in the context of applied contract theory, specifically the (neo) formalist-contextualist debate. In doing so, it aims to analyse the type of regulation that governs marine insurance and the suitability of such regulation for these types of markets. The (neo) formalist-contextualist debate provides an important framework to analyse the 2015 Act: to determine what type of statutory regulation the 2015 Act is; and to analyse how judges should approach the new 2015 Act. This thesis shows that the 2015 Act reflects 'contextualist' tendencies and is a new type of statutory regulation for commercial marine insurance contracts. It further claims that a more suitable framework for the regulation of commercial (marine) insurance contracts would have been a contract law minimalist approach to the design of statutory regulation. It explains why and how judges should adopt a minimalist approach to the interpretation and application of the 2015 Act to contracts between sophisticated parties.

This thesis provides an important new normative perspective for the 2015 Act, specifically in relation to commercial marine insurance contracts. It is an original contribution to knowledge both through the research questions posed and answered and, the research methodology employed to do so. Insurance contract law under the 2015 Act is in its early stages of development and this thesis offers a timely contribution to understanding the operation of the Act and its implications for sophisticated markets, such as marine insurance.

Table of Contents

Table of Cases

List of Legislation

Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA)

Consumer Rights Act 2015 (CRA)

Financial Services and Markets Act 2000 (FSMA)

Insurance Act 2015 (IA)

Insurance Conduct of Business Service Handbook

Marine Insurance Act 1906 (MIA)

Misrepresentation Act 1976

Sales of Goods Act 1949

Unfair Contract Terms Act 1977 (UCTA)

Uniform Commercial Code, The

Research Thesis: Declaration of Authorship

Print name:	Livashnee Naidoo

Title of thesis:	Applied Contract Theory and the Legal Regulation of Marine Insurance Contracts: The Case of Risk Control Terms and Contracting Out under the Insurance Act, 2015

I declare that this thesis and the work presented in it are my own and has been generated by me as the result of my own original research.

I confirm that:

This work was done wholly or mainly while in candidature for a research degree at this University;

Where any part of this thesis has previously been submitted for a degree or any other qualification at this University or any other institution, this has been clearly stated;

Where I have consulted the published work of others, this is always clearly attributed;

Where I have quoted from the work of others, the source is always given. With the exception of such quotations, this thesis is entirely my own work;

I have acknowledged all main sources of help;

Where the thesis is based on work done by myself jointly with others, I have made clear exactly what was done by others and what I have contributed myself;

None of this work has been published before submission.

Signature:		Date:	12 February 2020

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'Float like a butterfly, sting like a bee'.

Chapter 1: Introduction

1.1 Background

The context for this research is the reform of insurance contract law undertaken by the English and Scottish Law Commissions ('the Law Commissions') in 2006 in response to growing calls for reform from various interested bodies, including practitioners, judges,[1] and academics ('the 2006 reform project').[2] The reform agenda had been in the pipeline for some time and largely built on the work of the English Law Commission in 1957 and 1980,[3] and the British Insurance Law Association in 2002.[4] There were various target areas of reform (discussed below) which were covered by a series of Issues [5] and Consultation Papers.[6]

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[1] Andrew Longmore, 'An Insurance Contracts Act for a New Century' [2001] LMCLQ 356.

[2] The 2006 joint reform project of the English and Scottish Law Commissions ('the Law Commissions') began with a scoping paper to determine if insurance law needed to be reformed. Law Commissions, *Insurance Contract Law: A Joint Scoping Paper* (January 2006).

[3] Law Commission, *Fifth Report of the Law Reform Committee* (Law Com CP No 62, 1957) and Law Commission, *Non-Disclosure and Breach of Warranty* (Law Com CP No 104, 1980) respectively.

[4] British Insurance Law Association, *Insurance Contract Law Reform* (September 2002).

[5] The Law Commissions' Issues Papers included: (i) *Issues Paper 1: Misrepresentation and Non-Disclosure* (September 2006); (ii) *Issues Paper 2: Warranties* (November 2006); (iii) *Issues Paper 3: Intermediaries and Pre-Contract Information* (March 2007); (iv) *Issues Paper 4: Insurable Interest* (January 2008); (v) *Issues Paper 5: Micro-businesses* (April 2009); (vi) *Issues Paper 6: Damages for Late Payment and Insurer's Duty of Good Faith* (March 2010); (vii) *Issues Paper 7: The Insured's Post-contractual Duty of Good Faith* (July 2010); (viii) *Issues Paper 8: The Broker's Liability for Premiums: Should Section 53 Be Reformed?* (July 2010); (ix) *Issues Paper 9: The Requirement for A Formal Marine Policy: Should Section 22 Be Repealed?* (October 2010).

[6] The Law Commissions' Consultation Papers included: (i) *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (Law Com CP 182, 2007; SLC DP 134, 2007); (ii) *Insurance Contract Law: Post-Contractual Duties and Other Issues* (Law Com CP 201, 2011; SLC DP 152, 2011); (iv) *Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties* (Law Com CP 204, 2012; SLC DP 155,

The 2006 reform project culminated in two pieces of legislation which, in some respects at least, separated consumer insurance contracts from commercial insurance contracts.[7] The first piece of legislation, the Consumer Insurance (Disclosure and Representations) Act 2012, came into force on 6 April 2013 and is mandatory for consumer contracts ('CIDRA 2012'). The second – the focus of this thesis – is the Insurance Act of 2015, which received Royal Assent on 12 February 2015 and entered into force in mid-2016 ('the 2015 Act').[8] The 2015 Act is concerned with both business insurance and consumer insurance, particularly, Part 3 of the 2015 Act which deals with 'warranties and other terms' applies to both consumer and non-consumer insurance.[9] The difference though is that the reforms in the 2015 Act in relation to consumer insurance cannot be contracted out off.[10] However, in relation to commercial insurance the 2015 Act operates as a default regime thereby allowing parties to 'opt out' of provisions of the Act provided certain requirements have been met.[11] As the 2015 Act is applicable to all commercial insurance contracts, marine insurance also falls within its purview of 'commercial insurance'.[12]

These reforms are significant because they represent the largest overhaul of insurance law since the Marine Insurance Act of 1906 ('the 1906 Act'), which was originally designed only to address marine insurance. Over time the 1906 Act was extended to non-marine

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2012); The Law Commissions' Report, *Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment* (Law Com Report 353; SLC Report 238, 2014).

See also M Clarke, 'Insurance Warranties: the Absolute End?' [2007] LMCLQ 474; R Merkin and J Lowry, 'Reconstructing Insurance Law: The Law Commissions' Consultation Paper' (2008) 71 MLR 95; B Soyer, 'Beginning of a New Era for Insurance Warranties' [2013] LMCLQ 384; J Davey, 'Remedying the Remedies: the Shifting Shape of Insurance Contract Law' [2013] LMCLQ 476.

[7] John Lowry and others, *Insurance Law Doctrines and Principl*e (3rd edn, Hart Publishing 2011) 12.

[8] The Insurance Act 2015 is based upon the Law Com Report 353 and SLC Report 238, 2014 (n 6).

[9] John Birds, *Birds' Modern Insurance Law* (10th edn, Sweet & Maxwell 2016) 177. For the sake of consistency and clarity, non-consumer insurance will be referred to as 'commercial insurance' from this point forward.

[10] The Insurance Act 2015 ('The IA 2015'), s15.

[11] ibid, s16 (2) and (3). The requirements to be satisfied are contained in s17.

[12] This thesis does not deal with consumer marine insurance such as that pertaining to yachts. This is discussed below.

cases as well and considered to be authoritative statements of common law principles that apply to all insurance. The 2015 Act amends the existing common law and the 1906 Act and has recast several long-standing principles. In contract law generally, there has been a growing emphasis on measures to protect consumers and this trend has continued in insurance contract law.[13] Accordingly, there was greater demand for reform in consumer insurance law than in marine and commercial insurance law.[14] In the latter instance while there was support for reform there was a lack of consensus on the proposals and their suitability.[15] It is with this latter group that this thesis is concerned.

1.2 The Narrative of this Thesis

1.2.1 Aims and Methodology

Leading up to and pursuant to the coming into effect of the 2015 Act, contemporary scholarship has been valuable in focusing on the changes to the law in explaining the provisions of the 2015 Act and how it differs from the 1906 Act. However, in my view, contemporary scholarship has reached a point wherein the analysis of the 2015 Act has not proceeded beyond a consideration of the substantive law changes and a 'wait and see' approach has been adopted.[16] This 'wait and see' approach is understandable given that there is no case law as yet on warranties and contracting out under the 2015 Act and therefore any projections on the future direction of insurance contract law is, at best, speculative. The contemporary position therefore leaves much to be determined by the courts in how to interpret and apply the 2015 Act.

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[13] David Hertzell, 'The Insurance Act 2015: Background and Philosophy' in M Clarke and B Soyer (eds), *The Insurance Act 2015: A New Regime for Commercial and Marine Insurance Law* (Informa Law from Routledge 2017) 2.

[14] ibid 3.

[15] For a comprehensive analysis of the proposals, see Clarke, 'Insurance Warranties' (n 6); B Soyer, 'Reforming Insurance Warranties – Are We Finally Moving Forward?' in B Soyer (ed) *Reforming Marine & Commercial Insurance Law* (Informa 2008).

[16] For example, Robert Merkin and Ozlem Gurses, 'The Insurance Act 2015: Rebalancing the Interests of the Insurer and Insured' (2015) 78 (6) MLR 1004; Baris Soyer, 'Risk Control Clauses in Insurance Law: Law Reform and the Future' (2016) 75 (1) 109; Robert Merkin and Ozlem Gurses, 'Insurance Contracts after the Insurance Act 2015' (2016) 132 (3) Law Quarterly Review 445; Clarke, *The Insurance Act 2015* (n 13).

This thesis has gone further, taking a more critical look at the reforms for three reasons. First, the changes to insurance contract law are not just at a substantive level but - as is claimed in this thesis - are indicative of a broader change in the law. The 2015 Act is a different creature to the 1906 Act with a reorientation of values from freedom of contract and legal certainty to fairness and proportionality.[17] This signals a change in the type of statutory regulation governing insurance contract law. Secondly, the Law Commissions drafted the 2015 Act along a 'principles-based' approach to give courts the flexibility to develop the law organically.[18] It is therefore essential to understand what the judicial role should look like under the 2015 Act. Thirdly, the 2015 Act was not drafted with the marine insurance market in mind. It is therefore important to understand the implications of this new type of statutory regulation on sophisticated markets (explained below), such as marine insurance.

Operating within the bounds of a mixed-market economy, the issue is not whether to regulate marine insurance contracts, but rather, how much legal regulation there should be, and the design of that legal regulation. The specific research questions are:

(i) As seen through the case studies of warranties, risk control terms, and contracting out does the Insurance Act 2015 reflect a new type of legal regulation for marine insurance contract law and if so, what type of regulation?

(ii) What are the implications of this type of legal regulation for the judicial regulation of marine insurance cases?

These questions deal with statutory and judicial regulation respectively. Statutory regulation uses the substantive law changes as case studies to analyse the 2015 Act, whereas judicial regulation refers to the development of case law through the interpretative approach that courts adopt in relation to statutes. Judicial regulation, as it is used here, does not deal with the making of new common law rules.[19] In answering the first research question, the fundamental purpose of my thesis is to demonstrate that the

[17] Bernard Rix, 'Conclusion: General Reflections on the Law Reform' in Clarke, *The Insurance Act 2015* (n 13) 122. See also Law Com CP 204 and SLC DP 155, 2012 (n 6) paras 14.39, 14.57; Special Public Bill Committee, *Insurance Bill* (HL 2014, 81) 36.

[18] SPBC, *Insurance Bill* (n 17) 1 - 3. See also Law Com Report 353 and SCL Report 238, 2014 (n 6) para 1.

[19] Such as the fraudulent claims rule in *Versloot Dredging BV and Another v HDI Gerling Industrie Versicherung AG and others* [2016] UKSC 45; [2014] EWCA Civ 1349.

2015 Act reflects a new 'contextualist' paradigm for commercial (marine) insurance contract law. The 2015 Act has expanded the legislative boundaries of marine insurance law beyond formal, strict rules by making 'context' a significant part when interpreting the 2015 Act. Following on from this, answering the second question will show that judges have 'a more serious regulatory role'[20] under the 2015 Act. I argue that the reforms should rather have been modelled on a 'minimalist' approach to statutory and judicial regulation. Despite this, judges may prove to be more resistant to this kind of intervention in commercial markets and they may indeed take a more minimalistic stance.

The methodology blends a legal doctrinal analysis and applied contract theory. While these approaches may sometimes be viewed as contrary to each other, this thesis uses them in a complementary way.[21] A doctrinal analysis provides an important preliminary step to understand the substantive law changes introduced by the 2015 Act and continues to find an audience amongst judges and practitioners.[22] As will be explained at section 1.5 scholarship to date on the 2015 Act has primarily focused on a legal doctrinal approach. The application of contract theory takes a broader look at the new legal regime to examine what the changes to the substantive law provisions means for the broader regulation (both statutory and judicial) of commercial (marine) insurance contract law. It recognises that insurance contract law operates within a social and economic context and that contract law is the framework within which insurance law operates.[23] The blending of methodological issues is intended to exemplify a deeper theoretical analysis of the reforms whilst remaining grounded in the practicalities of the insurance market.

[20] Roger Brownsword and John Adams, The Unfair Contract Terms Act: A Decade of Discretion' (1988) 104 LQR 94, 112.

[21] Van Gestal, Micklitz and Rubin, 'Introduction' in Van Gestal, Micklitz and Rubin (eds), *Rethinking Legal Scholarship: A Transatlantic Dialogue* (CUP 2017) 9. See also Andrew Burrows, 'Challenges for Private Law in the Twenty-First Century' in Kit Barker and others (eds), *Private Law in the Twenty-First Century* (Hart Publishing 2017).

[22] ibid.

[23] Malcolm Clarke, *Policies and Perceptions of Insurance Law in the Twenty-First Century* (OUP 2002) 357. See also YongQiang Han, 'The Relevance of Adams and Brownsword's Theory of Contract Law Ideologies to Insurance Contract Law Reform in Britain: An Interpretative and Evaluative Approach' (PhD thesis University of Aberdeen 2013) 2.

1.2.2 An Introduction to Marine Insurance

1.2.2.1 Nature of the Marine Insurance Market and Marine Risks

This section introduces the marine insurance industry insofar as it is necessary to frame the thesis and to provide a background to the claims propounded in this thesis, in particular, that marine insurance is a sophisticated market where contractual autonomy remains (and indeed should remain) a central tenet. The starting point is the London market which is the main marine insurance market and includes three broad classes of marine insurers: the Lloyd's underwriters, insurance companies and, Protection & Indemnity Clubs (P&I).

All of these bodies are subject to regulation in respect of their insurance activities with the governing statutes being the Financial Services and Markets Act 2000 ('FSMA 2000') as amended by the Financial Services Act 2012.[24] The FSMA 2000 is supplemented by statutory instruments, notably, the Prudential Regulation Authority Rulebook (PRA) and the Financial Conduct Authority Handbook (FCA). The former covers insurance rules relating to solvency of insurers and the latter stipulates rules for the regulation of insurance business.[25] Lloyds is regulated by both PRA and the FCA 'although with a somewhat lighter touch than that which affects insurance companies'.[26] Lloyd's also involves a measure of self-regulation through the Lloyd's Act 1982 which established the Council of Lloyd's and the Committee of Lloyd's.[27] These bodies have 'management and regulatory powers over underwriters, agents and members of Lloyd's'[28], and the Council 'is empowered to make regulations and by-laws for the operation of the Lloyd's market'.[29]

[24] Jonathan Gilman and others, Arnould *Law of Marine Insurance and Average* (19th edn, 2018) 4-01. The regulatory structure will be discussed in more detail in Ch 3 section 3.4 insofar as it is necessary to frame the reforms.

[25] ibid 4-04.

[26] ibid 4-06. Lloyd's has entered into cooperation agreements with the FCA and the PRA 'with the aim of ensuring that in areas of mutual regulatory interest, the approach of Lloyd's and the relevant regulatory body is consistent, complementary and avoids unnecessary duplication'.

[27] Arnould *Law of Marine Insurance and Average* (n 24) 4-06.

[28] ibid.

[29] ibid.

Historically, non-marine insurance was not underwritten in the Lloyd's market and there were only a handful of companies that competed with Lloyd's underwriters to underwrite marine risks.[30] The marine insurance market nowadays is no longer limited to Lloyd's as there are many other companies that will write marine risks but 'Lloyd's and marine insurance are still almost synonymous terms to a great many people'.[31] Lloyd's encompasses both Lloyd's market and the Corporation of Lloyds'. Lloyd's market is not an insurer but a market place where risks are underwritten by underwriters who operate in syndicates which sell insurance products. There are numerous syndicates operating in this market which compete with each other for insurance business. The Corporation of Lloyd's, on the other hand, provides a regulatory support structure to the Lloyd's market to ensure that standards are maintained.

Marine insurance is indemnity insurance whereby the insurer undertakes to indemnify the insured against 'marine losses'.[32] Marine losses include property loss and financial loss and liabilities relating to perils of the sea arising from a 'marine adventure'.[33] Marine insurance therefore encompasses different types of marine insurance cover. The most common types of marine insurance are Hull and Machinery Cover (H&M), cargo insurance, and cover provided by mutual associations (Protection & Indemnity Clubs). The best example of property insurance is hull insurance, which provides insurance for the 'hull of the vessel' along with all the articles and pieces of furniture on the ship. This type of insurance is meant to guard against the risks shipowners face arising from the loss of their vessel. This cover is provided by both H&M and by the Protection & Indemnity Clubs (P&I). A significant part of marine property insurance (such as Hull cover) is underwritten in the London market.[34]

P&I is a mutual association for shipowners that covers insurance not covered by H&M cover, as well as for liabilities to third parties not covered by other policies. The risks and liabilities covered by P&I Cubs can be broadly divided into three categories. First, P&I covers loss, damage or liability arising out of perils such as inter alia death or liability to crew or other third parties (eg stevedores), liability for loss or damage to third party property, collision and pollution liability, liability for wreck removal, towage liability,

[30] ibid. 2-05

[31] ibid.

[32] The Marine Insurance Act 109 (The MIA 1906'), s1 .

[33] ibid, s.

[34] Howard Bennett, *Law of Marine Insurance* (2nd edn, OUP 2006) 30.

life salvage, loss of cargo, personal injury.[35] Secondly, some Clubs have a sub-division that cover 'freight, demurrage and defence (FDD)'. For an additional premium the FDD divisions will pursue claims for freight, demurrage,[36] and defend claims made against members of the Club which fall outside the normal scope of P&I cover.[37] Thirdly the Clubs provide cover against war risks.

Therefore, like other types of insurance, marine insurance also has a division between property insurance and third party insurance. The former would be an example of damage to the vessel itself, whereas the latter may involve liability to a third party such as injured workers. An insurance contract can therefore encompass other relationships than just the relationship between the insured and insurer. Third party insurance may well involve less sophisticated parties which raise different considerations, hence it is not considered in this thesis. The focus is therefore on property insurance by focusing on the relationship and transaction between the insured and insurer in the context of merchant shipping and not SMEs. In sum, the scope of this thesis relates to commercial marine insurance with a focus on merchant shipping in the London market.

1.2.2.2 Marine Insurance Contracts and the Contracting Process

Marine insurance underwritten in the London market is largely based on standard wording for marine polices which are incorporated into policies by attachment. The most commonly used standard clauses are the Institute Hull Clauses: the Institute Hull Clauses (Voyage and Time) 1982 and 1996, and the International Hull Clauses 2003. Despite the use of standard forms in marine insurance, it would not be entirely correct to refer to a marine insurance policy as a standard form contract.

In many instances an insurance policy is recognised as a standard form contract, or a contract of adhesion[38] however, some caution needs to be expressed to this sentiment.

[35] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn, Vol 1 Sweet & Maxwell 2018) A-0074.

[36] Demurrage refers to damages, usually liquidated, paid by a charterer for delay in loading or unloading the vessel beyond the stipulated number of lay-days.

[37] Merkin & Colinvaux (n 35) A-0074.

[38] Jay Feinman, 'Contract and Claim in Insurance Law' (2018) 25 Connecticut Insurance Law Journal 159, 162. One of the central questions of modern contract law is how to regard such

This sentiment is more reflective of the position in the US than the UK.[39] The label of 'contract of adhesion' is more at home in relation to consumer insurance contracts as there is less opportunity for negotiation between the parties.[40] As Merkin and Steele say '[i]t would be wrong, therefore, to classify insurance policies as 'standard form' even though their content is heavily influenced by market organizations'.[41] The reason propounded is that while inequality of bargaining may indeed exist in some types of insurance contracts that is not the case across all insurance contracts.[42] The broker nature of marine insurance exerts a 'countervailing power'[43] to the possibility of inequality of bargaining due to the 'market strength of brokers'.[44]

These 'standard form contracts' do not necessarily imply an inequality of bargaining power in this type of market. The standard form wording is the product of both insurers and insureds, as both are 'represented in negotiations for recommended wordings, and the outcome is generally regarded as a fair compromise between the parties' conflicting interests'.[45] The wording of insurance contracts in markets such as marine insurance is also a product of market practice and experience which results in the evolution and development of wordings through trial and error.[46] If the terms are too onerous to one side, the standard terms may be abandoned by the market as was done with the

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contracts. See also Friedrich Kessler, 'Contracts of Adhesion: Some thoughts on Freedom of Contract' (1943) 43 Columbia Law Review 629; Todd Rakoff, 'Contracts of Adhesion: An Essay in Reconstruction' (1983) 96 (6) Harvard Law Review 1173.

[39] Rob Merkin and Jenny Steele, *Insurance and the Law of Obligations* (OUP 2013) 24. There are certain key distinctions between the approaches to insurance contracts in the US as opposed to the UK. The US take a more 'consumerist' approach to insurance contracts even in relation to commercial insurance as they view insurance as an industry with a strong public interest element. For those reasons the doctrines of 'reasonable expectations' and 'contra proferentem' feature quite predominantly when interpreting insurance contracts. This is not the position in the UK. Insurance regulation in the US also occurs at a federal rather than state level. English law however sees insurance contracts as 'private'.

[40] ibid 47.

[41] ibid.

[42] ibid 48.

[43] ibid.

[44] ibid.

[45] ibid 46-7.

[46] ibid.

International Hull Clauses 2003 which was viewed as too favourable to insurers.[47] The broker nature of marine insurance acts to balance the inequality of bargaining power that exists in other insurance markets. Broker pressure has ensured that the marine insurance market 'adheres to the more benign earlier versions of the Hull Clauses as promulgated in 1982 and 1996.'[48]

The formation process in insurance contracts pertaining to consumers and small to medium sized commercial enterprises (SMEs) usually differs to that of large commercial risks. In the former instance, there is usually less scope for negotiation as the individual insurer will usually devise the terms of the policy,[49] and smaller commercial risks are usually underwritten by a single underwriter. Larger commercial risks are frequently underwritten on the subscription market which commonly includes several underwriters sharing the risk and the process occurs through brokers.[50] In the latter instance of large commercial risks, brokers play a significant role in the placing of risks and the formation of insurance contracts. In marine insurance this implies an equality of bargaining between the insurer and the insured as both parties:

> are represented in negotiations for recommended wordings, and the outcome is generally regarded as a fair compromise between the parties' conflicting interests and with the capability of reducing the costs of negotiation in any one case.[51]

The use of the slip procedure for formation of the insurance contract in the subscription market was adopted in the London marine insurance market no later than the eighteenth century at Lloyd's and remained until the introduction of the Market Reform Contract in 2009. A 'slip' summarised the insurance cover and was presented by the broker to the leading underwriter, who has a reputation in the market as an expert and whose lead in subscribing to a percentage of the risk was likely to be followed. The slip was then presented by the broker to successive underwriters who also then subscribed to a proportion of the risk which they are willing to accept – a process known as 'scratching'.[52]

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[47] ibid.

[48] Merkin and Steele (n 39) 46-7.

[49] ibid

[50] ibid 45.

[51] ibid 47.

[52] *American Airlines Inc v Hope* [1973] 1 Lloyd's Rep 233.

Prior to the Market Reform Contract, the process of scratching a slip constituted a method of entering into a contract of marine insurance but the formal policy wording would only be issued at a later stage (if at all).[53] The 'slip' procedure resulted in two primary problems: policy wording would in many cases not be issued which created uncertainty as to what exactly had been agreed between the parties; and where such policy wording had in fact been issued there were inconsistencies between the slip and the policy wording.[54] The slip has been abolished and brokers are required to prepare standard policy in the form of the new Market Reform Contract for risks placed in the London market and subscriptions are confirmed by signing the Market Reform Contract.[55] The Market Reform Contract was intended to remedy these problems by presenting the policy terms in full to each underwriter, thereby the two-stage process under the slip procedure has been replaced with a single step.[56]

Broker's therefore play a key role in the London market. The broker is the agent of the insured (ie the purchaser of insurance) and is experienced in underwriting marine risks and is able to ensure that he/she finds the best cover for his/her principal. In marine insurance, brokers are a crucial part of the process in ensuring that the market remains competitive for the placing of risks. A potential insured will approach a broker with instructions to obtain insurance cover for particular marine risks. In the London market there may well be a chain of brokers: the assured's broker (the producing broker) who may be based in another jurisdiction and hence may need to appoint a placing broker who is based in the London market to place the risk at Lloyd's. The broker is always the agent of the insured and where there is a chain of brokers, there would potentially be three legal relationships: between the insured and the producing broker; the insured and the placing broker; and between both brokers.[57] Brokers therefore play a central role in marine insurance both in terms of placing risks and managing any claims, but also 'in bridging the knowledge gap' between insured and insurers.[58]

The London market therefore consists of many repeat players which may be described as:

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[53] Arnould *Law of Marine Insurance and Average* (n 24) 2-13.

[54] Merkin and Steele (n 39) 45-6.

[55] *Arnould Law of Marine Insurance and Average* (n 24) 2-13.

[56] ibid 2-05.

[57] ibid. This is beyond the scope of this thesis.

[58] Baris Soyer, *Warranties in Marine Insurance* (3rd edn, Routledge 2017) 187.

> contracting parties that are experienced in the relevant market for the transaction, have resources and counsel at their disposal and, because they are often involved in such transactions, have every incentive to use their resources and seek out advice in a way that benefits them in the present deal, as well as in future deals.[59]

In marine insurance (as relied on for purposes of this thesis) there are indeed repeat players including the underwriters in the syndicates in the Lloyd's market, the brokers who are well versed in securing marine insurance cover, and the insureds such as shipowners and time charterers who are frequently large multi-national companies. As Soyer says:

> A huge majority of purchasers of insurance hold strong bargaining positions and they normally enter into insurance contracts following a lengthy negotiation process. There is, therefore, every reason to believe that they have muscle in terms of dictating the contents of their insurance cover.[60]

Marine insurance is viewed as a specialised and sophisticated market within insurance law. Marine insurance contracts are created by the completion of the policy form and by the incorporation of the relevant Institute Clauses, which are amended to suit the individual needs of the parties. The English marine insurance market (largely through the International Underwriting Association) has taken a lead role in producing standard form terms for marine insurance. These include the Institute Clauses (discussed above) which form the basis of marine insurance contracts internationally yet apply English law and jurisdiction. This serves to highlight that the London market is a competitive and leading market for marine insurance with peculiarities that set it apart from other areas of insurance law, including but not limited to the broker nature of how marine insurance contracts are concluded, the use of held-covered clauses[61] and the standard form model

[59] Meredith Miller,' Contract Law, Party Sophistication, and the New Formalism' (2010) 75(2) 493, 531-2. 'Sophistication' is discussed in more detail at section 1.3.2.

[60] Soyer, 'Beginning of a New Era for Insurance Warranties?' (n 6) 386 , 397.

[61] This is discussed in in Ch 3 section 3.6.4.1. A Held Covered clause (h/c) holds the insured covered in certain instances within the confines of the h/c clause, by giving the insured the option of obtaining cover beyond that originally agreed in the policy. See Rhidian Thomas, 'Held-Covered Clauses' in R Thomas (eds), *The Modern Law of Marine Insurance: Volume 2* (Informa 2002*)* 12. Examples of h/c clauses include: The Transit Clause in the Institute War Clauses

Institute clauses that are frequently incorporated into marine policies.[62]

1.3 Scope and Target Areas

1.3.1 Consumer, Commercial and Marine Insurance Law

To clarify the scope of this thesis, the overlapping areas will be first identified and then elaborated on as follows: (i) consumer versus commercial contracts; (ii) the heterogeneity of commercial parties within commercial contracts; (iii) marine insurance encompasses both consumer and commercial insurance; and (iv) the heterogeneity of commercial parties within commercial *marine* insurance.

First, the Law Commissions recognised that 'the market for consumer insurance had developed in a different way to business insurance'.[63] They decided to separate the reforms into consumer and business but determined that any further divisions would be too complicated.[64] An important – albeit sometimes unclear – distinction exists between consumer and commercial contracts. As Roger Brownsword has said:

> In the modern law of contract, the transactional world is largely class-divided, on the one hand, there are commercial contracts and on the other there are consumer contracts; the relative strength of bargaining position is treated as the basis for this division as well as being the key to a contractor's class membership.[65]

(Cargo); Clause 1.3 of Institute Fishing Vessel Clauses 20.7.87 and Clause 1.4 of Institute Time Clauses (Hulls) 1.11.95; Clause 9 of ICC (A), (B) and (C) 1.1.82.

[62] Jonathan Gilman and others, Arnould, *Law of Marine Insurance and Average* (n 24) 19-07. Marine insurance underwritten in the London market is largely based on the standard Institute Clauses which have been developed by the International Underwriting Association.

[63] Hertzell (n 13) 4. Where Hertzell provides examples, including the 'reduction in the asymmetry of information', the increasing use of resolving consumer disputes via the Financial Ombudsman Service ('the FOS'), which was developing a separate jurisprudence not based on the 1906 Act.

[64] The Law Commissions decided to classify small businesses as businesses rather than as consumers and therefore these businesses are treated as commercial insureds. Law Commissions *Joint Scoping Paper* (n 2) 5.

[65] Roger Brownsword, *Contract Law: Themes for the Twenty-First Century* (2nd edn, OUP 2006) 73.

The consumer/commercial distinction is relevant at both a statutory and judicial level. In the former instance, it serves to clarify which statute applies to a given contract, and therefore influences the judicial approach. CIDRA 2012 defines a consumer as 'an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession'.[66] Similarly, the 2015 Act defines a 'non-consumer insurance contract' as 'a contract of insurance that is not a consumer insurance contract'.[67] The Insurance Conduct of Business Services Handbook ('ICOBS') defines a 'consumer' as 'any natural person who is acting for purposes which are outside his trade or profession'[68] and a 'commercial customer' is defined as 'a customer who is not a consumer'.[69] In sum, it can be assumed that anybody who is not a consumer within the above definitions is then a commercial party. The distinction between consumer and commercial is not easy to draw. However, this thesis does not aim to re-write the 'grey areas' between consumer and commercial; it accepts the divisions (even with the overlapping boundaries) as they exist in law. This thesis is not concerned with consumer insurance but draws upon it, when needed, to explain commercial insurance contracts.

Secondly, within *commercial* law there exists a further distinction. Commercial parties are a heterogeneous group; at one end are the small to medium-sized enterprises (SMEs), which can arguably fall within the boundaries of 'consumer', and at the other end are the sophisticated commercial parties.[70] This position subsists in relation to commercial insurance contracts as well. Recognising this fact, the Law Commissions aimed to draft a law that would sit in the middle between the large scope of businesses that the 2015 Act was meant to cover. As was explained in the Special Committee Report:

> At the more sophisticated end, we expect businesses to take care of themselves, as they do now with their individual contracts, and at the less sophisticated end

[66] The Consumer Insurance (Disclosure and Representations Act) 2012 ('CIDRA 2012'), s1(a).

[67] The IA 2015, s1.

[68] The Insurance Conduct of Business Services ('ICOBS') Handbook, s2.1.1 G3. <www.handbook.fca.org.uk/handbook/ICOBS.pdf > accessed 02 June 2019.

[69] ibid s2.1.1 G4.

[70] As there is no clear definition of SMEs, the definition relied on is that used by the FOS, which are 'firms with an annual turnover of under £6.5 million, an annual balance sheet total of under £5 million, or fewer than 50 employees' <www.fca.org.uk/publication/policy/ps19-08.pdf> accessed 29 May 2019.

> we have the Financial Ombudsman Service. This legislation is intended to be focused on the mainstream commercial marketplace. We expect the people who operate outside that marketplace to contract on different terms, as they do now. It is a default regime that essentially seeks to achieve as neutral an outcome as possible for its various participants.[71].

The Law Commissions determined that there were no particular reasons for marine insurance to be subject to a different legal regime and marine insurance therefore falls within the above classification.[72]

Thirdly, *marine* insurance also has the consumer/commercial distinction. An example of marine consumer insurance would be policies relating to yachts for private use as these will fall within the above-mentioned definition of consumer insurance contracts.[73] Similarly based on the above definitions, marine commercial insurance would cover everything that is not a consumer insurance contract. The distinction, once again, between consumer and commercial is not an easy one to draw. As Colinvaux says:

> If the policy is taken out by a consumer, the subject matter is irrelevant. Thus, high value subject matter, including yachts and even private jets, are not excluded [from the classification as consumer insurance]...[74]

Finally, within *commercial marine* insurance there are a range of stakeholders. On the one hand it includes sophisticated marine insurance and reinsurance parties to a 'normal' commercial policy, such as large marine risks in a merchant shipping context,[75] to less sophisticated insureds at the other end of the spectrum, for example, fishing

[71] SPBC, *Insurance Bill* (n 17) 3.

[72] Law Commissions, *Issues Paper 2* (n 5) para 7.10.

[73] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2018) para 1.5-04.

[74] ibid 7-007.

[75] Case examples include *Amlin Corporate Member Ltd v Oriental Assurance Corporation ('The Princess of the Stars')* [2013] 2 Lloyd's Rep 523; [2014] EWCA Civ 1135; [2014] 2 Lloyd's Rep 561 (CA); *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1992] 1 A.C 233. See Section 4.5.1 in Ch 4 and Section 3.2.3.5 in Ch 3.

trawlers.[76] Most contracts of marine insurance are non-consumer insurance contracts and marine insurance therefore falls within the definition of a commercial insurance contract.[77] Marine insurance is recognised as a sophisticated insurance market where both insureds and insurers are large corporate entities with access to similar resources such as lawyers and brokers.[78] The scope of this thesis is on sophisticated commercial marine insurance and 'sophistication' will be considered next.

1.3.2 Sophistication and Marine Insurance

In this thesis, reference is made to marine insurance as a sophisticated market. The concept of a 'sophisticated party' is relied on for two reasons: marine insurance is usually identified as a sophisticated market[79] and recognition of this is important due to the theoretical debate in contract law.[80] As this thesis argues, a minimalist approach means that sophisticated parties should be held to a different set of rules, grounded in freedom of contract.[81] For that reason, it is germane to expand on the concept of 'sophistication' as it is used here. While consumers are commonly contrasted with sophisticated parties, the relevance of sophistication 'transcends any one area of substantive law'.[82] For example:

> a mega-yacht insured for a high wealth individual has the same level of expertise in risk irrespective if it's owned and insured by a corporation or privately. Conversely, the operator of an inshore fishing vessel of 10m length will not suddenly acquire risk expertise merely by incorporating his business.[83]

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[76] There is likely to be substantial variation in the level of expertise in those groupings. See James Davey and Katie Richards, 'Marine Insurance for the 21st Century: A Quality Obligation for Insurers' (2013) 44 Cambrian LRev 33, 45.

[77] Colinvaux (n 73) 1.5-04.

[78] Other such sophisticated industries include but are not limited to, reinsurance, aviation and energy but the specifics of which falls outside the scope of this thesis.

[79] Davey and Richards (n 76).

[80] Miller (n 59)495.

[81] ibid. Contract Law Minimalism is explained and discussed in Ch 2.

[82] Miller (n 59) 494 where she gives the examples of commercial, business, employment, franchise, insurance, family and property disputes, among others.

[83] Davey and Richards (n 76) 45.

It is therefore acknowledged that a degree of sophistication can be present in consumer markets and yet be absent in commercial markets strictly construed. The concept of a 'sophisticated party' is a nebulous concept.[84] Determining what is 'sophisticated' or the precise contours of that definition is unclear as there is no clear legislative or judicial definition of the term.[85] The dichotomy between sophisticated and unsophisticated parties is usually explained as relating to 'resource and information asymmetries among contracting parties'.[86] Some of the characteristics associated with 'sophistication' include: access to information;[87] 'resources to allocate risk';[88] the level and type of experience that a party has relative to other contracting parties, including access to information and resources such as lawyers, brokers;[89] and 'that the person or entity understands or should understand the intricacies, risks and consequences of the transaction'.[90]

What is clear is that marine insurance is generally recognised as a sophisticated insurance market wherein both insureds and insurers are large corporate entities with access to similar resources such as lawyers and brokers. While there is no empirical basis to support

[84] Party sophistication in contract law is a largely unstudied area in the UK whereas the US has seen more of an engagement with this concept, although that too has been very limited. See Miller (n 59) 493 where she provides some examples from scholarship in the US, including Benjamin Hermalin & Michael Katz, 'Judicial Modification of Contracts between Sophisticated Parties: A More Complete View of Incomplete Contracts and Their Breach' (1993) 9 JL Econ & Con 230, 233; Alan Schwartz & Robert Scott, 'Contract Theory and the Limits of Contract Law' (2003) 113 Yale LJ 541, 547 (arguing for formalist interpretation of contracts between sophisticated economic actors); Allen Blair, 'A Matter of Trust: Should No-Reliance Clauses Bar Claims for Fraudulent Inducement of Contract?' (2009) 92 Marq LRev 423, 428 (advocating for enforcement of no-reliance clauses but limiting focus exclusively to contracts between 'sophisticated parties with relatively equal bargaining power').

[85] See Miller (n 59) 518 who affirms this position by stating that, '[w]idely cited and highly regarded works in the area of contract law in the US have stated that their theories only apply to sophisticated parties without a serious attempt to explain who falls into that category'. Miller also provides the example of Schwartz & Scott, *Contract Theory* (n 84).

[86] Miller (n 59) 531-2.

[87] ibid 497.

[88] ibid 495.

[89] ibid.

[90] ibid 533.

this classification, the fact that commercial marine insurance is regarded as a sophisticated market leads to an assumption of equality of bargaining power in this market. The evidence for this is the 1980 Report in which marine insurance was specifically excluded from the reform project,[91] and also in the Special Committee Report, which observed that: '[a]t the more sophisticated end, we expect businesses to take care of themselves.'[92] Marine insurance was therefore not the target of the reforms but was viewed as an industry that would largely regulate itself by contracting out of the 2015 Act.

One of the reasons why equality of bargaining power is assumed in commercial marine insurance markets is due to the 'broker' nature of that market, that is, the use of brokers as an intermediary in effecting insurance. A significant part of marine property insurance (such as Hull cover) is underwritten by the London market.[93] This market operates on a subscription basis with insurers accepting a percentage of the risk and the process occurring through brokers.[94] As Kees van der Klugt stated when giving evidence on the Insurance Bill:[95]

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[91] Law Com CP 104, 1980 (n 3). In the 1980 report, The Law Commission concluded that the reforms should not extent to marine, aviation and transport insurance ('MAT'). They based their decision on several factors including that they did not want 'to disturb this basis of legal certainty by making substantial changes to the 1906 Act' in view of the competitiveness of the London market. They added that [t]he contracts falling within MAT are generally effected by 'professionals' who operate according to well-known rules and practices and that they can reasonably be expected 'to be aware of the niceties of insurance law'.

[92] SPBC, *Insurance Bill* (n 17) 3.

[93] Howard Bennett, *Law of Marine Insurance* (2nd edn, OUP 2006) 30. The London market consists of 'a group of insurance companies and Lloyd's operating from London and specialising in international and commercial insurance'. See Hertzell (n 13) 5.

[94] *American Airlines (*n 52)

[95] Kees Van Der Klugt represented the Lloyd's Market Association while giving evidence before the Special Public Bills Committee on the IA 2015. SPBC *Insurance Bill* (n 17) 19. Kees van der Klugt says:

> The LMA—the Lloyd's Market Association—represents the common interests of all the managing agents at Lloyd's writing for all the syndicates, so we work a lot with the Corporation of Lloyd's as well as with the IUA and LIIBA, the other associations for the company market and the brokers. The LMA does a lot of work on market processes, for market efficiency, and a lot of educational work in the market. We are ultra-sensitive, on

> …in our market a lot of the insurance contracts come into underwriters having already been prepared in the broker's office. That is an important thing to realise. The brokers work up a contract with our clients and then bring them into the room at Lloyd's for a quote. When one is talking about things such as contracting out, it is important to realise that that is where the contracts often originate—not always, but often.[96]

The fact that marine insurance is viewed as a 'sophisticated' market wherein equality of bargaining power is assumed is in fact just that: an assumption. This thesis accepts that certain assumptions will have to be made given the absence of empirical evidence to prove these assumptions. However, the assumptions made are based on the nature of the marine insurance market as a subscription market and on the fact that this is the generally accepted sentiment that prevails. This is evidenced by the treatment of marine insurance by the Law Commissions where it was viewed as a 'sophisticated' market that can contract out of the reforms.[97] For that reason, this thesis accepts the assumption that marine insurance is a 'sophisticated market' and proceeds to analyse the implications that flow from that when interpreting and applying the 2015 Act.

Within the scope of this thesis,[98] the factors that would indicate that a party is sophisticated within the marine insurance market would include:

- The nature of the marine risks underwritten. For example, large marine risks such as H&M cover to cover property damage to merchant vessels;
- The nature of the contracting parties., such as underwriters that commonly underwrite large marine risks in the subscription market (discussed above) and

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behalf of our members, about anything that might add to costs in the market or decrease efficiency, which is what really informs the way we approach the new Bill.

[96] SPBC, *Insurance Bill* (n 17) 19-20. See *American Airlines* (n 55) where Lord Diplock describes the process at Lloyds whereby brokers seek to obtain underwriters' subscriptions to the risk.

[97] A search for 'marine insurance sophisticated' will produce several results from within the insurance and shipping industry itself, which refers to the marine insurance industry as 'sophisticated', such as the UK Protection & Indemnity Club, British Marine, along with various law firms.

[98] This therefore excludes consumer insurance and SMEs in the context of commercial marine insurance context.

large corporate insureds such as ship-owners or time charterers of merchant vessels;

- If the risk is underwritten on the subscription market (eg Lloyds) where parties involved can be expected to have specialist knowledge and understanding of the marine insurance market;
- Tied to the above point is the frequent use of specialist brokers in the subscription market. As brokers act for the insured, they are able to ensure a fairly level playing field in negotiating marine insurance cover;
- Where both the insured and insurer are usually large multi-national companies with resources such as lawyers (and brokers as above) which implies there is fairly even bargaining strength between insured and insurers in the market as well as information symmetry.

1.3.3 Areas of Reform

The 2015 Act has reformed four core areas of English insurance contract law: (i) the duty of utmost good faith;[99] (ii) pre-contractual disclosure and misrepresentation now entitled 'fair presentation of the risk';[100] (iii) the law of insurance warranties and;[101] (iv) contracting out.[102] This thesis only addresses points (iii) and (iv): warranties, risk control terms, and contracting out ('the case studies'). The reason for this is two-fold: first, space and time constraints render it unfeasible to cover all the areas of reform in this thesis without it amounting to a superficial analysis. Secondly, the selected case studies are novel statutory introductions not seen before in the area of commercial insurance contract law.

Risk control terms are a common feature in insurance policies and are used by insurers to control any alterations of risk during the currency of the policy. Warranties are the most common risk control term used in practice. The provision on risk control terms is one of the most controversial provisions as it was a last-minute addition to the 2015 Act. The Insurance Bill which was published in 2014 did not include s11. Certain sectors of the insurance industry opposed the inclusion of the proposed s11 and suggested that it should

[99] The IA 2015, s 14.

[100] ibid, ss 2-8.

[101] ibid, ss 10 and 11.

[102] ibid, ss 16-17.

not be included in the Insurance Bill that was to be implemented under the uncontroversial measures process. Accordingly, the proposed section was excluded from the Bill. As Merkin and Gurses say:

> The Treasury asked the Law Commissions to consider redrafting that clause to effect some reform in this area. A revised draft was circulated for comments on 12 November 2014. The Insurance Bill started its Parliamentary process before the House of Lords Special Public Bills Committee (SPBC) on 2 December 2014.[103]

Witnesses gave evidence on provisions of the bills with varying opinions.[104] The revised version of s11 was included in the Insurance Bill. However what is surprising is that:

> after four half-days of evidence and discussion, almost none of which related to the new cl.11, [the Bill] sailed through the House of Commons with scant consideration, becoming law on 12 February 2015.[105]

The introduction of s11 was resisted by the marine insurance industry[106] and has created much uncertainty as to how the provisions on s11 should be interpreted. The contracting out provisions are a by-product of the 2015 Act being a default regime that parties can contract out off. It was not specifically debated by the Law Commissions or at the stage of the Special Committee Report, which is surprising given that it imposes a higher regulatory threshold for contracting out among sophisticated commercial parties.[107]

It is necessary to discuss an important restriction on the scope of this thesis. When one thinks of marine insurance, implied warranties usually spring to mind as these types of warranties are specific only to marine insurance contracts.[108] It was decided during the research phase that these types of warranties will not form part of this thesis. The reasons for that are because a focus on the implied warranties would have invariably shifted the focus of the thesis to a more substantive analysis of marine insurance law as it pertains to

[103] Merkin and Gurses, 'Insurance Contracts' (n 16) 451.

[104] The evidence is contained the SPBC, *Insurance Bill* (n 17).

[105] Merkin and Gurses, 'Insurance Contracts' (n 16) 451.

[106] SPBC, *Insurance Bill* (n 17) 20-1, 78.

[107] It was simply dealt with as an associated item to the core areas of reform.

[108] The MIA 1906, ss 39 and 41.

warranties. Even though this thesis considers the substantive changes to the law in detail, the focus is not on the history, purpose, rationale or development of the law of warranties. That research has already been done.[109]

A focus on implied warranties would have necessarily digressed from the core questions which this thesis seeks to answer. The focus of this thesis is on understanding the 2015 Act as a new type of statutory regulation for commercial insurance contract law, and the implications that follow when judges interpret and apply the relevant provisions. The context of doing so is marine insurance contracts and practice. However it is important to recognise that the focus on marine insurance is not on marine insurance *law* per se. Instead this thesis draws on the recognition of marine insurance as a sophisticated market which fell outside the main purview of the Law Commissions core target market for the 2006 reform project. It uses the marine insurance market as a proxy for other high value commercial markets (that is, sophisticated markets) to better understand how contracts in these insurance markets should be regulated both legislatively and through the courts.

1.3.4 Applied Contract Theory and Legal Regulation

Legal regulation is a difficult concept to define and can acquire a variety of meanings depending on the lens through which it is viewed.[110] Hugh Collins uses 'regulation' 'to describe any system of rules intended to govern the behaviour of its subjects'.[111] Law is one type of social regulation.[112] 'Regulatory private law'[113] and regulatory theory[114] are beyond the scope of this thesis, as is the philosophical foundations of regulation. A

[109] Including: Wenhao Han, 'Warranties in Marine Insurance: A Survey of English Law and Other Jurisdictions with a view to Remodeling the Chinese Law' (PhD thesis, University of Southampton 2006); Soyer, *Reforming Marine and Commercial Insurance Law* (n 15); Soyer, *Warranties in Marine Insurance* (n 58).

[110] Matthew Adler, 'Regulatory Theory' in Dennis Patterson (ed), *A Companion to Philosophy of Law and Legal Theory* (2nd edn, John Wiley & Sons 2010) 591.

[111] ibid.

[112] Hugh Collins, *Regulating Contracts* (OUP 1999) 7. Other types of social regulation include custom, convention, and organised bureaucracies.

[113] As coined by Roger Brownsword and others, 'Introduction – Contract and Regulation: Changing Paradigms' in Roger Brownsword and others (eds), *Contract and Regulation: A Handbook on New Methods of Law Making in Private Law* (Edward Elgar Publishing 2017) 7.

[114] Adler (n 111).

distinction may be drawn between regulation and contract law which may highlight the public-private divide. For example, the law governing consumer contracts is subject to the general principles which apply to other contracts, yet 'it is subject to so much special regulation that it has been transformed ... and is better treated as separate'.[115]

This thesis draws on the approach of Collins whereby he merges both 'contract' and 'regulation'. Even though he adopts a public perspective as is made clear through the title *Regulating Contracts* what he is in fact attempting to achieve is to transcend the public-private divide to show that they are not incompatible. For purposes herein 'regulation' is taken to refer to the role private law plays in regulating marine insurance contracts. 'Private law' in this thesis refers to state intervention in contracts (i.e the 1906 and 2015 Acts), the marine insurance contract itself and regulation by the courts.[116] Similar to Collins's approach, the reference to the *role* which private law plays in regulating marine insurance refers to the extent to which (insurance) contract law is increasingly embracing public law concerns both through statutory and judicial regulation. 'Regulation' is therefore not used in the context of public law regulation except insofar as it serves to frame the reforms which led to the 2015 Act and to depict the extent to which regulatory principles and norms may impinge on the parties' contractual relationship.[117]

The starting point for this thesis when dealing with regulation/applied contract theory is the debate between the 'contextualists' and the '(neo) formalists'. This thesis is not simply concerned with intellectual arguments about the merits of formalist, contextual and neo-formalist paradigms in commercial insurance contract law. Instead, by relying on these visions of the 'neo-formalists' and the 'contextualists', my thesis aims to pursue a more fundamental critique of the 2015 Act by assessing whether fresh regulation of marine insurance contracts is justified and by observing the objectives of the 2015 Act and its likely consequences. In particular, to determine what the design of the 2015 Act tells us about statutory regulation, and how to interpret the Act, now that it is in place.

[115] Hugh Beale, 'Relational Values in English Contract Law' in Campbell, *Changing Concepts of Contract* (Palgrave Macmillan 2013) 118. Other such examples may include employment contracts.

[116] Referring to judicial regulation as defined above.

[117] The public law regulation aspect in this context is discussed in in Ch 3 section 3.4.

1.4 Structure: Parts and Chapters

The thesis consists of five chapters. Chapter I provides the introduction to the thesis by setting out the aims, methodology, scope, and outcomes and explains why this research is original and relevant.

Chapter 2 is a theoretical chapter that presents the broader framework for this thesis. It introduces the 2015 Act and (marine) insurance law and practice, and situates it within the general contract law framework. By drawing on the insights of the contextualist and (neo) formalist debate this chapter highlights a key distinction between law and scholarship. It describes and analyses the shift towards contextualism in contract scholarship and, to a lesser extent, in contract law. Contract law minimalism as propounded by Jonathan Morgan is a central hypothesis relied on in this thesis. This chapter defines and sets out the primary theses for contract law minimalism as a response to contextualism, in order to lay the foundation for a later application of the minimalist hypothesis to the 2015 Act.

Chapter 3 takes a doctrinal analytical approach in reviewing the substantive law changes to the law of warranty and contracting out under the 1906 Act and the 2015 Act. The methodology adopted in this chapter differs to that adopted in Chapter 2 yet this chapter serves a vital purpose. Chapter 3 looks briefly at the historical development of warranties. It then highlights the key problems in these case studies under the 1906 Act and proceeds to analyse the path to reform and the underlying policy objectives of the reform process. This is followed by a detailed analysis of the case studies under the 2015 Act which examines the rationale, scope, and functionality of each of the case studies. An understanding of the substantive changes furthers an understanding of the type of statutory regulation and how judges ought to approach interpretation. In so doing, it paves the way for a normative analysis in Chapter 4.

Chapter 4 unites the strands by blending the theoretical visions and the substantive law aspects to analyse statutory regulation (the 2015 Act) and judicial regulation. It shows that the 2015 Act, when viewed through the case studies, reflects contextualist tendencies in sophisticated markets and therefore a new type of statutory regulation. It claims that a more suitable form of regulation for sophisticated marine insurance markets would have been a minimalistic approach to the design of the 2015 Act. Notwithstanding that, it is important to look forward to how judges are likely to respond to the case studies in the 2015 Act and what would a minimalist approach to judicial regulation entail.

Chapter 5 concludes by reaffirming support for a formalist restatement of marine insurance contract law at both a statutory and judicial level. It provides a holistic assessment of the thesis before proceeding to unpack core threads relating to: (i) regulation and the 2015 Act, (ii) commercial insurance contract law and party sophistication, and (iii) contract law minimalism.

1.5 Originality and Relevance

The 2015 Act is a new piece of legislation that is yet to be applied by the courts and therefore there is much uncertainty surrounding the interpretation of the case studies in particular. My thesis offers a timely contribution to the development of scholarship on modern commercial and marine insurance contract law. It is relevant as this contribution not only analyses the substantive changes to the law, but it also considers the 'bigger picture' of how the 2015 Act has effected a paradigmatic shift in the nature of legal regulation of marine insurance contracts. In doing so, it explains how judges ought to approach their role in light of this change in legal regulation.

With notable exceptions,[118] commentaries from insurance contract law scholars on the 2015 Act have focused on legal doctrinal issues.[119] This is not meant to discredit such a methodology and the useful contribution that such scholarship has made. But pursuing a doctrinal approach in this thesis only takes us so far and is unlikely to contribute much to the research that has already been done in this area. Applied contract theory is not simply about academic theories but is valuable in framing the way in which the provisions of the 1906 Act and 2015 Act are analysed and evaluated.

Crucially, marine insurance law has not been reviewed through a critical lens and indeed, not through the lens which I adopt in my thesis. The last critical lens through which marine insurance was reviewed was a comparative approach by the Comitė Maritime International, comparing differences and similarities across the common/civil law

[118] James Davey, 'Utmost Good Faith, Freedom of Contract and the Insurance Act 2015' [2016] Insurance Law Journal 247.

[119] See (n 16).

jurisdictional divide with a possible view to harmonising marine insurance law.[120] My thesis is thus relevant and original in terms of the research questions it seeks to answer and the methodology it employs to do so.

1.6 Outcomes

As a result of this thesis, the following points will be made clear:

- What type of regulation is the 2015 Act
- What type of statutory rules are the provisions on warranties (s10), risk control terms (s11) and contracting out (ss 16-17)
- The implications of this type of regulation and these types of rules in sophisticated commercial marine insurance contracts and practice
- The type of regulation that is appropriate for sophisticated commercial markets, like marine insurance
- What is contract law minimalism and why it is a viable alternative for the regulation of the above-mentioned types of markets.
- What a contract law minimalist approach to the design of the case studies in the 2015 Act would look like
- How judges can adopt a minimalist approach to the regulation of marine insurance contracts
- Why applied contract theory is a sound methodological foundation from which to analyse and evaluate insurance contract law

[120] John Hare, *The CMI Review of Marine Insurance report to the 38th Conference of the CMI Vancouver 2004*, CMI Yearbook 2004 <https://comitemaritime.org/work/marine-insurance/ > accessed 15 June 2019.

Chapter 2: The Contextualist-Formalist Debate and Commercial Marine Insurance Contract Law

2.1 Introduction

The Insurance Act 2015 ('the 2015 Act') has substantially reformed various areas of commercial insurance contract law. As stated in Chapter 1, scholarship on the 2015 Act to date has focused on the substantive law changes to those core areas of reform.[1] This thesis recognises that (insurance) contract law is more than just rules and concepts, and the theoretical visions (discussed below) play an important role in understanding the nature of the new regulation introduced by the 2015 Act.

The starting premise of this chapter (and more broadly this thesis) is that regulation in contract law is not uniform.[2] Indeed, different parts of contract law raise different concerns, which therefore warrant different types and levels of regulation. For instance, it can be accepted that the regulatory threshold (whether through statute or the judiciary) for intervention in consumer contracts is generally lower than that of commercial contracts, given that there is a need for the law to protect parties in a weaker position.[3] But in relation to commercial contracting parties, the type and level of intervention that is appropriate remains unclear. This position subsists in relation to general contract law[4] as well as insurance contract law.

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[1] For example, Robert Merkin and Ozlem Gurses, 'The Insurance Act 2015: Rebalancing the Interests of the Insurer and Insured' (2015) 78 (6) MLR 1004; Baris Soyer, 'Risk Control Clauses in Insurance Law: Law Reform and the Future' (2016) 75 (1) 109; Robert Merkin and Ozlem Gurses, 'Insurance Contracts after the Insurance Act 2015' (2016) 132 (3) Law Quarterly Review 445; Malcolm Clarke and others (eds), *The Insurance Act 2015: A New Regime for Commercial and Marine Insurance Law* (Informa 2017); Baris Soyer, *Warranties in Marine Insurance* (3rd edn, Routledge 2017). With exceptions, see James Davey, 'Utmost Good Faith, Freedom of Contract and the Insurance Act 2015' (2016) Insurance Law Journal 247.

[2] See section 1.3.4 in Ch 1 regarding how 'regulation' is used in this thesis.

[3] Rajiv Shah, 'Morgan's Minimalism: An Epistemic Approach to Contract Law' (2016) 28 (3-4) Critical Law Review 356, 370.

[4] It is beyond the scope of this thesis to engage in the debate about whether there exists a general contract law. See YongQiang Han, 'The Relevance of Adams and Brownsword's Theory of Contract Law Ideologies to Insurance Contract Law Reform in Britain: An Interpretative and

This is where the theoretical visions mentioned above become relevant. There is a long-standing debate in contract law between two dominant schools of thought: contextualism, and formalism, with its modern variant being neo-formalism.[5] This debate is, to some extent, relevant to the design of statutes[6] but, more importantly this debate centres on 'the rules of contract law as applied by judges in resolving contract disputes in courts'.[7] Formalism refers to a theory of contract law that gives preference to the written contract so form over substance. It is rules-based and favours literal approaches to interpretation. The concept of private ordering is central to formalism, that is, that private actors should be free to create their own voluntary, legally binding obligations free of unnecessary judicial and statutory interference. It upholds classical values such as freedom of contract and legal certainty but 'leaves little room for case-by-case inquiries that consider the context of the deal, the behavior of the parties and their relative bargaining positions'.[8] Contextualism on the other hand, is sensitive to context and it emphasises values such as fairness and reasonableness.[9]

John Gava supplements this:

> …contextualism, argues that judges should give effect to the expectations, practices and desires of the business community when deciding contract disputes and developing contract law. A contextualist law of contract would give primacy to standards such as good faith and unconscionability and look to business norms and practices to interpret contracts and to fill any gaps. This would be dynamic

Evaluative Approach' (PhD thesis, University of Aberdeen 2013) 9; Tony Weir, 'Contract—The Buyer's Right To Reject Defective Goods' (1976) 35 CLJ 33, 38; Nathan Oman, 'A Pragmatic Defense of Contract Law' (2009) 98 Georgetown L Journal 77.

[5] Zhong Xing Tan, 'Beyond the Real and the Paper Deal: The Quest for Contextual Coherence in Contractual Interpretation' (2016) 79(4) MLR 623**,** 627.

[6] For example, a more protectionist approach may result in the design of mandatory rules, or a more contextualist law may result in more open-natured default rules. Default rules do not necessarily imply a less protectionist approach as is discussed below at Section 2.4.2.4.

[7] Catherine Mitchell, 'Commercial Contract Law and the Real Deal' in Christian Twigg-Flesner and Gonzalo Villalta-Puig (eds), *The Boundaries of Commercial and Trade Law* (Sellier European Law Publishers, Munich, 2011) 21.

[8] Meredith Miller,' Contract Law, Party Sophistication, and the New Formalism' (2010) 75(2) 493, 498-9.

[9] ibid.

> contract law because it would be continually refined to give effect to changing business norms, expectations and behaviour.[10]

Gava adds:

> The alternative response, formalism, argues that since business uses law selectively, that is, when the law suits its purposes, it would be counterproductive if the law were anything other than predictable. In other words, if the law is continually changing to match perceived notions of business needs or expectations, the law would be unpredictable and not a useful tool for these businesspeople. Formalism eschews open-ended concepts such as good faith and relies on bright-line rules and strict limits on judicial discretion.[11]

Formalism has evolved into neo-formalism of which its primary proponent in the UK is Jonathan Morgan.[12] Neo-formalism recognises the existence of relational norms to a contractual transaction but views a contextual approach as giving rise to concerns pertaining to the limited capacity of judges to enforce such norms.[13] As espoused by Morgan, contract law should be minimalist, in that, default rules should be clear, simple and strict. This view acknowledges that 'sophisticated parties are better able to draft optimal contracts than the law can supply optimal default rules'[14] and contract law minimalism provides the better framework to support commercial markets.

These schools of thought translate into different levels of private law regulation that pursue different purposes. At one end of the spectrum is Morgan's neo-formalist approach, which advocates for a contract law minimalist approach to the regulation of commercial contracts. At the other end of the spectrum are the more mainstream theoretical perspectives, broadly grouped under 'contextualism' that calls for a different

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[10] John Gava, 'Taking Stewart Macaulay and Hugh Collins Seriously' (2016) 33 Journal of Contract Law 108, 109. See also R Brownsword, 'Static and Dynamic Market Individualism' in R Halson (eds), *Exploring the Boundaries of Contract* (Aldershot, Dartmouth 1996).

[11] Gava, 'Taking Stewart Macaulay and Hugh Collins Seriously' (n 10) 109.

[12] Jonathan Morgan, *Contract Law Minimalism: A Formalist Restatement of Commercial Contract Law* (CUP 2013).

[13] Tan, 'Beyond the Real and the Paper Deal' (n 5) 627. 'Contextualism' in this sense is intended to subsume the relational theory scholarship.

[14] Morgan, *Contract Law Minimalism* (n 12) xiv.

approach to the regulation of contracts,[15] including the relational theory approach and Hugh Collins's relational/regulatory approach.[16]

At this juncture it is pertinent to highlight a salient theme that will run throughout this thesis: law versus scholarship. The reason for this distinction is because the debate has had a different reception within contract law as opposed to contract scholarship. Key to this distinction is whether this debate influences law, or indeed should influence law.[17] As will be shown, the contextualist movement is the leading school of thought in scholarship, whereas law as applied by judges tends to remain more formalistic. This distinction is of course too tidy, and the exceptions and the overlaps between law and scholarship will be discussed in due course. It however suffices for now to acknowledge this distinction and its potential implications on the development of insurance contract law.

A key aspect pertaining to the different levels of regulation is how interventionist the law should be at both a statutory and judicial level. In other words, to what extent should statutes intervene in commercial relationships and transactions, and how far should judges intervene when resolving a dispute between commercial parties? Should the written contract take precedence or should judges look to the socio-economic context of the parties' contract? As Hugh Collins says, 'the design of legal regulation is both a complex task and one which has implications for contractual behaviour'.[18] It is not in dispute that marine insurance markets should be regulated rather the dispute arises with the type of regulation that is appropriate for these markets.

[15] A point of clarification is that a different approach to regulation in this context is taken to mean more regulation. But this also takes into account the view that other types of regulation, such as relational theory, is not exactly 'more' regulation because it takes into account different values. See David Campbell, 'Arcos v Ronaasen as a Relational Contract' in Campbell and others (eds), *Changing Concepts of Contract: Essays in Honour of Ian Macneil* (Palgrave Macmillan 2013) 138; David Campbell, 'Adam Smith and the Social Foundation of Agreement: *Walford v Miles* as a Relational Contract' (2017) 21(3) Edinburgh Law Review 376.

[16] These are discussed below at Section 2.4.2.

[17] While this is considered to some extent in this thesis, the full scope of this discussion will form part of my research post-PhD.

[18] Hugh Collins, *Regulating Contracts* (OUP 1999) v.

The purpose of this chapter is to discuss and evaluate the debate and thereby lay the groundwork for the following central normative claims of this thesis as discussed in Chapters 3 and 4:

(i) the 2015 Act reflects a new type of regulation that pursues 'contextualist' tendencies as viewed through the case studies of warranties, risk control terms and the contracting out provisions;
(ii) the design of the 2015 Act implicates a different approach to default rules; and
(iii) a more suitable form of regulation for marine insurance contract law is contract law minimalism as advocated by Morgan.

Contract law minimalism as an alternative framework will be defended on two levels: statutory and judicial regulation. The former analyses the type and design of the 2015 Act by drawing on default rules analysis.[19] Secondly, in relation to judicial regulation I exemplify the type of analysis in which courts should be engaging following the 2015 Act.[20] Even though my thesis supports a minimalist approach to the regulation of marine insurance contract law it does not have the same goals as Morgan's monograph. I am not pursuing a formalist restatement of commercial law, and hence an exhaustive restatement of minimalism is beyond the scope of this thesis. I instead adopt the key claims of minimalism to critique the type and level of regulation that is the 2015 Act and to highlight challenges to judicial regulation.

This chapter first provides an overview of marine insurance contract law and the 2015 Act. Secondly, the foundational elements of contract law minimalism as set out by Morgan are discussed. Thirdly, it examines the main scholarship on the debate between (neo) formalism and contextualism and demonstrates why minimalism is the better theoretical approach for commercial (insurance) contracts. Fourthly, it examines the influence of these theoretical approaches *in law* by providing an overview of the direction of contractual interpretation. Fifthly, it discusses some contract law cases to highlight the tug-of-war between the different theoretical approaches. Finally, it concludes by reaffirming that minimalism is the better option for sophisticated commercial markets.

[19] Discussed at Section 2.4.2.4.

[20] Judicial regulation refers to the development of case law through the interpretative approach that courts adopt in relation to statutes. Judicial regulation, as used here, does not deal with the making of new common law rules.

Finally, the originality and relevance of this chapter is that it does not simply rehearse the academic debates about the theoretical visions for contract law; rather it adopts a critical evaluation of those paradigms by applying it to commercial marine insurance contract law. This is a novel methodology in relation to both the 2015 Act and marine insurance contracts.

2.2 (Marine) Insurance Contract Law

The aim of this section is to introduce marine insurance contract law and to situate it within the contract law framework, thereby helping to orientate the discussion for later chapters. Although there is an alignment between insurance contract law and general contract law, there is also certainly a level of distinctness between both. Insurance law has a 'unique economic rationale'[21] as it is about risk. Even though the allocation of risk is also pertinent to non-insurance transactions, the point of insurance is to facilitate the transfer of the consequence of risk for the payment of a premium by the insured.[22] The economic rationale should not however detract from the fact that an insurance policy is a contract, and like every other contract it is regulated by law that encompasses statutory, judicial and administrative regulation.[23]

The point to be made here is that insurance law is 'not an exotic species'[24] that functions or develops in isolation. Rather it is a sub-species of the law of contract and 'is an alliance of statute, common law doctrine and ideology at the heart of which lies the core values of freedom of contract and legal certainty'.[25] The bottom line is that commercial insurance contracts are commercial contracts, and it is within commercial law that the classical law

[21] Han (n 4) 6.

[22] ibid 29.

[23] Jay Feinman, 'Contract and Claim in Insurance Law' (2018) 25 Connecticut Insurance Law Journal 159,161.

[24] KS Abraham, *Distributing Risk* (New Haven, Conn 1986) 9. See also Malcolm Clarke, *Policies and Perceptions of Insurance Law in the Twenty-First Century* (OUP 2007) 357.

[25] Howard Bennett, 'Reflections on Values: The Law Commissions' Proposals with respect to Remedies for Breach of Promissory Warranty and Pre-formation Non-Disclosure and Misrepresentation in Commercial Insurance' in Baris Soyer (ed), *Reforming Marine and Commercial Insurance Law* (Informa 2008) 157.

finds its biggest support.[26] Commercial law is grounded historically in the need to support trade and commerce, which necessitated clarity, predictability and certainty in devising and applying legal rules to facilitate these markets. The alignment between insurance contract law and contract law provides the impetus for considering the utility of contract theory to marine insurance contracts. Much of the developments in insurance contract law is also an attempt to bring it in line with general contract law. It also means that the findings of this thesis in relation to marine insurance provides a useful perspective for statutory and judicial regulation for other types of commercial contracts.

In view of the above, the formation and interpretation of a contract of marine insurance is therefore governed by the ordinary principles of contract law. Notwithstanding that, the application of these principles must be considered in the context of the practice of insurance markets.[27] As explained by Rob Merkin and Jenny Steel:

> Insurance is an institution of the market which is directed at profit as much as security; and like obligations law, it necessarily has a close association with market relations.[28]

Marine insurance is the oldest form of premium insurance and the longevity of the Marine Insurance Act 1906 ('the 1906 Act') is well-known.[29] It was one of the products of the Victorian codification movement and while applicable to marine insurance law, over time its principles were extended to and applied to all insurance. The reform of the 1906 Act has been in the pipeline since 1980 and in 2006 was picked up by the English and Scottish Law Commissions who undertook a project to reform insurance contract law ('the Law Commissions').[30]

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[26] Clarke, *Policies and Perceptions* (n 25) 357.

[27] H Bennett, *The Law of Marine Insurance* (2nd edn, London 2006) 29.

[28] Rob Merkin and Jenny Steele, *Insurance and the Law of Obligations* (OUP 2013) 34.

[29] The Marine Insurance Act 1906 ('the MIA 1906') which acted as an informal harmonising instrument, particularly in common law jurisdictions, formed the basis of marine insurance laws in several jurisdictions. The MIA 1906 was either incorporated verbatim in jurisdictions such as Australia, Canada, Hong Kong, New Zealand, Singapore, Malaysia and India, or permeated the development of insurance law in jurisdictions such as South Africa, the USA and Japan.

[30] English Law Commission, *Non-Disclosure and Breach of Warranty* (Law Com CP 104, 1980).

The scope of 'commercial marine insurance' for the purposes of this thesis was discussed in Section 1.3.1. For convenience, some of the key aspects of the new statutory dispensations are reiterated here. First, CIDRA 2012 applies only to consumer insurance whereas the 2015 Act applies to both consumer and commercial insurance. CIDRA 2012 is a mandatory regime for consumer contracts whereas the 2015 Act operates as a default regime that allows non-consumer parties to 'opt out' of provisions of the Act.[31] It can be assumed that anybody who is not a consumer within the definition in CIDRA 2012 and the 2015 Act is therefore a commercial party.[32] Secondly, the 2015 Act amends the existing common law and the 1906 Act and is applicable to all commercial insurance contracts, including marine insurance. As most contracts of marine insurance are non-consumer insurance contracts,[33] the 2015 Act and not CIDRA 2012 will be considered.

Having introduced the scope of the reforms, I now turn to examine some preliminary points on the core reforms that are the focus of this thesis: warranties, risk control terms and contracting out ('the case studies').[34] Insurance warranties are different to warranties in contract law. A warranty in contract law is a relatively minor term of the contract, whereas in insurance law a warranty was a fundamental contractual term that functioned as a means for insurers to properly circumscribe the risk and to guard against an alteration of the risk that would render it materially different from the risk assumed by the insurer. It has an ancient pedigree dating back to marine insurance in the 17th century and comes in two types:[35] an affirmative warranty regulates the past or present state of affairs whereby the insured states unequivocally that a certain state of affairs exists at the time of making the warranty (such a warranty would state, for example, that a vessel has been surveyed in the last 12 months and has complied with the recommendations of that survey); a continuing warranty regulates what an insured may or may not do during the

[31] John Birds, *Birds' Modern Insurance Law* (10th ed, Sweet & Maxwell 2016) 16.

[32] CIDRA 2012, s1(a) defines a 'consumer' by reference to the definition of a 'consumer insurance contract'. A 'consumer' is therefore defined as 'an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession'. The IA 2015, s1 defines a 'non-consumer insurance contract' as 'a contract of insurance that is not a consumer insurance contract'.

[33] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn Sweet & Maxwell 2018) para 1.5-04.

[34] The Insurance Act 2015 ('the IA 2015'), s10 (warranties); s11 (risk control terms); ss 16-17 (contracting out). Discussed fully in Chapter 3.

[35] There are further sub-divisions such as warranties of belief or warranties of opinion.

currency of the policy so as not to increase the risk undertaken (for example, a warranty that a vessel shall not navigate in certain areas during the currency of the policy).

The Achilles heel of the law on warranties was the disproportionate remedy on breach which allowed an insurer to avoid all prospective liability notwithstanding that the breach was not material and/or the fact that the breach did not cause the loss.[36] Section 10 of the 2015 Act has amended the remedy for breach of warranties from automatic discharge of the insurer's liability upon breach[37] and instead provides for suspension of the insurer's liability from the time of breach.[38] If the breach is remedied, liability will reattach.[39] But s10 is said to only provide a partial solution as it does not prevent insurers relying on a breach of warranty that has nothing to do with the loss in question. For instance, if the warranty requires the assured to not transit through certain prohibited areas during the policy period, the assured will not be able to recover for loss emerging from an unrelated fire arising at whilst the vessel was in the prohibited area. Section 11 of 2015 Act (s11) has been designed to improve the position of the assured in such a case, to prevent insurers relying on irrelevant warranties (terms) where there is no connection between breach and loss. These provisions will be expanded on in Chapter 3.

The idea behind the 2015 Act was that the entire area of commercial insurance law would be reformed but where these rules did not suit the untargeted market (eg marine insurance) then such parties would still have the option to contract out of the reforms. The contracting out provisions regulate instances where contracting out of the 2015 Act puts the insured in a worse position than s/he would be under the 2015 Act.[40] In so doing, these provisions were meant to ensure that the contracting out process was transparent and explicit. Contracting out was viewed as a 'saving grace' in maintaining freedom of contract for sophisticated markets who choose to opt out of the default regime. However, this thesis claims that the case studies reflect a new type of regulation in marine insurance contexts. The narrative of this thesis is that contract law minimalism as advocated by Morgan is a better framework for regulating sophisticated marine insurance contracts.

[36] The MIA 1906, s33(3).

[37] The IA 2015 Act, s10(1) and s10(7)(a).

[38] ibid s10(2). The provisions on warranties in the IA 2015 applies to both consumers and commercial parties.

[39] ibid s10(4), s10(5) and s10(7)(b).

[40] The IA 2015 Act, s16(1).

2.3 Defining Contract Law Minimalism

The contextualist-(neo) formalist debate provides the theoretical framework for this thesis and there are several strands to this debate. One of those strands is the neo-formalist perspective as propounded by Morgan[41] This thesis lends support to Morgan's hypothesis on contract law minimalism and extends that hypothesis to commercial insurance contract law. By drawing on insights from the minimalist hypothesis, the central claims of this thesis are two-tiered. The first tier is statutory regulation which analyses the type and design of the 2015 Act by drawing on default rules analysis. This thesis claims that the 2015 Act should have been modelled along minimalistic lines. The second tier is judicial regulation, examining why and how judges should adopt a minimalistic approach to interpretation in sophisticated commercial (marine) insurance contracts. I will expand on these propositions below but it is first necessary to explain the minimalist hypothesis, thereby creating a platform for the defence of minimalism in subsequent analyses.

As stated previously there are different levels of private law regulation to suit different types of contractual transactions and parties. The type of regulation depends on the purpose that it serves. For instance, statutory regulation in some instances may consist of default rules whereas in other instances immutable rules may be more appropriate. The obvious example that comes to mind in the latter instance is immutable rules to protect consumers from unfair contract terms. A higher level of regulation or a more interventionist form of regulation is usually deemed acceptable to protect parties in a weaker position, such as consumers. In contrast, where parties occupy a stronger bargaining position in relation to each other or where equality of bargaining power can be assumed, a less interventionist regulatory stance would be more suitable, and in that instance default rules will suffice.[42] Herein lies one of the central claims of this thesis, and marine insurance is relied on as the quintessential example that justifies a less interventionist approach in an insurance context.

Commercial contract law consists largely of default rules which means that the default rule will govern unless there is agreement to the contrary. This requires a qualification though as contract law minimalism is a hypothesis for commercial contract law as opposed to consumer contracts. This restriction to commercial contracts is understandable

[41] Morgan, *Contract Law Minimalism* (n 12).

[42] See *Photo Production Ltd v Securicor Ltd* [1987] 1 AC 827 (HL).

when the rationale for contract law minimalism is considered. Minimalism is the approach of least interference in the regulation of commercial contracts and upholds the classical values of freedom of contract and legal certainty. Morgan explains that given the lack of evidence of the positive effect of regulation it is best to leave parties to design their own rules.[43] Morgan advances a hypothesis for the minimal regulation of commercial contract law with the following main elements:

(i) That commercial contract law serves a central purpose, which is to provide a suitable legal framework for trade;
(ii) That it is fundamentally optional in nature in that it comprises default rules;
(iii) That these default rules should be clear, simple and formal; and
(iv) That these rules are for dispute resolution not contract governance.[44]

In elaborating on these main elements, first, Morgan posits that contract law is instrumental as it has 'a social purpose of supporting trade and commerce'.[45] Minimalism, in his view, is the best way to fulfil this broader social purpose.[46] Morgan says that minimalism 'is *instrumental* formalism, neither ideological nor doctrinaire'[47] and contrasts traditional formalism with its neo-formalist variant. Traditional formalism focused on the written contract between the parties and to giving effect to the words of the contract. Minimalism, on the other hand, is not formalism for the sake of being formalist. Rather it recognises the necessity of formalism to support a broader social goal of supporting trade and commerce.

The second and third elements of minimalism are that commercial contract law is largely comprised of default rules due to the need to satisfy parties' preferences.[48] Morgan believes that this reasoning is justified on the basis that sophisticated parties (such as those in the marine insurance market) can and do contract out of inefficient rules and may exit the legal system altogether.[49] Default rules can reflect 'multiple competing regulatory

[43] Morgan, *Contract Law Minimalism* (n 12) 154.

[44] ibid xiii.

[45] ibid 98.

[46] ibid.

[47] ibid.

[48] ibid 87. cf Catherine Mitchell, *Contract Law and Contract Practice: Bridging the Gap between Legal Reasoning and Commercial Expectations* (Oxford Hart 2013).

[49] Morgan, *Contract Law Minimalism* (n 12) xiii.

objectives'[50] and that is why the design of default rules is important to any law reform project.[51] A dominant stand of the minimalist view is that the design of default rules for commercial contract law should be clear and 'non-sticky'[52] thereby maximising freedom of contract and legal certainty. In contrast, immutable rules exist as a matter of public policy to generally protect weaker parties from an abuse of power, such as fraud, duress, and illegality.[53] As Morgan says:

> [t]he publicly supplied rule of contract should be minimalist. Simple default rules are the easiest for the courts to formulate and apply. Their clarity and predictability also makes them the easiest rules to contract away from.[54]

The final element of minimalism is that the law is for dispute resolution rather than 'contract governance'.[55] Morgan views contract law as being instrumental to the resolution of disputes rather than to the relationship between the parties.[56] This is achieved through the characteristic features of the law such as formal rules and procedures that are best suited for dispute resolution. Morgan connects this final element of minimalism to Lisa Bernstein's distinction between Relationship Preserving Norms (RPN) and End Game Norms (EGN).[57]

Bernstein conducted empirical research into private dispute resolution procedures in particular industries. She found that business people tended to rely on their own industry's dispute resolution regimes (supplemented by measures such as loss of reputation) when

[50] ibid 116-7; Jean Braucher, 'Contract versus Contractarianism: The Regulatory Role of Contract Law' (1990) 47 Washington & Lee L.R. 701-2.

[51] This is dealt with in detail in Chapters 3 and 4.

[52] This refers to default rules analysis, which will be discussed in more detail below in Section 2.4.2.4.

[53] Morgan, *Contract Law Minimalism* (n 12) 91.

[54] Jonathan Morgan, 'In Defence of *Baird Textiles*: A Sceptical View of Relational Contract Law' in Campbell and others (eds), *Changing Concepts of Contract: Essays in Honour of Ian Macneil* (Palgrave Macmillan 2013) 180.

[55] Morgan, *Contract Law Minimalism* (n 12) 88.

[56] Shah (n 3) 368.

[57] Morgan, *Contract Law Minimalism* (n 12) 103. See also Lisa Bernstein, 'Merchant Law for a Merchant Court: Rethinking the Code's Search for Immanent Business Norms' (1996) 144 (5) University of Pennsylvania Law Review 1765.

there was a breach of contract rather that have recourse to the law.[58] By examining these private dispute procedures in certain industries, Bernstein found that there was a rigid adherence to strict rules of the trade association in enforcing the contract between the parties.[59] This displayed a preference for a formalistic approach for dispute resolution in these markets. According to Bernstein, RPN prevail during the relationship and:

> induce the parties to co-operate with each other and deter[ring] them from taking aggressive action such as (paradigmatically) litigation that would damage the relationship of trust between them.[60]

EGN are applicable at the stage when there is dispute between the parties, that is, a break down in their relationship.[61] In the 'end game' stage, 'the parties vigorously assert rights against each other and generally behave in a legalistic fashion'.[62] Mitchell says that Bernstein's work has 'enriched and complicated the debate about the interrelationship between formal and non-formal sanctions for breach'.[63] In Bernstein's empirical study of the intra-trade dispute in the cotton and grain industries she highlighted the problem of courts relying on informal norms (RPN) to resolve disputes.[64] Her work revealed that traders in this industry tend to opt out of the public legal system in favour of their own private dispute resolution mechanisms, which Bernstein found, were hard-edged formal trade rules (incorporated into contracts) rather than open-textured standards such as good faith.[65] These formalist arbitral philosophes co-existed with relational cooperative norms as identified by Macneil and Macaulay.[66] The point of these empirical studies is that

[58] Catherine Mitchell, 'Remedies and Reality in the Law of Contract' in Halson & Campbell (eds), *Research Handbook on Remedies in Private Law* 72-3.

[59] Catherine Mitchell, *Interpretation of Contracts* (2nd edn, Routledge-Cavendish)102-3.

[60] Bernstein, 'Merchant Law for a Merchant Court' (n 75) 1765.

[61] Morgan, *Contract Law Minimalism* (n 12) 103.

[62] ibid.

[63] Mitchell, 'Remedies and Reality in the Law of Contract' (n 76) 72-3.

[64] Lisa Bernstein, Private Commercial Law in the Cotton Industry, Creating Cooperation through Rules, Norms, and Institutions' (2001) 99 Mich L Rev 1724

[65] Mitchell, *Interpretation of Contracts* (n 77) 117-118. Bernstein, 'Cotton Industry' (82).

[66] Morgan, *Contract Law Minimalism* (n 12) 104.

Bernstein found that relational norms during the relationship and formal norms at dispute resolution both existed in a commercial relationship. [67]

Caution needs to be expressed as to how Bernstein's research is used to support the minimalist hypothesis in relation to marine insurance contracts. The types of contracts which formed the substance of Bernstein's research is different to that of marine insurance contracts. The industries and markets which formed part of Bernstein's empirical work dealt with contracts drafted by industry associations who represented both parties – buyers and sellers. The participants in the insurance industry - with the exception of Protection and Indemnity Clubs – are either sellers or purchasers of insurance. Hence, the contract is not drafted by an overarching industry body representing both sides. Notwithstanding that, Bernstein's arguments are relied on to show that a different set of values informs the relationship and dispute resolution and, this furthers the minimalist claim that contract law is for dispute resolution.[68] Bernstein, like Collins, argues that there are 'different normative orders governing a contractual relationship'. [69] Bernstein, in contrast to Collins, argues that courts should reason by relying on the legal-contractual perspective when parties are in the end game or dispute stage.

In relation to commercial contracts generally, Morgan is of the view that the EGN or the dispute resolution phase is when law best serves its function. He explains this by examining the relationship between legal and extra-legal norms (such as co-operative norms). He believes that the former is largely irrelevant to commercial relationships 'because recourse to the law is a last resort'.[70] In expanding on this notion, Morgan argues that it is counter-productive to enforce extra-legal norms as enforcing co-operation through the law is counter-intuitive to the notion of co-operation itself.[71] Consequently, Morgan posits that the legal process is inimical to promoting trust between the parties[72] and hence it best serves its function when the relationship has broken down (ie dispute

[67] ibid.

[68] ibid 103.

[69] ibid 104.

[70] Shah (n 3) 366.

[71] Morgan, *Contract Law Minimalism* (n 12) 88.

[72] ibid.

resolution).[73] Commercial parties, in his view, are better able to regulate their interactions themselves than have the courts do so.[74]

Morgan's approach (supported by Bernstein's research) is relied on to show that a distinction between RPN and EGN also exists in relation to marine insurance contracts. During the currency of an insurance contract, relational norms will govern as parties will cooperate in order to secure and maintain insurance coverage and for the insurer to continue to receive its premium. However when a dispute arises, this is when insurance contract law serves its function by being formal and certain. Relational norms impose flexibility and at the end game parties want to maintain control over flexibility, rather than have it enforced.[75]

Morgan's minimalism is also distinguished from what commercial contract law should not aim to do.[76] As mentioned above, default rules can pursue different regulatory objectives. Here, two rival regulatory objectives to minimalism are briefly discussed: that the goal of the law of contract should either be economic efficiency (law and economics), or recognising the empirical reality between parties (relational theory).[77] The law and economics approach advocates that '[l]egal rules should be designed as efficiently as possible'[78] as '[t]his will maximise the wealth of the parties (in a contractual setting)'.[79] In criticising the law and economics approach:

> Morgan questions neo-classical economic assumptions about the rationality of actors and he maintains that it is impossible to make testable predictions about the impact of a given law on economic efficiency'.[80]

[73] Shah (n 3) 377.

[74] ibid.

[75] Mitchell, *Interpretation of Contracts* (n 77) 117-118.

[76] Morgan, *Contract Law Minimalism* (n 12) 89; cf Alan Schwartz and Robert Scott, 'Contract Theory and the Limits of Contract Law' (2003) 113 Yale LJ 541.

[77] Morgan, *Contract Law Minimalism* (n 12) 117. This thesis does not examine the merits of the 'law and economics' scholarship in detail.

[78] ibid 43.

[79] ibid 43.

[80] Shah (n 3) 357.

As such, even if economic efficiency was indeed a viable goal to be pursued, the practicalities of a law of contract built around this goal would be uncertain. Consequently, 'the law should not try to fill gaps in contracts with 'efficient' default rules'.[81] To support this view, Morgan draws on Posner, commenting that 'the economic debate about default rules is mired in complexity'[82] and that it 'seems to founder for want of the empirical data necessary to apply the economic models'.[83] Morgan says that commercial parties prefer the clarity of rules, characteristic of formalism in English contract law and, consequently the complexity of the law and economics movement lends support to the preference for 'simple rules of law'.[84]

On the other hand, the proponents of relational theory 'call for defaults to narrow the gap between (classically discrete) contract law and the co-operative norms structuring commercial relations'. [85] Relational theory has proved influential in scholarship. Relational theory characteristically calls for doctrinal flexibility and for the law of contract to accommodate greater flexibility of relationships of trust and co-operation. Relational theory will be discussed in more detail in section 2.4.2.1 but it suffices to say that Morgan, in opposition to the views of some relational contract theorists, asserts that the law should not enforce norms of trust and co-operation.

A question arises about why it was necessary for Morgan to write a formalist restatement of commercial contract law. It became necessary due to the trajectory of modern legal regulation. Legal regulation has become increasingly relevant largely prompted by a move from the classical law of contract towards a 'contextual turn' in contract law theory and practice. Minimalism has been criticised for 'impoverishing commercial law by focusing on its default nature' and that it empties it of 'normative substance'.[86]

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[81] Morgan, *Contract Law Minimalism* (n 12) 89.

[82] The debate on the design of default rules is well explored in contracts scholarship in the North Atlantic. Seminal articles in this area include, I Ayres and R Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 Yale LJ 87; C Goetz and R Scott, 'Principles of Relational Contract' (1981) 67 Virginia LR 1089.

[83] Morgan, 'In Defence of *Baird* (n 72*)* 180.

[84] Morgan, *Contract Law Minimalism* (n 12) 60.

[85] ibid 117.

[86] Catherine Mitchell, 'Obligations in Commercial Contracts: A Matter of Law or Interpretation?' (2012) 65(1) Current Legal Problems 455, 488.

Morgan disagrees by saying that minimalism is 'formal' in 'its adherence to strict rules over vague principles'[87] and focuses on the written text of agreements than context. However minimalism has a 'distinct theoretical basis' which differs from classical formalism.[88] Morgan states that the new formalism 'no longer believe[s] in doctrine for doctrine's sake'.[89] Rather 'purity in contract law is promoted for avowedly instrumental reasons.'[90] He adds that minimalism 'is criticized for lacking fidelity to classical contract law, being instead a formalist critique'[91] but that '[m]odern formalism, or minimalism, is functional and pragmatic, not merely abstract or aesthetic'.[92]

Minimalism is the minority viewpoint, as evidenced by the dearth of scholarship in England that supports Morgan's thesis. Morgan however finds support from the American neo-formalists, led by scholars such as Lisa Bernstein, Robert Scott and Alan Schwartz.[93] Like any theory, minimalism has its limitations and is described as a hypothesis by Morgan rather than a settled theory.[94] As will be discussed below, minimalism is supported by empirical evidence and the inherent limits of the legal process.[95] I assert that minimalism should be applauded and not derided. Even though minimalism is simple to define it is by no means a simple abstraction that does little for contract law and practice. To defend the minimalist hypothesis as a more suitable framework for marine insurance

[87] Morgan, *Contract Law Minimalism* (n 12) 90.

[88] ibid.

[89] ibid.

[90] ibid.

[91] ibid. Gava, Can Contract Law be Justified on Economic Grounds?' (2006) 25 University of Queensland LJ 253.

[92] Morgan, *Contract Law Minimalism* (n 12) 90.

[93] Among others: Robert Scott, 'A Relational Theory of Default Rules for Commercial Contracts' (1990) 19 Journal of Legal Studies 597; Alan Schwartz, 'Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies' (1992) 21 Journal of Legal Studies 271; Lisa Bernstein, 'Opting Out of the Legal System: Extra-legal Contractual Relations in the Diamond Industry' (1992) 21 Journal of Legal Studies 115; Bernstein, 'Merchant Law for a Merchant Court' (n 75); Robert Scott, 'The Case for Formalism in Relational Contract' (2000) 94 North-Western University LR 847; Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' (n 99); Robert Scott, 'The Death of Contract Law' (2004) 54 University of Toronto LJ 369.

[94] Morgan, *Contract Law Minimalism* (n 12) 100.

[95] Discussed further in Section 2.4.2.5 below.

contract law, it is pertinent to examine the contemporary shift in legal regulation that has given rise to different schools of thought.

2.4 The Shifting Paradigms in Contract Law Scholarship

2.4.1 The Debate: (Neo) Formalism and Contextualism

Contract law minimalism is reactionary as it is a response to a shift in legal regulation towards 'contextualism'. It was previously highlighted that there is a distinction between law and scholarship.[96] Despite contract law remaining largely formal, the tide of recent thinking reflects a 'tension within contemporary contract law'[97] and scholarship. In contract *scholarship*, '[f]ormalism has become an insult'.[98] Formalism is viewed as simplistic,[99] unsophisticated and lacking a proper appreciation and understanding of how contracting works.[100] This shifting paradigm is due to growing dissatisfaction with contract law for various reasons, including the lack of differentiation for tracking the complexity of contracting practices[101] and the limitations of classical contract law in giving effect to and 'developing relational and network dimensions to contractual practice'.[102] This section first provides an overview of the contextualist-(neo) formalist debate before proceeding to discuss the specific strands that make up the debate. Understanding this debate along with its merits and limitations will help to understand why this debate should matter in insurance contract law.

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[96] Referred to in Sections 1.4 in Ch 1 and 2.1 above.

[97] Ronan Condon, 'From the 'Law of A and B' Roger Brownsword and others (eds), *Contract and Regulation: A Handbook on New Methods of Law Making in Private Law* (Edward Elgar Publishing 2017) 175. See also R Brownsword, 'Contract Law, Co-operation and Good Faith: The Movement from Static to Dynamic Market Individualism' in S Deakin and others (eds), *Contracts, Co-operation and Competition* (OUP 1997).

[98] Thomas Nachbar, 'Form and Formalism' University of Virginia School of Law, Public Law and Legal Theory Research Paper Series (January 2018) 1.

[99] ibid 1- 3. See also Richard Posner, 'What Has Pragmatism to Offer Law' (1990) 63 Southern California LR 1653, 1665.

[100] Nachbar, 'Form and Formalism' (n 105) 1-3.

[101] Condon, 'From the 'Law of A and B' (n 104) 171.

[102] ibid 172. See also Roger Brownsword, *Contract Law: Themes for the Twenty-First Century* (2nd edn, OUP 2006).

As the American scholar Omri Ben-Shahar has observed:

> Well-rooted in modern commercial law is the idea that the law and the obligations that it enforces should reflect the empirical reality of the relationship between the contracting parties. The Uniform Commercial Code ('Code') champions this tradition by viewing the performance practices formed among the parties throughout their interaction as a primary source for interpreting and supplementing their explicit contracts. This approach, which allows the reality of the relationship to override rigid allocations of rights and duties in the bargain, has long been celebrated for its nonformalist spirit. Formalism – the separation of law from life, of the meaning of the text from its context – is rejected in favor of pragmatism.[103]

Even though Ben-Shahar was speaking to the position in the US, his views echo the sentiments of much of the 'contextualists' in England, in particular the rejection of formalism and the embrace of the 'reality' of the contractual relationship over the contract. The US provides a notable example of the shift from formalism to contextualism (realism) as one of the best depictions of that is the Uniform Commercial Code (UCC).[104] The UCC was drafted along contextualist lines by drawing on business practice in relation to commercial contracts.[105] Llewellyn who wrote extensively on the jurisprudence of the UCC was a realist who favoured flexibility and contextualism in interpreting contracts and was critical of the classical law.[106]

Morgan adds that formalism has been increasingly diluted since the middle of the 20th century through what he describes as the 'creep of contextualism, discretion and

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[103] Omri Ben-Shahar, 'The Tentative Case Against Flexibility in Commercial Law' (1999) 66 University of Chicago Law Rev 781.

[104] Hugh Beale and Roger Brownsword write that 'contextualism' in England dates back to the late 1990s. The US had a much earlier reception to 'contextualism' with its origins in American realism in the 1920s, which was later accepted by US courts in the 1960s and 1970s.
See Jay Feinman, 'Introduction' in Campbell, *Changing Concepts of Contract* (n 16) 3; Hugh Beale, 'Relational Values in English Contract Law' in Campbell, *Changing Concepts of Contract* (n 16) 131; Roger Brownsword, 'Post-Technique: The New Social Contract Today' in Campbell, *Changing Concepts of Contract* (n 16) 23.

[105] Morgan, *Contract Law Minimalism* (n 12) 90.

[106] ibid.

regulation'.[107] The 'realist' approach had attempted to make courts 'sensitive to the goals and norms of the regulated'.[108] Formalism was therefore rejected and shunned. The developments in the US and England have been moving at different paces. English courts have been embracing contextualism,[109] whereas in the US the neo-formalist approach has reinvigorated an approach 'that resemble[s] the abstraction of traditional English courts'.[110] This was indicative of a move from formalism to realism but then to neo-formalism in the US.[111] Despite these theoretical approaches, English law (as opposed to scholarship) remains broadly formalist, with doctrinal reasoning and the emphasis on the written contract outweighing 'considerations of social and economic policy.[112] Lord Mansfield's comment, even though timeworn, remains relevant:

> 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.[113]

The area in which 'contextualism' has been most embraced is in 'interpretation'.[114] A pure literal interpretation is fading as English contract law has become more sensitive to the context in which the contract was made.[115] This is a marked departure from the classical approach. Roger Brownsword takes this further and asserts that the 'contextualist' development that began in interpretation cases has now spread 'across the whole range of transactional disputes between commercial contractors'.[116] He elaborates

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[107] ibid 219.

[108] ibid 124, citing cf John E. Murray Jr, 'Contract Theories and the Rise of Neoformalism' (2002) 71 Fordham LR 869, 880.

[109] This is the general sentiment in relation to interpretation notwithstanding caution expressed about contextualism in *Wood v Capita Insurance Services Ltd* [2017] UKSC 24 and *Arnold v Britton* [2015] UKSC 36. This is explored further in Section 2.6.1.

[110] Feinman, 'Introduction' (n 127) 3.

[111] Morgan, *Contract Law* (n 12) 90.

[112] Atiyah and Summers, *Form and Substance in Anglo-American Law* (Oxford Clarendon Press 1987).

[113] *Vallejo v Wheeler* (1774) 1 Comp 143, 153.

[114] Discussed below in Section 2.6.1.

[115] An analysis of contract and statutory interpretation and the accompanying case law is beyond the purview of this thesis.

[116] Brownsword, 'Post-Technique: The New Social Contract Today' (n 127) 25.

that:

> the contextualist development of the English commercial law of contract that, having been initiated by Lords Steyn and Hoffmann, has now become a wide-ranging form of commercial realism that is sweeping all before it.[117]

While there has been some engagement with elements of relational theory in the courts,[118] the accuracy of Brownsword's sweeping statement is questionable. In contemporary practice there has generally been a lack of judicial engagement with relational theory, possibly because, as Mulcahy observes, judges are not convinced by its logic.[119] The next section maps the contributions of the major strands of the 'contextualist' side of the debate before proceeding to a defence of the (neo) formalist angle.

2.4.2 The Competing Arguments

2.4.2.1 Relational Contract Theory

The works of Ian Macneil[120] and Stewart Macaulay[121] on relational contracting have been widely welcomed in contract law *scholarship* and have given rise to two schools: contextualism and formalism. The aim here is to outline the key tenets of relational theory as relevant for the purposes of this thesis. Relational theory is proposed as a solution to

[117] ibid.

[118] Beale, 'Relational Values in English Contract Law' (n 127).

[119] Mulcahy, 'Telling Tales about Relational Contracts: How do Judges learn about the Lived World of Contracts' in Campbell and others (eds), *Changing Concepts of Contract* (n 16) 197.

[120] Including Ian Macneil, 'A Primer of Contract Planning' (1975) 48 Southern California LR 627; 'Relational Contract Law: Challenges and Queries' (2000) 94 Northwestern University LR 877.

[121] Including Stewart Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 (1) American Sociological Review 55; 'Elegant Models, Empirical Pictures, and the Complexities of Contract' (1977) 11 Law and Society Review 507; 'Law and Behavioral Science: Is There Any There?' (1984) 6 Law and Policy 149; 'An Empirical View of Contract' (1985) Wisconsin LR 465; 'Relational Contracts Floating on a Sea of Custom? Thoughts about the Ideas of Ian Macneil and Lisa Bernstein' (2000) 94 Northwestern University LR 775; 'The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules' (2003) 66(1) Modern Law Review 44; 'The New versus the Old Realism: Things Ain't What They Used to Be?' (2005) Wisconsin LR 367.

the limitations of (neo) formalism and is said 'to remain the richest of the theoretical approaches to contracting and contract law'.[122] It has strong academic support in the UK from leading academics, including, Campbell,[123] Collins,[124] and Mitchell.[125]

Assuming a monistic conceptualisation of relational theory would not do it justice. For that reason it is useful to refer to Robert Scott's separation of relational theory into 'economic relationalism' and 'socio-relationalism'.[126] Despite that it is important to recognise that these divisions cohere with one another as the principal focus is on the relationship between parties. 'Economic relationalism' is commonly aligned with the neo-formalist approach to contract adjudication,[127] and 'socio-relationalism' subscribes to contextualism.[128] These dimensions also highlight the divergence between Macaulay's and Macneil's work.

Macaulay's seminal paper 'Non-Contractual Relations in Business: A Preliminary Study'[129] was the inspiration for 'economic relationalism.[130] Macaulay's work was the starting point to the debate surrounding the nature and role of contract law and judges in transacting in the marketplace. It sparked a proliferation of empirical and theoretical research on the use and non-use of contract law in the marketplace.[131] Macaulay's above-

[122] Feinman, 'Introduction' (n 127) 3.

[123] See David Campbell, 'Reflexivity and Welfarism in Modern Contract Law' (2000) 20(3) OJLS 477; 'Arcos v Ronaasen as a Relational Contract' in Campbell and others (eds), *Changing Concepts of Contract* (n 16); 'Adam Smith and the Social Foundation of Agreement' (n 16).

[124] Collins (n 19).

[125] Catherine Mitchell, 'Contracts and Contract Law: Challenging the Distinction between the Real and Paper Deal (2009) 29 OJLS 675. 'Obligations in Commercial Contracts' (n 109); *Contract Law and Contract Practice* (n 65);

[126] Robert Scott 'The Promise and Peril of Relational Contract Theory' in Braucher, Kidwell and Whitford (eds), *Revisiting the Contracts Scholarship of Stewart Macaulay: On the Empirical and the Lyrical* (Oxford: Hart, 2013).

[127] Zhong Xing Tan, 'Disrupting Doctrine? Revisiting the Doctrinal Impact of Relational Contract Theory' (2019) 39 Legal Studies 98, 100.

[128] ibid.

[129] Macaulay 'Non-Contractual Relations in Business' (n 144) 55.

[130] Tan, 'Disrupting Doctrine?' (n 1504)100.

[131] Morgan, *Contract Law Minimalism* (n 12) 72; Macaulay's seminal article, 'Non-Contractual Relations in Business' (n 144) explored the relevance of the role of contract law in commerce by

mentioned article did not focus on the effect that legal sanctions for breach had on commercial contracting parties; rather his work highlighted the low importance of contract law to business people, to whom reputation, trust and other non-legal mechanisms featured more predominantly in their transactions.[132] Furthermore, 'contracts were often drawn up for internal bureaucratic and other non-legal reasons by businesses'.[133]

Macaulay found that planning by commercial contractors was tied to describing performance rather than legal sanctions for default, as the latter was more likely to undermine trust.[134] Macaulay's findings about attitudes towards breach were that descriptions of performance were tailored towards negotiation in the event that problems arose, rather than focusing on legal sanctions as litigation only occurred when the relationship between the parties was at an end.[135] Macaulay's work highlighted the disparity between 'the real deal' agreed between the parties and 'the paper deal'.[136] The 'paper deal' (the written contract) tends to consist of clear, formal rules that are straightforward to enforce but these rules are very different from the 'real deal' that governs the transaction. The 'real deal v paper deal' scenario emphasises the social relations between the parties, which includes the economic context of their behaviour.[137] This does not ignore the contract, rather the relationship between the parties is seen as the

focusing on business attitudes. Hugh Beale and Tony Dugdale, 'Contracts between Businessmen: Planning and the Use of Contractual Remedies' (1975) 2 (1) British Journal of Law and Society 45; Jay Feinman, 'The Significance of Contract Theory' (1990) 58 University of Cincinnati LR 1283, 1305; RC Ellickson, *Order Without Law: How Neighbors Settle Disputes* (Cambridge, Mass: Harvard University Press, 1991); Mitchell, *Contract Law and Contract Practice* (n 65); RC Ellickson 'When Civil Society Uses an Iron Fist: The Roles of Private Associations in Rulemaking and Adjudication' (2016) 18 Am L and Econ Rev 235.

[132] Gava, 'Taking Stewart Macaulay and Hugh Collins Seriously' (n 10). See also Morgan, *Contract Law Minimalism* (n 12) 108.

[133] ibid.

[134] Macaulay 'Non-Contractual Relations in Business' (n 144) 63.

[135] ibid 65-6.

[136] Macaulay, 'The Real and the Paper Deal' (n 144) 44.

[137] Sally Wheeler, 'Visions of Contract Law' (2017) 44 (51) Journal of Law and Society S74, S78. See also Scott, 'The Promise and Peril of Relational Contract Theory' (n 133).

core ingredient.[138] Given this difference, resorting to the law would be invoking a contract that the parties did not think they had agreed upon.[139]

'Economic-relationalism' can be equated with the 'relational contracting without law' school of thought which emphasises 'private ordering' and is best represented by Lisa Bernstein's research on private ordering in certain markets.[140] As Tan says:

> the implications of this school of thought for contract law and doctrine are straightforward: as Morgan points out, law should be 'minimalist', employing 'easily determined formal criteria rather than intractable questions of substance or context'. The upshot is that this version of relationalism has no interest in working out how relational insights can be translated into doctrine.[141]

On the other hand, 'socio-relationalism' builds on the work of Macneil. Macaulay's focus was mainly the empirical workings of the 'law in action', whereas Macneil's focus was to develop 'a fuller socio-cultural account of contractual relations which he coined 'relational contract theory'.[142] 'Socio-relationalists' following Macneil argue for 'key relational norms [to be]… deployed by courts to require relational sanctions in what is associated with 'contextualist' modes of adjudication'.[143] Macneil famously used his scotch egg and haggis example to explain how the contract is embedded within a relational framework.[144] The scotch egg sits in the middle of the haggis and the former represents the contract. The haggis represents the relational context of the commercial transactions and the coating of the scotch egg represent the relations between the parties which are specific to that particular transaction. In order to reach the contract, it is

[138] Morgan, *Great Debates in Contract Law* (Palgrave 2012) 271; cf Mitchell 'Contracts and Contract Law' (n 148).

[139] Stewart Macaulay, 'The Real and the Paper Deal' (n 144) 44.

[140] Tan, 'Disrupting Doctrine?' (n 150) 100-103. Bernstein, 'Opting Out of the Legal System' (n 100). Bernstein 'Cotton Industry' (n 82). Bernstein 'Merchant Law in a Merchant Court' (n 75).

[141] Tan, 'Disrupting Doctrine?' (n 504) 102.

[142] ibid.

[143] Tan, 'Disrupting Doctrine?' (n 150) 100-103.

[144] Iain Macneil, 'Reflections on Relational Contract Theory after a Neo-Classical Seminar' in D Campbell, H Collins, and J Wightman (eds), *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (Hart 2003) 208-9.

necessary to pass through the outer layers. In that vein, the contract can only be understood in the context of the broader relationship.[145]

Macneil's model of relational contract directed attention more to the circumstances and justifications of breach, rather than on contract law remedies. The reason is because Macneil (like Macaulay) believed that legal sanctions were rarely resolved by the courts and the preferable method to a breach was reputational sanctions or a negotiated settlement.[146] Relational theory eschews a binary conception of remedies as either relating to performance or damages. As explained with the scotch egg example above, relational theory therefore sees the social context of an agreement as fundamental.

Campbell says the reason why relational theory is superior to classical and neo-classical models is because all contracts can only be fully understood 'when their relational dimension is made explicit'.[147] Relational contracts do not constitute a distinct class; instead, every contract is relational in the sense that every contractual relation has both discrete and relational elements.[148] 'Relationists' claim that, proven by empirical studies of the contracting world, 'the neo-classical model of contract fails to adequately reflect commercial practice'.[149] For many, neo-classical contract law does not go far enough. It is broader than classical law but it not as broad as relational contract theory.[150] As Collins notes:

> The conventional contextual or neo-classical approach refers to the context in order to supplement the contractual agreement or to resolve ambiguities...Under Macneil's sociological approach, however, one has to start from the outside with the relations between the parties within which context the exchange is made, and then work inwards towards the contract.[151]

[145] ibid.

[146]Macaulay, 'Empirical Pictures of Relationships' (n 144).

[147] Campbell, '*Arcos v Ronaasen* as a Relational Contract' (n 16) 138.

[148] ibid.

[149] Mulcahy, 'Telling Tales about Relational Contracts' (n 142) 193.

[150] Feinman, 'Introduction' (n 127) 3.

[151] Hugh Collins, 'The Contract of Employment in 3D' in Campbell and others (eds) *Changing Concepts of Contract* (n 16) 67.

In teasing out the implications, the starting points are different. Relational theory starts with context, so contract law should take the context into account unless the parties have agreed otherwise. English law starts with the contract, so the context should be ignored unless the parties have provided for it to be taken into account.[152] As the American neo-formalist Scott points out:

> The question is not whether contracts are relational but whether contract *law* is relational. A contract may be relational, firmly embedded in a particular context, but the law may still treat it as discrete by ignoring the context. This abstraction may be imposed by the courts or by legislation, or it may be agreed by the parties.[153]

Campbell specifically challenged the suggestion that 'relational' means more regulation. He says that resistance to relational theory is due to it being viewed as a 'paternalistic' theory 'opposed to freedom of contract', one which has little or no place for competition.[154] Campbell argues that a relational approach has 'superior explanatory and normative power than either a market-individualist or a welfarist approach to contract law',[155] which has been classical law's most successful rival so far. On reflection, despite its popular reception in contract scholarship relational theory has had little traction in the courts.[156]

2.4.2.2. Welfarism, Market-Individualism and Consumer-Welfarism

Campbell says that:

> the central thrust of the welfarist law is the replacement of the excessive individualism of the classical law with an appreciation of the necessity of cooperation between the parties articulated in a doctrine of good faith.[157]

[152] Beale, 'Relational Values in English Contract Law' (n 127) 118.

[153] Robert Scott, 'The Case for Formalism in Relational Contract' (n 1160) 852. My emphasis.

[154] Campbell, '*Arcos v Ronaasen* as a Relational Contract' (n 16) 138.

[155] ibid.

[156] This may well be in dispute. See Tan, 'Disrupting Doctrine?' (n 150) 98.

[157] Campbell, 'Arcos v Ronaasen as a Relational Contract' (n 16) 138.

Adams and Brownsword contend that there are different ideologies in contract law. The first layer of antithetical ideologies is formalist and realist.[158] Formalism refers to the judicial approach which apply 'the materials of the rule-book, irrespective of the result'.[159] Realism, on the other hand, is more result-orientated as it is concerned with working out the most acceptable result without having the rule-book dictate.[160]

The second layer are the two realist ideologies underlying contract law: market-individualism and consumer-welfarism. The former emphasises party autonomy in that parties are free to agree their terms and to have those terms enforced, and the latter is concerned with fairness between contracting parties.[161] A market-individualist approach requires a less interventionist approach by judges and by the law of contract and is therefore more suited for business-to-business transactions.[162] Consumer-welfarism is more suited for business-to-consumer transactions[163] given that the law is needed to address the inequality of bargaining between the consumer and business.[164]

Brownsword has tried to refine welfarism to make it more plausible by bringing 'dynamic' market-individualism into his former opposition of 'static' market individualism.[165] These are explained as follows:

> Static market-individualism sees the principal function of contract law as being to establish a clear set of ground rules within which a market can operate. Dynamic market-individualism favours a more flexible approach guided by the practices and expectations of the contracting (commercial) community. Dynamic market-individualism departs from static market-individualism in two principal aspects:

[158] Adams and Brownsword in their seminal article, 'The Ideologies of Contract Law' (1987) 7 Legal Studies 205, 215-17 refers to ideologies as 'a set of values and ideas which may be employed as a facilitative resource for interpreting orthodox contract law rules and for understanding more clearly what is going on when judges resolve contract disputes'.

[159] ibid 213.

[160] ibid.

[161] Adams and Brownsword, *Understanding Contract Law* (5th edn, Sweet & Maxwell 2007) 38-39.

[162] Han (n 4) 23.

[163] ibid.

[164] ibid.

[165] David Campbell, 'Reflexivity and Welfarism' (n 146) 482.

> firstly, it takes a more flexible view of the situations in which contractual obligations may arise; and secondly, it takes a potentially more restrictive view of the extent to which a contracting party may privilege its own economic interests.[166]

These ideologies have followed the developments in the English law of contract. As discussed previously, the formalist approach was increasingly challenged by scholars and practitioners. This was coupled with the emergence of paternalism, which views the state (and therefore law) as having a role to play in protecting parties for their own best interests. This was largely tied to a need to protect consumers due to the prevalence of standard form contracts in which parties had little say over onerous contract terms that were offered to them due to the inequality of bargaining power.[167] Due to this inequality it appeared that 'freedom to negotiate contracts was dead in consumer transactions'.[168]

Regulation through legislation became necessary and restrictions on freedom of contract were justified to address the use of standard form contracts with weaker parties. There was an increasing need for consumer transactions to be recognised and regulated distinctly from commercial transactions. This saw the emergence of the second strand of the realist ideology: consumer-welfarism.[169] It exemplifies a policy of consumer-protection by upholding the principles of fairness and reasonableness in the contract.[170] Under this ideology judges take a more interventionist approach to ensure a fair deal for contractors.[171] Consumer-welfarism and market-individualism should not, however, be viewed as a dichotomy; rather both theories should be viewed as existing on a spectrum. As Han states:

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[166] Han (n 4) 121. Brownsword, *Themes for the Twenty-First Century* (n 125) 139- 140.

[167] Friedrich Kessler, 'Contracts of Adhesion: Some thoughts on Freedom of Contract' (1943) 43 Columbia Law Review 629,640.

[168] Iain Ramsay, *Consumer Law and Policy* (2nd edn, Hart Publishing 2007) 159.

[169] Han (n 4) 23.

[170] Adams and Brownsword, *Understanding Contract Law* (n 184) 38-39.

[171] Han (n 4) 23.

> [C]onsumer contract law and consumer-welfarism grow out of commercial contract law and market-individualism: they are not and cannot be detached from each other'.[172]

These ideologies differ from relational contract theory, as discussed above. Relational contract theory emphasises the relationship between the parties as being central to the contract. That is not the case with the market-individualism and consumer-welfarism ideologies. These ideologies are still viewed as a 'command and control' approach, which imposes external standards on the contract rather than looking to the relational expectations created by the parties to the contract (recall the scotch egg and haggis illustration).[173] According to the 'relationists', pure individualism *per se* is not the problem, but relational theory shows that 'pure individualism can never be consistent in the way it grounds contracting'.[174] In highlighting the superiority of relational theory over its rivals, Campbell claims that:

> this lack of consistency matters, only if we see that even highly competitive contracting is never a matter of pure individualism but of the pursuit of self-interest within an appropriate relational framework.[175]

2.4.2.3 Collins's Relational/Regulatory Contract Law

The contextualist school of thought is reworked and repurposed in Collins's *Regulating Contracts,*[176] which presents a 'new' concept of legal regulation by calling into question the welfarist theory of contract.[177] Collins has offered a more critical analysis of party autonomy (*laissez faire*) and welfarism in which he merges both these concepts to argue for a new type of hybrid regulation. On the one hand is the pursuit of communal goals under welfarism coupled with 'the private drive to maximise utility'.[178]

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[172] ibid 19.

[173] Macneil, 'Reflections on Relational Contract Theory after a Neo-Classical Seminar' (n 167).

[174] Campbell, '*Arcos v Ronaasen* as a Relational Contract' (n 16) 163.

[175] ibid.

[176] Collins (n 19).

[177] ibid 498.

[178] Campbell, 'Reflexivity and Welfarism' (n 146) 481.

Collins's focus is on the private law rather than legislation but his perspective remains relevant to this thesis, particularly in relation to the judicial role. This thesis relies on Collins's definition of regulation as 'a generic term to describe any system of rules intended to govern the behaviour of its subjects'.[179] Law falls into that definition of regulation as one of the many aspects of social regulation.[180] In exploring the purpose and effects of legal regulation on contractual relationships, Collins reaches his conclusions by comparing 'trust and sanctions as key variables in ensuring contractual performance.'[181] One of the core themes that Collins develops from his previous research is that:

> legal systems are in a process of transition from the dominance of traditional private law regulation to one where welfarist regulation increasingly provides the basic discourse of the legal regulation of contracts.[182]

Collins relies on empirical work (such as Macaulay) which shows how marginal contract doctrine is to everyday commerce. He refers to the 'self-referential' character and 'closure rules' in contract law which he calls the formalism of private law.[183] Collins is sceptical of the neo-classical model and dismisses formalism as a 'virus' that infected the common law in the 19th century.[184] Collins's argument is that formalism in private law is a phenomenon that 'is disintegrating' rapidly under the impact of a 'collision' with public law regulation.[185]

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[179] Collins (n 19) 7.

[180] ibid. Including custom, convention, and organised bureaucracies.

[181] Anthony Ogus, 'Regulating Contracts' (2000) Law Quarterly Review 1.

[182] Hugh Collins, *The Law of Contract* (London: Weidenfeld and Nicolson, 1986) 1, 15.

[183] Collins (n 19) 41. Collins says that private law discourse is 'self-referential' in the sense that it evolves its own doctrinal concepts of what counts as a legally enforceable contract and its own rules governing the bargaining process. The doctrinal concepts are 'closed' in the sense that they direct the legal examination of the facts of a dispute with strict criteria of relevance'. The erosion of private law in this sense is through the increasing reliance on 'non-legal reasons', such as references to the effects of law or policies of law; interaction of the law with its external environment, rather than behaving as a closed intellectual system; increasing reference to fairness and other standards external to the law; explicitly instrumental reasoning, such as the deliberate correction of market failures; and restrictions on private power.

[184] Collins (n 19) 194-5.

[185] ibid 46.

Collins highlights that the private and public divide cannot work in isolation. The private law stream refers to the rules of contract law and the bargain struck, whereas the public regulation stream refers to the welfarist or community concerns. Collins argues that the private law of contract responded to burgeoning growth of legislation by 'including welfarist regulation within its normative domain'.[186] In doing so, both the private and the public went through a productive disintegration and 'private law sought to reconfigure itself'.[187]

In considering 'how contract's role as a regulatory tool can be improved',[188] Collins first asserts 'that contract can only carry out its role if it openly and consistently incorporates market custom and sociological insights into its rules and decision-making'.[189] In doing so, he sets out the central thrust of his argument: that the 'collision' between private law and public regulation has resulted in a modern hybrid of regulatory private law discourse that has the capacity to produce effective regulation designed to combat instances of unfairness in contracts.[190] The outcome of this collision of discourses consists of a reconfiguration of private law reasoning.[191] Secondly, the new hybrid regulation has birthed a new analytical framework of contractual behaviour that, building on the work of the relational theorists, blends the divergent economic, social and legal discourses: 'economic deal', 'business relation,' and 'contract'.[192]

The 'deal' aspect of a transaction is concerned with the benefits associated with a transaction, specifically a particular, discrete transaction, and use of the law here will depend on how important the transaction is.[193] The 'relationship' aspect concerns how

[186] ibid 49.

[187] ibid.

[188] John Gava and Janey Greene, 'The Limits of Modern Contract Theory' (2001) 22 Adelaide Law Review 299, 301

[189] ibid.

[190] Collins (n 19) 41-55. Public law regulation differs from the private law of contract as they apply in different contexts. Public regulation tended to govern transactions such as that pertaining consumer contracts or particular types of market practices.

[191] ibid.

[192] ibid 128-132.

[193] Gava, 'Taking Stewart Macaulay and Hugh Collins Seriously' (n 10). See also J Wightman, 'Beyond Custom: Contract, Contexts, and the Recognition of Implicit Understandings' in Campbell, *Implicit Dimensions of Contract* (n 167) 143–186.

any particular deal fits into the longer-term relationship between the parties.[194] The 'contract' aspect refers to the written documents setting out the parties' rights and obligations. In sum, Collins thesis is that:

> [T]he type of law that best contributes to the construction of markets and a vibrant economy would be one that avoids clear-cut entitlements based upon the contractual framework in favour of a more contextual examination of business expectations based upon the business relation and the business deal.[195]

In elaborating on the above, Collins, like Macaulay, says that the courts should not limit themselves to the contract but that if the law is to do its job of supporting commerce, it should enforce the implicit dimensions of trust in every contractual relationship.[196] Generally, Collins says that courts should not be 'mesmerised' by the terms of the formal written contract and in doing so he endorses the view that the gap between the 'real and paper' deal should be closed.[197] Collins takes a robust stance by saying that courts 'should then not hesitate to engage in suitable measures of judicial revision of the planning documents'[198] where a discrepancy arises between the written contract and reasonable expectations. In short, the expectations of the parties should out-rank the formal contract perspective. In reflecting on Collins's approach, Campbell points out that welfarism has stressed a 'command and control' style of regulation based on legislation – which is not the type of intervention that Collins is trying to establish.[199] However, statutory intervention (ie government interference through 'command and control') is, as Campbell stated, precisely that aspect of welfarism that 'we do not like'.[200]

The protection of party expectations is a truism of contract law.[201] But Collins's research suggests that far-reaching changes would be needed to produce similar results in England.

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[194] Gava, 'Taking Stewart Macaulay and Hugh Collins Seriously' (n 10).

[195] Collins (n 19) 176

[196] Hugh Collins, 'The Research Agenda' in Campbell, *Implicit Dimensions of Contract* (n 167).

[197] Morgan, *Great Debates* (n 161) 73; Collins (n 19) 173.

[198] Collins (n 19)165.

[199] Campbell, 'Reflexivity and Welfarism' (n 146).

[200] ibid 488.

[201] Morgan, *Great Debates* (n 161) 73. See also Johan Steyn, 'Contract law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 The L.Q. Rev 433; Cf Catherine Mitchell,

Morgan cites the palpable problem of freedom of contract on the basis that parties (and not courts) make agreements.[202] But he says that this is 'a circular argument with which to respond to Collins'[203] as Collins's central point is that the implicit dimensions of the commercial relationship represents the true agreement between the parties. Consequently, the 'contractual' document 'does not and so need not be treated with the respect properly due to party autonomy'.[204] Morgan concludes that it seems unlikely that the courts would go as far as Collins recommends, ignoring the written contract as a kind of legal fiction overridden by 'reasonable expectations'.[205]

2.4.2.4 In Defence of Minimalism: Statutory Regulation and the Design of Default Rules

In considering the shifting paradigms of legal regulation, this section provides the foundation for later chapters to examine what type of regulation the 2015 Act is and translates the key tenets of minimalism into what that means for the design of default rules in the 2015 Act. Default rules and the debate about how to frame and design them has become of central importance in contracts scholarship, particularly in the North Atlantic.[206] This thesis brings that debate into the realm of insurance contract law in the UK. Default rules can be a misnomer as it implies a choice which, in turn, implies a notion of freedom. While that is true to a certain extent, the default rules debate is more complex as default/immutable rules operate on a continuum rather than being polar opposites. This will become apparent when applied to the design of the default rules under the 2015 Act.[207]

One of the important aspects about default rules is their default nature with parties free to contract out. A preliminary question is why then have default rules in the first place if parties can simply choose to displace those rules? The answer is that 'the law must supply

'Leading a Life of its Own? The Roles of Reasonable Expectation in Contract Law' (2003) 23 OJLS 639.

[202] Morgan, *Great Debates* (n 161) 73.

[203] ibid.

[204] ibid.

[205] ibid.

[206] (n 105).

[207] Discussed in Section 4.2.3 in Ch 4.

a great deal of the content of contractual obligations'[208] as parties can never provide for every contingency in their contracts. For example, the law of contract must provide for certain foundational rules such as that pertaining to formation of contracts, what constitutes a breach, and sanctions for breach.[209] Default rules also minimise transaction costs by providing a minimum layer of rules that will apply unless parties choose to vary the default rules. Yet contracting out of default rules (or 'opting out') may not be a simple process and it raises different concerns. These include the increase in transaction costs when parties attempt to vary the default rules, the fact that a contracting party may become suspicious when the other party seeks to vary a default rule.[210] Parties can also fail to successfully 'opt out' of rules. Courts may prevent attempts to contract out, possibly in the interests of fairness, and may attempt to uphold the default rules.[211] Indeed, this is a caution expressed in this thesis in relation to the 2015 Act – which will be explored later.

The main rival to minimalism is 'relational contract' which is persuasive to some extent given that trust and co-operation pervade commerce and are essential to it.[212] Given Macaulay's and Macneil's research, the question arises: should relational theory, with its focus on the form of contracting and the contract norms, influence the default rules debate?[213] Put more simply, should the goals of commercial contract law be 'relational' default rules? According to Morgan, minimalism means a minimally 'sticky' default regime, which means that parties prefer and that the law should adopt default rules that are 'strict, formal and rule-based.[214] Statutory regulation, according to the minimalist thesis, requires clarity and formality from the law.[215]

But why should default rules remain in the classical rigid form rather than take a 'relational' design? Morgan says that the answer lies in the nature of default rules.[216]

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[208] Morgan, *Contract Law Minimalism* (n 12) 115, quoting Braucher (n 68) 701.

[209] Morgan, 'In Defence of *Baird Textiles'* (n 72) 180.

[210] ibid.

[211] Shah (n 3) 367.

[212] Morgan, *Contract Law Minimalism* (n 12) 95.

[213] Morgan, 'In Defence of *Baird Textiles'* (n 72) 180.

[214] ibid 178.

[215] Morgan, *Contract Law Minimalism* (n 12) 88.

[216] Morgan, 'In Defence of *Baird Textiles'* (n 72) 179.

Default rules are the starting point and should therefore be unambitious; they govern what is to happen *unless* the parties say otherwise.[217] Having default rules that are simple and clear facilitates contracting out and the stipulation of more complex standards where those are desired.[218] The clarity and simplicity of default rules are their virtue, as parties then know precisely what to contract out of.[219]

A vital question is how to formulate these default rules. The usual recommendation is that the law should supply the default rule that the majority of contractors would want, which is termed a 'majoritarian' default rule. This reduces transaction (drafting) costs as more parties will find this rule acceptable, thus satisfying 'reasonable expectations'.[220] Another theory is that lawmakers deliberately turn a default rule into an undesirable rule so that it is not meant to reflect the rule that the parties want. This is what Ian Ayres and Robert Gertner have dubbed 'penalty defaults'.[221] The point of penalty defaults is to incentivise the disclosure of welfare-enhancing information thereby curing information asymmetries between parties.[222] The type of default rules influences the ease of modification. Ayres claims that default rules must also 'have an associated theory of 'altering rules' – the extent to which the defaults are modifiable and how this can be done'.[223] Where more hurdles are placed in the way of contracting out of the default rules, 'whether de facto or as a matter of law, the default becomes 'sticky' – or quasi-mandatory'.[224] Contracting out will always have some 'stickiness' as there will invariably be some costs involved.[225] The

[217] ibid.

[218] Morgan, 'In Defence of *Baird Textiles'* (n 72) 179.

[219] ibid.

[220] Morgan, *Contract Law Minimalism* (n 12) 92.

[221] Ayres and Gertner, 'Filling Gaps in Incomplete Contracts' (n 105).

[222] ibid.Morgan, *Contract Law Minimalism* (n 12) 92. Cf Lisa Bernstein, 'Social Norms and Default Rules Analysis' (1993) 3 Southern California Interdisciplinary LJ 59.

[223] ibid 93. See also Ian Ayres, 'Regulating Opt Out: An Economic Theory of Altering Rules' (2012) 121 Yale LJ 2032.

[224] ibid 92. cf Omri Ben-Shahar and John Pottow, 'On the Stickiness of Default Rules' (2006) 33 Florida State University LR 531.

[225] Morgan, *Contract Law Minimalism* (n 12) 92.

stickiness therefore refers to something more than this standard 'stickiness' such as drafting costs or restrictive approaches to interpretation.[226]

The two main points of minimalism that are relevant for purposes of this thesis are first that default rules should be simple and clear to facilitate contracting out. Morgan says that 'the argument here is only that the default position should not be relational and not that relational terms should never be judicially enforced'.[227] Morgan expands:

> Parties that want relational contract law can and should contract for it... parties are perfectly able to indicate that relational norms are to be used to resolve contractual disputes, if they so desire.[228]

This ties in with the second point, which is that courts should give effect to the parties' contract. Minimalism is compatible with the view that courts should enforce express relational clauses when the parties do include them in contracts,[229] and such an approach is simpler for the courts to apply.[230] The dissonance however arises from, as Morgan argues, attempting to extrapolate a relational contract *law* from Macneil's account of relational contracting *behaviour*.[231] Morgan says that:

> relational contract law is a well-meaning but misguided attempt to support implicit dimensions of contract law that work perfectly well or much better without legal intervention.[232]

Robert Scott reiterates that view in saying:

[226] ibid. Default rules will be considered in more detail in Section 4.2.3 in Ch 4 when applied to the 2015 Act.

[227] Morgan, 'In Defence of *Baird Textiles*' (n 72) 179.

[228] Morgan, 'In Defence of *Baird Textiles*' (n 72) 181.

[229] ibid 179.

[230] ibid. Cf Campbell, 'Arcos v Ronaasen as a Relational Contract' (n 16).

[231] Morgan, 'In Defence of *Baird Textiles'* (n 72) 168.

[232] ibid 170. See also Schwartz and Scott, 'Contract Theory' (n 99).

> All contracts are relational, complex and subjective. But contract law, whether we like it or not, is none of those things. Contract law is formal, simple, and . . . classical. [233]

Paradoxically, relational contracting is indeed compatible with discrete, classical contract law (as generally still prevails in England) after all.[234]

2.4.2.5 In Defence of Minimalism: Judicial Regulation

Morgan cites a wealth of literature[235] that suggests that Macneil's and Macaulay's research simply shows 'that relational contracting flourishes *in spite of* rather than because of the law'.[236] Morgan identifies two problems with the enforcement of relational norms: first, he questions whether the law *can* properly enforce relationships as opposed to discrete contracts; secondly and more importantly, he questions whether the law *should* (attempt to) do so.[237] Such norms are not located in the written contract but are implicit in the relationship between the parties. They are not fixed at the time of entering into the contract in the manner in which written terms are.[238] The central point is that where trust and co-operation have broken down, the law cannot maintain those norms and even if it could, doing so would be counter-productive as 'judicialization changes and weakens such norms'.[239] There are studies which support the view that enforcing relational norms

[233] Catherine Mitchell, 'Contracts and Contract Law' (n 148) 681. Scott, 'The Case for Formalism in Relational Contract' (n 116).

[234] Morgan, 'In Defence of *Baird Textiles'* (n 72) 170. See also Schwartz and Scott, 'Contract Theory' (n 99).

[235] See also Morgan, 'In Defence of *Baird Textiles'* (n 72) 171. See also Ellickson, *Order Without Law* (n 154), where he famously said that it is possible to have 'order without law'. Bernstein, 'Cotton Industry' (n 182) provides further evidence through her research on cotton industry tribunals. It was found that the application of rules at the dispute stage were formal, rather than being contextual or relational.

[236] Morgan, *Contract Law Minimalism* (n 12) 99.

[237] ibid.

[238] Morgan, 'In Defence of *Baird Textiles'* (n 72) 174.

[239] ibid 171.

may 'crowd out' true trust.[240] Arguably, trust needs to develop without the confines of the law to allow co-operative behaviour to flourish organically, rather than relying on the law to coerce trust. Morgan claims that 'the interface between law and social norms are intricate and difficult'[241] and one should exercise restraint in 'recommending its blanket enforcement'.[242]

Morgan, by relying on Lisa Bernstein's studies of doing business and resolving disputes in the cotton and grain industries, provides empirical evidence for the claim as to whether Bernstein's sequential distinction between Relationship Preserving Norms (RPN) and End Game Norms (EGN) is well-founded.[243] In her research with business participants, Bernstein finds the existence of 'formalist dispute resolution' measures as well as the existence of 'co-operative relational behaviour' during the relationship between participants.[244] Morgan says that there does 'seem to be empirical support for distinct norms…for relationship preservation and (in the end game) for dispute resolution'.[245]

Similar to Collins, Bernstein has also identified a normative framework in contractual relationships. However both Collins and Bernstein's normative frameworks differ in that Bernstein's framework is 'sequential and mutually exclusive'.[246] The first, RPN, corresponds to Collin's 'business relation' and 'economic deal' perspectives.[247] The 'deal' aspect of a transaction is concerned with the benefits associated with a particular, discrete transaction. Use of the law here will depend on how important the transaction is.[248] The 'relationship' aspect concerns how any particular deal fits into the longer-term

[240] ibid 170. See also Deepak Maholtra and Keith Murningham, 'The Effects of Contracts on Interpersonal Trust' (2002) 47 Administrative Science Quarterly 534.

[241] Morgan, *Contract Law Minimalism* (n 12) 105. See also D Kimel, 'The Choice of Paradigm for Theory of Contract: Reflections on the Relational Model' (2007) 27 OLJS 233, 241.

[242] Morgan, *Contract Law Minimalism* (n 12) 105.

[243] ibid 104; See also Bernstein, 'Merchant Law' (n 75).

[244] Morgan, *Contract Law Minimalism* (n 12) 104.

[245] ibid.

[246] ibid 103.

[247] ibid. These are based on Macaulay and Macneil's relationships of trust and co-operation.

[248] Gava, 'Taking Stewart Macaulay and Hugh Collins Seriously' (n 10) 112 gives the example:

> If a company's future is dependent on the success of a particular deal it is clear this deal will take priority over maintaining good relations with its trading partner or the company's reputation amongst its trading partners.

relationship between the parties.[249] Within this phase, Bernstein's RPN prevail, inducing the parties to co-operate with each other and deterring them from taking aggressive action such as litigation, which would damage the relationship of trust between them.[250] In the second phase, Bernstein's EGN govern disputes between the parties once the relationship between them has broken down.[251] Morgan adds that:

> In the 'end game', the parties vigorously assert rights against each other and generally behave in a legalistic fashion (corresponding to the 'contract law perspective' in Collins's account).[252]

There is a fundamental difference in how Collins's and Bernstein's normative framework should be applied by a court when faced with a contractual dispute.[253] For Collins generally, the business relationship trumps all else, but in particular circumstances either the deal or the legally enforceable contract can assume first rank importance in transacting. Collins, by drawing on the research of Macaulay and others, believes that the legal framework is not the focal point when parties enter into contracts. Instead the focal point of contracting parties is to build a business relationship where their transactions are profitable.[254] Collins argues that the 'contractual' perspective should not be the dominant strand and should rather take on a 'peripheral role',[255] whereas 'for Bernstein it is entirely appropriate that the courts should reason in this way, given that litigating parties are by definition in the end game'.[256] In contrast, judges continue to apply Collins's contractual perspective to the exclusion of others. To develop this point, Collins thinks this is mistaken because:

[249] Gava, 'Taking Stewart Macaulay and Hugh Collins Seriously' (n 10) 112.

[250] ibid.

[251] Morgan, *Contract Law Minimalism* (n 12) 103.

[252] ibid.

[253] ibid.

[254] Gava, 'Taking Stewart Macaulay and Hugh Collins Seriously' (n 10) 112.

[255] Morgan, *Contract Law Minimalism* (n 12) 103.

[256] Morgan, *Contract Law Minimalism* (n 12) 103.

> all three communication systems will always be present in contractual relations, and that all three will be required to provide an adequate explanation of the rationality of contractual behaviour in every instance.[257]

Collins posits that a better approach to interpretation of contracts would entail that courts consider the parties' expectations as including the possibility of co-operation and flexibility.[258] In that instance, 'the duty to co-operate should supplement and even override express terms of the contracts, to provide legal support for wealth-maximising potential for this type of transaction.'[259] According to Morgan, contract law should therefore concern itself only with EGN (this goes back to Morgan's earlier thesis that contract law is for dispute resolution rather than 'contract governance').[260] He reasons that the dynamics of a relationship change once a relationship has broken down, the parties do not get along and there is no reason to require them to do so – hence there is no point enforcing RPN. He likens this to a marital breakdown: it would be like forcing a couple to stay together when they want to divorce.[261] Yet when the relationship is still ongoing, there is no need to enforce RPN.[262] 'If there is already a good relationship between the parties, enforcement would at best be superfluous' – at worst, it would damage the relationship. Ongoing relationships are best preserved by means of extra-legal norms.[263]

A recent argument by Mitchell shows that trust and contract may not be competing paradigms.[264] Morgan says:

> The fear is that even if the law could perfectly enforce relational norms (or punish defections from relational norms) to do so would undermine the relationship. Parties could no longer tell whether apparently trustworthy behaviour was motivated by true relational commitment or a tactical decision to simulate

[257] Collins (n 19) 143.

[258] Collins (n 19) 171.

[259] ibid 172

[260] Discussed at Section 2.3 above.

[261] Shah (n 3) 368.

[262] ibid.

[263] ibid.

[264] Morgan, 'In Defence of *Baird Textiles*' (n 72) 169. Mitchell 'Contracts and Contract Law' (n 148) 685.

> cooperation to avoid legal liability. This may damage the relationship in the long run. It may be better to have contracts (and a law of contract) committed to enforcing main obligations on both sides. This provides a basic guarantee of performance while leaving space for trust to develop.[265]

Morgan recognises that the dichotomy between ongoing and broken relationships, and thus between RPN and EGN may be too crisp. But the important element of default rules is its default nature. Morgan emphasises the choice that parties have; parties are free to contract out of default rules (and, hence, a minimalist approach) and to choose contextual interpretation.[266] The courts must respect the enforcement of such implicit relational norms and such choice.[267] Thus, some parties might in fact want RPN to be legally enforced, and Morgan argues that if this is the case, the courts should comply. Currently, English courts refuse to enforce certain obligations to act in good faith even if the parties want them to do so.[268]

Morgan's narrative of minimalism explores the relationship between law and extra-legal norms and rejects the approach that the law should enforce extra-legal norms.[269] In other words due to the difficult epistemic position that courts (and legislators) find themselves in, it is important to recognise the limited capacity of courts and legislators to actively regulate contracts.[270] I therefore argue that Collins's 'contextualist' project fails because it not only imposes higher regulatory demands on judges but because it is beyond judicial capacity. Gava and Greene provide a justification for this view:

> it requires information that often does not exist, or was costly to obtain; that it runs counter to the best evidence suggesting that parties used law tactically; and that it ignores the inequality of power in business dealing; all of which, instead, supported a formalist law of contract.[271]

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[265] Morgan, 'In Defence of *Baird Textiles'* (n 72) 174.

[266] Discussed further in Section 4.5.2 in Ch 4.

[267] Morgan, *Contract Law Minimalism* (n 12) 88.

[268] Shah (n 3) 368-9.

[269] ibid 88.

[270] Shah (n 3) 357.

[271] Gava, 'Taking Stewart Macaulay and Hugh Collins Seriously' (n 10) 112; Gava and Greene, (n 191) 605.

Collins's hybrid model has taken contextualism to new heights and in doing so has highlighted that a fully contextual law is counter-intuitive. In their review of Collins book, Gava and Greene complain that he sets a regulatory task for the judiciary at which even a 'superhuman would baulk'.[272] Morgan adds to that view by saying that:

> [O]stensibly the critics concern is a pragmatic not ideological one: that courts are not able to meet the strenuous demands of discovering and enforcing relational norms. This argument is another reason for caution before translating Macneil's sociological findings into contract law doctrine.[273]

As discussed below, in modern contract law and interpretation there is a growing emphasis on the contractual context and common sense, but at a cost of greater uncertainty.[274] Epstein, on the other hand, calls for 'simple rules and boring courts'.[275] The above discussion provides a justification for such as view, as it demonstrated *why* the minimalist hypothesis provides a sensible and pragmatic approach for judicial regulation of commercial contracts over the contextualist approach.

Bernstein's distinction between RPN and EGN should also be considered in relation to how judges adjudicate commercial disputes. Judges are required to adjudicate with knowledge of the context of the End-Game (ie the dispute before the court) and in terms of the Civil Procedure Rules 1998 whereby courts should encourage a negotiated settlement and where litigation is seen as a last resort. During litigation the information which a court receives is limited to the arguments and evidence adduced by the parties.

The Civil Procedure Rules are used in civil matters that come before the Court of Appeal, the High Court and County Courts in England and Wales, and which applies to all cases heard after 26 April 1999.[276] The overriding objective of the Rules are in Part 1 which requires courts to actively manage cases, notably to: 'encourage[ing] the parties to co-

[272] Morgan, 'In Defence of *Baird Textiles'* (n 72) 175.

[273] ibid 176.

[274] Beale, 'Relational Values in English Contract law' (n 127) 135.

[275] Morgan, *Contract Law Minimalism* (n 12) 121 quoting Richard Epstein, 'Economics and the Judges: The Case for Simple Rules and Boring Courts' (New Zealand Business Roundtable, 1996).

[276] Civil Procedure Rule, s 2.1

operate with each other in the conduct of the proceedings'[277] and to 'settle the…case;[278] to identify 'the issues at an early stage';[279] 'encourage[ing] the parties to use an alternative dispute resolution' where appropriate;[280] and to make legal proceedings more cost effective, quicker and easier to understand for non-lawyers.

Pre-Action Protocols are part of the Rules and sets out the steps that the court requires parties to take before commencing certain types of civil proceedings. The objectives of the Pre-Action Protocols require parties to set out the claim in full in an attempt to negotiate a settlement.[281] The emphasis is placed on cooperation to identify the main issues and a failure to cooperate may lead to penalties.[282] Litigation is therefore seen as a last resort.[283]

Morgan recognises that the dichotomy between ongoing and broken relationships, and thus between RPN and EGN may be too crisp. There are undoubtedly grey areas that make the application of a strict application of these norms difficult, such as the use of the Financial Ombudsman Service, alternate dispute resolution mechanisms, and the Civil Procedure Rules as discussed above. These are 'softer' dispute resolution measures and therefore raise the question of whether RPN can in fact be encouraged and enforced at the dispute resolution stage. Settlement can be viewed as an indication of cooperation between the parties. However, as Morgan shows repeat players, such as insurers and banks, will engage in settlements in order to avoid the matter being taken to court where a negative precedent may be set against them, particularly in relation to matters which reach the Supreme Court of Appeal.[284] Therefore in some instances, a settlement is not always a sign of cooperation but can be pursued for ulterior motives.

As Mitchell says:

[277] ibid, s 1.4 (2)(a).

[278] ibid, s 1.4 (2)(f).

[279] ibid, s 1.4(2)(b).

[280] ibid, s 1.4 (2)(e).

[281] Pre-Action Protocol, ss (3) and (8)

[282] ibid, s 13.

[283] ibid, s 8.

[284] Morgan, *Contract Law Minimalism* (n 12).

> Scholars differ over what is the prime motivating factor in the decision whether parties choose legal or non-legal sanctions and norms to govern their relationship. Bernstein would seem to believe that it depends on the stage of the contracting relationship.[285]

The Civil Procedure Rules could be equated to a form of relationship-preserving dispute resolution such as commercial mediation which attempts to confine the relational dispute to the contractual relationship rather than to hard doctrinal law. This may well provide a counter-argument to Bernstein's theory that RPN exist when there is cooperation under a contract and EGN apply when there is a dispute and breakdown in the relationship. However Bernstein's work simply aims to show that merchants in certain industries prefer to have strict rules govern their dispute in the end game, than to try and preserve the relationship through flexible standards. Even though these industries differ from marine insurance (as discussed in 2.3) this thesis adopts the findings of Bernstein which shows that contract law should be directed to the end game ie dispute resolution whereby a different set of values prevails. The formalism prevalent in the end game should not matter whether it be a form of 'private commercial law' in certain industries or whether it is directed at the resolution of disputes by courts or other arbitrators. The point is that Macneil too recognised litigation as being different to the contractual relationship itself. In Macneil's words:

> the court is conducting an autopsy on the corpse, not in examining an ongoing relationship in which exchange and other motivations create a mutual need for cooperation. Instead of constituting a way of satisfying such motivations – as does a viable contractual relationship -the contractual relationship in litigation has become simply a tool for securing or avoiding damages.[286]

While the Civil Procedure Rules reflects an approach of the law towards co-operation; whether is it is *effective* at 'enforcing' cooperation is another matter. This question cannot be answered without further empirical work on this issue which is beyond the scope and purpose of this thesis. The Civil Procedure Rules attempts to create a cooperative attitude during the end game. However a distinction needs to be drawn between contract law and the rules governing civil procedure. It appears that even though the Civil Procedure Rules seem to impose RPN in the end game, the purpose is geared more at procedural

[285] Mitchell, *Interpretation of Contracts* (n 77) 120.

[286] Macneil, 'A Primer of Contract Planning' (n 144) 692.

convenience by clarifying the issues for litigation, to ensure litigation is cheaper and faster and to minimise the resort to litigation.

It is not in dispute that context in taken into account when judges adjudicate commercial disputes. A formalist approach that 'seeks to deny any role for context can be very easily dismissed'.[287] Morgan's narrative of minimalism, when applied to the Civil Procedure Rules, would reject the approach that the law should enforce extra-legal norms.[288] The bottom line is not that parties should not cooperate in the 'end game', rather if parties want RPN to apply in the end game, then that should be done. The point, however is that the application of RPN should not be applied in the first instance. At this stage it is the contract that matters. Morgan views that as an indication that the relationship has already broken down and the law should be directed at ending that relationship rather than preserving it. The minimalist view, according to Morgan, is that clear rules best facilitates dispute resolution.[289] By relying on Bernstein's empirical evidence, Morgan asserts that the enforcement of norms to preserve the relationship between the parties is counterproductive and that relational contracting does not mean that relational norms should be enforced by courts.

2.4.2.6 Drawing the Debate Together: The Relevance to Insurance Contract Law

The above discussion on the (neo) formalist-contextualist debate only touched on such parts of it as are essential to developing the themes in this thesis. There are several voices in this debate - some dissenting, some concurring - which are summarised below. This thesis does not aim to provide a new voice to that debate, in that, it does not provide a unique perspective on relational theory or neo-formalism and so forth. Yet it provides a new voice in two different respects. First, insurance contract law has usually lain outside this debate in contract law. While there have been references to insurance law these tend to be relegated to footnotes or a cursory examination.[290] This thesis brings insurance contract law into that debate and adds a voice to the existing debate by echoing support

[287] Mitchell, *Interpretation of Contracts* (n 77) 94

[288] ibid 88.

[289] Morgan, *Contract Law Minimalism* (n 12). 89.

[290] For example, Tan, 'Disrupting Doctrine?' (n 150); Rob Merkin and Jenny Steele, *Insurance and the Law of Obligations* (OUP 2013)

for the minimalist approach.[291] Secondly, and more importantly, it applies and develops the debate in relation to commercial (marine) insurance contracts, to better understand the regulatory framework in which legal rules are applied following the 2015 Act. This is an entirely novel approach and one that is essential to understanding the nature of regulation following the 2015 Act.

Before tackling the fault lines between the contextualist-(neo)formalist theoretical approaches, it is pertinent to examine the similarities. One of Morgan's main theses regarding minimalism is that commercial contract law has a central purpose, namely to provide a suitable legal framework for trade. Gava believes that this puts him in the same company as otherwise disparate scholars – such as Collins, Mitchell, Campbell and Scott[292] – because they all see contract law in instrumental terms and simply differ over the best way to achieve the purpose of facilitating market exchange.[293] Indeed, Morgan argues that an instrumentalist view of contract law provides the best fit with the current law and that instrumentalism provides a good justification for that law.[294] Gava disagrees with their view and posits 'that there are historical, constitutional and institutional reasons for not seeing contract law in instrumentalist terms'.[295]

Having mapped the respective contributions to the (neo) formalist-contextualist debate, it emerges from scholars, such as, Campbell and Collins that the degeneration of the classical law is beyond contention.[296] The issue has therefore shifted to the most attractive rival to the classical law of contract as discussed above (those are, welfarism, relational theory and Collins's hybrid model).[297] Morgan, on the other hand, believes that it would

[291] Following a discussion with Dr Jonathan Morgan, he commented that the application of minimalism to insurance contract law is a novel and interesting approach – one which was not covered in his monograph. See Morgan (n 12).

[292] John Gava, 'What we know about Contract Law and Transacting in the Marketplace – A Review Essay of Catherine Mitchell, *Contract Law and Contract Law Practice: Bridging the Gap between Legal Reasoning and Commercial Expectation* and Jonathan Morgan, *Contract Law Minimalism: A Formalist Restatement of Commercial Contract Law*' (2014) 2 Adelaide Law Review 409, 418.

[293] ibid 411.

[294] ibid 417. Morgan, *Contract Law Minimalism* (n 12) 1-4.

[295] ibid 411.

[296] Campbell, 'Reflexivity and Welfarism in Modern Contract Law' (n 146).

[297] ibid.

be '[t]empting, but wrong' to call for the death or reconfiguration of English contract law.[298] He disagrees with the conclusion that the revelations of relational contract research as espoused by Macaulay and others have falsified the traditional English approach.[299] He reaffirms his defence for a rule-based, strict and minimalist law of contract[300] and cautions for regulatory restraint on the basis that classical contract law provides stability and predictability of expectations, leaving considerable scope for private ordering. [301]

Morgan asks how are we to choose between the relational/contextual and the neo-formalist approaches. [302] Each camp is in effect making the claim that this is what commercial contract law should look like and this is what contracting parties want. These claims should be capable of proof by empirical studies and indeed both sides have carried out empirical research to advance their respective cases. For contextualists, there are many studies showing that people rely much more on social norms of trust and co-operation than they do upon the clear rules of formal contract law.[303] Empirical research into relational contracts shows that parties may in practice understand the relationship differently and/or pay little attention to the contract. By contrast, Bernstein's study of the cotton and grain industries:

> finds explicit approval of the formalist dispute resolution approach but simultaneously clear expectations of flexible, co-operative 'relational' behaviour from trading partners –during the currency of a relationship'.[304]

It has been noted previously that Bernstein's empirical work focused on contracts that were framed by trade associations and therefore represented a greater balance between the interests of the respective parties – which differ from the position with marine insurance contracts. However this thesis draws on Morgan's reliance on Bernstein's work

[298] Morgan, *Contract Law Minimalism* (n 12) 97.

[299] ibid.

[300] ibid.

[301] Roger Brownsword, 'Introduction' in Brownsword, *Contract and Regulation* (n 114) 174. See also Bernstein, 'Merchant Law' (n 75) 1765.

[302] Morgan, *Great Debates* (n 161) 75.

[303] ibid. See also: Macaulay 'Non-Contractual Relations in Business' (n 144); Beale and Dugdale, 'Contracts between Businessmen' (n 138).

[304] Morgan, *Contract Law Minimalism* (n 12) 104. See also Morgan, 'In Defence of *Baird Textiles*' (n 72) 176.

to show the existence of different norms at different stages of a contractual relationship. In doing so, this thesis suggests that Morgan and Bernstein's work provides a strong foundation for recognising that different norms apply during the currency of an insurance contractual relationship and when there is a dispute or claim.

The debate 'seems insoluble and it has ramifications right across contract law'.[305] It is argued that it is necessary to look beyond the 'paper deal' to the 'real deal'. It may be that a relational contract *law* may support relational contracting better still, as Collins and many others have argued.[306] Morgan (like Bernstein) recognises the contribution of relational theory in directing attention to the context in which contracts are made and performed and the frequent relational character of that context.[307] But Morgan (like Bernstein) says there is reason to doubt whether relational contract *law* could work. Relational contract theory has always been more directly influential on the academic discourse than on the courts (and, one might add, is likely to remain so).[308] Resistance to the contextualist school emphasises, first, the limits of judicial capacity to uncover and enforce implicit norms between contracting parties, as it may be actively harmful to the very trust and co-operation that Collins would seek to promote.[309] Secondly the limits in designing economically efficient default rules to supplement the contract terms.[310]

Morgan claims that there is 'a growing emphasis on contextualism, discretion and regulation in both adjudication and through statutory incursions'[311] and this threatens classical values in English commercial insurance law.[312] I also contest the durability of Collins's scholarship as presenting a host of problems that lend further support to a minimalist approach to regulation. His normative framework is rich on paper but impoverished in practice. It seems unlikely that English judges will turn out to be 'closet relationalists'[313] given that 'relational contract' seems to have had little impact on the law

[305] Morgan, 'In Defence of *Baird Textiles'* (n 72) 75.

[306] ibid 172.

[307] ibid 170.

[308] Jay Feinman, 'Introduction' (n 127) 5. See also Mulcahy, 'Telling Tales about Relational Contracts' (n 142) 194.

[309] Morgan, *Great Debates* (n 161) 73.

[310] ibid 74; Schwartz and Scott 'Contract Theory' (n 99).

[311] Morgan, *Great Debates* (n 161) 74.

[312] ibid.

[313] Beale, 'Relational Values in English Contract Law' (n 127) 136.

of England and Wales.[314] But there may well be conflicting sentiments[315] as Tan has said that 'relational contract theory has been creeping into the courts' and mentions several cases to that effect.[316]

The debate is not concerned with controlling substantive contractual terms but is rather concerned with the consequences of breach of a term. In relation to risk control terms this is particularly relevant to the omnipotent issue of whether an insurer should be entitled to refuse to pay a claim where the breach of warranty is trivial or has no relation to the loss suffered. This speaks to the issue in contract law regarding primary and secondary obligations. The concern with warranties is not with the primary obligation (ie the insertion of a warranty in the insurance contract) but with the secondary obligation (ie that follows when the primary obligation is breached). Hence, the implications of the debate for insurance contract law is on right of an insurer to avoid its obligations on breach of the warranty by the insured.

In coalescing relational theory and *insurance* law, the American insurance law Feinman has in effect agreed with Macaulay's preference for the 'real deal' over the 'paper deal'. He has written that as an insurance policy is a form contract, 'the law needs to inquire more deeply into the nature of the insurance relation beyond the four corners of the policy'.[317] Feinman sees an insurance relationship as more than an agreement on express written terms but rather as a 'relationship of security, a relationship that is formally created by the policy but that is socially constructed and promoted by insurers as a group'.[318] The written contract, he says, is a starting point but is problematic as an end

[314] ibid 116.

[315] Tan, 'Disrupting Doctrine?' (n 150) 98.

[316] ibid. The primary case is the *Yam Seng v International Trade Corp Ltd* [2013] EWHC 111 (QB), [2013] 1 All ER 1321. Others include: *Baird Textile Holdings Ltd v Marks & Spencer plc* [2001] EWCA Civ 274, [2002] 1 All ER 737 at [16]; *Total Gas Marketing Ltd v Arco British Ltd* [1998] UKHL 22, [1998] CLC 1275 at 1286; *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661 at [54], [61]; *BP Gas Marketing Ltd v La Societe Sonatrach* [2016] EWHC 2461 (Comm) at [242]; *Monde Petroleum SA v WesternZagros Ltd* [2016] EWHC 1472 (Comm) at [250], [254], [259]; *Ilkerler Otomotiv Sanayai ve Ticaret Anonim v Perkins Engines Co Ltd* [2017] EWCA Civ 183 at [28]; *Microsoft Mobile Oy (Ltd) v Sony Europe Ltd* [2017] EWHC 374 (Ch) at [67]–[69].

[317] Feinman, 'Contract and Claim in Insurance Law' (n 23) 163.

[318] ibid 165.

point.[319] Another, perhaps more cogent way of expressing this line of reasoning is that the written terms, as the starting point, are emphasised as 'the core of the relationship'[320] over everything else – expectations created outside the written policy, public policies, measures against opportunism.[321]

Feinman also says that 'in considering insurance law issues across a range of doctrines, courts should be sensitive to the nature of the contract relation and the importance of claim process dynamics'.[322] Feinman is of the view that it is frequently the case that the insurer emphasises the terms of the written contract as embodying its obligation to the insured.[323] The insured however takes a different view and sees the written contract as only representing agreement on a few important terms, but as reflecting blanket assent to the relationship of security.[324] Feinman believes that this is the result of 'a relational expectation' of the insured which the insurer views as being in conflict with the written insurance contract.[325]

From that perspective, relational contract theory is seen as of continuing relevance in framing contractual issues not just in contract law but in insurance contract law as well. But Feinman questioned the possibility of whether relational theory could 'reshape the core of contract doctrine – the traditional doctrinal structure of rules and principles of formation, performance, etc'[326] and answered in the negative:

> While… I was once optimistic about the project, I now believe that the relational norms will not supplant the more familiar doctrines anytime soon, much less replace the even more fundamental doctrines such as indefiniteness, conditions, or parol evidence.[327]

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[319] Feinman, 'Contract and Claim in Insurance Law' (n 23) 166.

[320] ibid 173

[321] ibid 173

[322] ibid 173.

[323] ibid 181.

[324] ibid 181

[325] ibid 167.

[326] Tan Disrupting Doctrine?' (n 1150) 100.

[327] ibid. Feinman 'Relational Contract Theory in Context' (2000) 94 Northwestern UL Rev 737, 747–748.

On that note, the debate in contract scholarship remains unsettled and is unlikely to reach a consensus given the many differing perspectives and political views which influences to which school one aligns oneself. As was stated early on, there is a distinction between law and scholarship. While these arguments may be persuasive in scholarship, they have not had a similar reception in law. I turn to consider this aspect next.

2.6 The Influence of Contract Theory in Contract Law

2.6.1 Interpretation

The shift towards 'contextualism' has been most prevalent in contractual interpretation, thus it is relevant to highlight some key trends in contractual interpretation. As set out previously, marine insurance law forms part of the contract law framework hence the principles of interpretation applicable in general contract law can also be employed for the construction of marine policies.[328] Morgan says that '[i]nterpretation is the most vital question since the doctrines of contract law are only defaults, for which parties may substitute their own preferred rules'.[329]

As Hugh Beale notes, the traditional approach of English law to commercial contracts has favoured abstraction, scorned the context in which the agreement was made, and upheld certainty.[330] It is interesting to reflect on this preference for abstraction and the 'individualist nature of English contract law',[331] which, Beale says, can be explained by the nature of reported cases that the courts heard. They fall largely within the preserve of commercial cases 'usually involving high-value contracts between parties who are sophisticated parties…'[332] Beale adds that in those instances, the 'notions of freedom and sanctity of contract are quite plausible'.[333] However the tendency of English courts towards abstraction is changing as context becomes increasingly relevant.[334]

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[328] Soyer, *Warranties in Marine Insurance* (n 1) 16. See also Clarke, *Policies and Perceptions of Insurance Law* (n 24) 354; Digby Jess, *The Insurance of Commercial Risks: Law and Practice* (Sweet & Maxwell 2011) [2-03].

[329] Morgan, *Contract Law Minimalism* (n 12) 228.

[330] Beale, 'Relational Values in English Contract Law' (n 127) 129.

[331] ibid.

[332] ibid.

[333] ibid.

[334] ibid.

Context is unavoidable but the crux is the type and degree of context (that is, the *balance* between contextualism and textualism). *Investors Compensation Scheme Ltd v West Bromwich Building Society* ('*ICS*')[335] was a turning point for the construction of commercial contracts as Lord Hoffman emphasised the crucial role of context (or the factual matrix) in interpretation.[336] In his restatement of the rules of contractual interpretation, Lord Hoffman said that:

> [i]nterpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.[337]

Moreover Lord Hoffman stated that the background - the 'matrix of facts'- includes 'absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man'.[338] It was a turning point because the term did not have to be ambiguous in order for courts to resort to context. In his statement, Lord Hoffman stressed that if from the factual background one infers that the language used in the relevant clause is going to lead to a conclusion that flouts business common sense then the judges must opt for a construction that is in line with business common sense.[339] Lord Hoffman therefore assimilated the judicial task that 'common sense' requires interpretation in context – viz against the background of 'absolutely' anything reasonably available to the parties at the time of contracting. On that reasoning, an exemption clause would not be given a meaning where the literal words used would defeat the main object of the contract or create commercial absurdity.

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[335] *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1997] UKHL 28, [1998] 1 All ER 98, [1998] 1 WLR 896, [1998] AC 896 ('*ICS*').

[336] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn, Vol 1 Sweet & Maxwell 2018)3-005. See also *Prenn v Simmonds* [1971] 1WLR 1381; *Reardon Smith Line Ltd v Yngvar Hansen-Tangen (the Diana Prosperity)* [1976] 1 WLR 989.

[337] *ICS* (n 359) [12].

[338] ibid

[339] *ICS* (n 359) [12-13].

The *ICS* decision received a mixed reception. For some it was criticised for going too far,[340] due to the open-endedness of the what could be brought within the notion of 'factual matrix'. The open-endedness of this concept also brought with it the potential for increased litigation as parties would adduce more evidence drawn from the context.[341] For others, the *ICS* decision meant that there was more to do as the focus here was to look beyond the parties' contract and give effect to the 'real deal'.[342] This goes back to the discussion pertaining to Macaulay's 'real deal' v 'paper deal' and also to Collins's normative framework. To that end, the critique of the *ICS* decision is that the starting point should not be the contract but should be the context and the relationship between the parties ('the real deal'). Notwithstanding that, the principles in *ICS* were entrenched and expanded upon in subsequent decisions.[343]

The later case of *Chartbrook v Persimmon* concerned a development agreement where Persimmon would obtain planning permission on Chartbrook's site and undertake the development of commercial and residential property on the site.[344] Once complete, Persimmon would sell the units and Chartbrook would grant long leases to the buyers. It was agreed that Persimmon would receive the sale proceeds and would pay Chartbrook an agreed price for the site. The calculation of that price was included in the contracts and this is where the dispute arose regarding the construction of the term for calculation of the price. Chartbook was successful in the lower court and in the Court of Appeal; but in the House of Lords, they found for Persimmon (thereby agreeing with the dissenting judgment of Lawrence Collins LJ in the Court of Appeal). Lord Hoffman in delivering the leading judgment took into account the background and the context of the clause, rather than focusing on syntax which would make no commercial sense. He therefore read

[340] C Staughton, 'How Do the Courts Interpret Commercial Contracts?' (1999) 58 CLJ 303; M Clarke, 'Interpreting Contracts - The Price of Perspective' (2009) 59 CLJ 18.

[341] Lord Steyn, 'The Intractable Problem of the Interpretation of Legal Texts' (2003) _ 25 Sydney LR 5, 8-10.

[342] Johan Steyn, 'Contract law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 The L.Q. Rev 433.

[343] *Bank of Credit and Commerce International SA v Ali* [2001] UKHL 8; *Chartbrook Ltd v Persimmon Homes* [2009] UKHL 38

[344] The court revisited the rule in *Prenn v Simmonds* (n 360).

the clause in a manner that was not supported by a literal reading of the words based on whether that reading made 'commercial sense'.[345]

Similarly in *Rainy Sky SA v Kookmin Bank* the Supreme Court adopted a purposive constructive and held that the plain meaning of a contract of guarantee made 'no commercial sense'.[346] Lord Clarke stated that '[i]f there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and reject the other'.[347] But the majority of the Court of Appeal had held that there were any number of reasons why, under commercial pressure, such a form of words might have been used and, in the absence of insight into these factors, the court would risk imposing its own commercial judgment in a speculative fashion.[348]

The judicial approach in *Chartbrook* and *Rainy Sky* caused concern as it amounted to a wide latitude to courts to depart from the literal words and rewrite contracts.[349] Morgan's view is that business common sense can be viewed not just an aid to the construction of the contract but can be used to justify that the contract does not represent the parties' actual intentions, which allows a court to overstep the contract wording itself.[350] This view means that '[t]he court is not effectively enforcing the text of the contract at all, in such cases'.[351] Morgan says that *Rainy Sky* should not lead courts to:

> fall into the trap of re-writing the contract in order to produce what it considers to be a more reasonable meaning when the parties have expressed their intention in a carefully drafted agreement.[352]

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[345] *Chartbook* (n 368) [93].

[346] *Rainy Sky SA v Kookmin Bank* [2010] EWCA Civ 582; [2011] UKSC 50. Morgan, *Contract Law Minimalism* (n 12) 235.

[347] ibid [21].

[348] Morgan, *Contract Law Minimalism* (n 12).

[349] P Clark, 'Business Common Sense' (2012) 76 Conv 190.

[350] *ICS* (n 359) confirmed the approach taken in *Mannai Investment Co Ltd v Eagle Star Assurance* [1997] UKHL 19; [1997] AC 749; [1997] 3 All ER 352; [1997] 2 WLR 945; *Chartbrook* (n 368).

[351] Morgan, *Contract Law Minimalism* (n 12) 234.

[352] ibid 236; *Proctor & Gamble Co v Svenska Cellulosa AB* [2012] EWCA Civ 1413.

In *Arnold v Britton*[353] the Supreme Court expressed caution about contextualism as was advocated in *ICS* and *Rainy Sky*. *Arnold v Britton* concerned the interpretation of a service charge clause in 25 year lease agreements of holiday chalets whereby the lessees (Britton and others) had to pay the lessor (Arnold) an annual amount for the repair and maintenance of the leisure park where the chalets were located. The lessees argued that the clause related to a proportion of the expenses actually incurred by the lessor each year subject to a maximum cap on increases of ten percent. The lessor, on the other hand, argued that the amount was fixed and which increased at ten per cent per annum and was unrelated to the actual expenses incurred by the lessor.

Lord Neuberger in delivering the leading judgment laid out seven factors. Five of those factors are paraphrased here insofar as it is relevant to the discussion in this thesis:

(i) Commercial common sense and surrounding circumstances should not be invoked to undervalue the importance of the language of the provision.[354] Parties have control over the latter but not the former.

(ii) The less clear words appear, the more ready the court can be to depart from the meaning of the words. However courts should not search for 'drafting infelicities' solely to justify a departure from the natural meaning.[355]

(iii) Commercial common sense is not to be influenced by factors after the contract had been entered into'.[356] Courts should not override the meaning of a provision simply because it amounts to a bad bargain as it is not for the court to re-write the contract for the parties to escape a bad bargain.[357]

(iv) Commercial common sense is an important consideration when interpreting a contract but a court should be slow to reject the natural meaning of a provision simply because it appears to be an imprudent term to have been agreed on even ignoring the benefit of hindsight. Courts should not re-write a contract as the 'purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed'.[358]

[353] *Arnold v Britton* [2015] UKSC 36.

[354] ibid [17].

[355] ibid [18]

[356] ibid [19].

[357] Ibid [17-20].

[358] Ibid [20].

(v) Surrounding factual circumstances that may be taken into account must have been known or reasonably available to both parties at the time that the contract was made.[359]

The Supreme Court emphasised that there needs to be a balance between language and background' but it would be wrong to characterise the Supreme Court in *Arnold v Britton* as having overruled the decisions in *Rainy Sky* and *ICS* – in fact there was no direct criticism of those judgments. The dissenting decision of Lord Carnwath demonstrated that an emphasis on the language of the contract was still too dominant and more weight should have been given to the unreasonableness of the result. Lord Carnwath found that on the facts the purpose of the clause in question was to allow the lessor to recover the costs of maintaining the property and therefore the amount recoverable should be proportionate to the costs incurred. However the interpretation adopted by the majority meant that the recovery of costs was not proportionate and therefore, in Lord Carnwath's view, the outcome could not be correct. To support his view, Lord Carnwath drew on the judicial statement by Lord Reid in *Wickman Machine Tools Sales Ltd v L Schuler AG:*

> The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable the result, the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention abundantly clear.[360]

He also drew on Lord Diplock's comment in *The Antaios:*

> If detailed and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense it must yield to business common sense.[361]

However reference to these judicial observations by Lord Carnwath have to viewed in light of Lord Neuberger's point [iii] above, namely, that common sense should not be involved retrospectively. Parties enter into ill-advised transactions and it is not for courts to come to the aid of an unwise party and interpret the contract to relieve him/her of

[359] ibid [21].

[360] *Arnold* (n 391) [110]; *Wickman Machine Tools Sales Ltd v L Schuler AG* [1974] AC 235, 251.

[361] *Antaios Cia Naviera SA v Salen Rederierna AB (The Antaios):* [1985] AC 191, 201.

his/her imprudence. This serves to highlight that 'judges disagree over whether they should be the arbiters of what is reasonable or absurd'. [362]

Lord Hodge's view, set out in *Wood v Capita Insurance Services Ltd*,[363] was that textualism and contextualism are not 'conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation'.[364] The issue in this case centred on the interpretation of an indemnity clause included in a Share Purchase agreement between the seller of shares in a company and the buyer. The buyer (Capita) sought to rely on the indemnity clause in that it had suffered loss due to the mis-selling of insurance products prior to the sale being completed. The seller claimed that the indemnity did not apply as the requirement to compensate fell outside the scope of the indemnity clause.

In the High Court it was held that the clause required the seller to indemnify the buyer even if there had been no claim or complaint to the Financial Services Authority or to any other public regulatory body. The Court of Appeal disagreed on the basis that the indemnity was limited to loss arising out of such claims or complaints. The buyer appealed and said that the Court of Appeal was heavily influenced by *Arnold v Britton* by placing too much emphasis on the word of the agreement than on the factual matrix. The Supreme Court unanimously dismissed the appeal and Lord Hodge, giving the lead judgment, described the process of interpretation as:

> a unitary exercise; where there are rival meanings, the court can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense… This unitary exercise involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated… *Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance*. But… there may often… be provisions

[362] Mitchell, *Interpretation of Contracts* (n 77) 94.

[363] *Wood v Capita Insurance Services Ltd* [2017] UKSC 24.

[364] ibid [13].

> in a detailed professionally drawn contract which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type.[365]

In dissecting Lord Hodge's comments, it becomes clear that interpretation is a balance between textualism and contextualism, and which would be the more appropriate interpretative tool depends on the circumstances of each case. In some instances, textualism would be more appropriate where parties are commercially sophisticated and are experienced in the particular industry (as was the case in *Woods v Capita*). Or, perhaps where complex agreements are involved which have been negotiated and drafted with the assistance of skilled professionals. However, in other instances, contextualism would be the more appropriate interpretative tool where emphasis is given to the factual matrix due to, for example, the absence of skilled professionals, the simplicity or brevity of the contract. There does not exist a clear distinction in this respect, for as Lord Hodge went on to say there may well be complex, professionally drawn contracts which require recourse to the factual matrix when interpreting as the contract may lack clarity. Therefore he believes that the'iterative process'assists in ascertaining the objective meaning of the provisions in dispute.

This brings us to the question of whether there is a difference in how courts approach the balance between textualism and contextualism where sophisticated parties are concerned. *Rainy Sky* dealt with sophisticated parties, the appellants, were shipowning companies, contracted to buy a ship from a shipbuilding company and the respondent was a first class Korean bank. Despite this the court favoured a contextual interpretation which was criticised by some commentators, such as Morgan. Yet, in *Woods v Capita* the court specifically looked at sophistication as a possible option in determining whether a textual or contextual approach would be more appropriate. Indeed, context such as the fact that detailed planning and legal advice went into the drafting of the contract may serve to demonstrate that a more literal interpretation should prevail.[366] In some commercial contracts a formalistic approach may be preferred if the contract is sufficiently detailed

[365] *Wood* (n 403) [11] – [13] (my emphasis).

[366] As was adopted by the Court of Appeal in *BMA Special Opportunity Hub Fund Ltd v African Minerals Finance Ltd*[2013] EWCA Civ 41 [24-5].

and it has been drafted by lawyers or specialists in that industry and the contract is between parties of equal bargaining power who are repeat players in that market.[367]

In the older case of *Re Stigma Finance Corporation*[368] the Supreme Court followed the interpretation in *Chartbrook* and refused to give effect to 'the clear and natural meaning' of 'a commercial document prepared by skilled and specialist lawyers for use in relation to sophisticated financial transactions'.[369] The plain meaning was held to be inconsistent with sensible commercial results.[370] The case concerned the priority of a payment in terms of a Security Trust Deed for a structured investment vehicle (SIV). The issue centred on whether the relevant provision should be interpreted so that debts which are due within the 'realisation period' should be paid before other short term creditors. A textual reading meant that these debts should be paid whereas, a contextual approach (as adopted by the majority in the Supreme Court) meant that such debts should not be paid ahead of other creditors.

It is not a novel view that the law should not intervene in all aspects of commercial relationships and similarly it is equally accepted that that view has its limitations.[371] In *Photo Production Ltd v Securicor Transport Ltd* there was an agreement for Securicor to provide security services at night at the claimant's factory. The claimant's factory was destroyed by fire started by the security guard. The contracts contained an exclusion clause which excluded liability for negligence of Securicor's employees. The issue of whether this clause excluded liability was a matter of interpretation.[372] Lord Diplock stated:

> Parties are free to agree to whatever exclusion or modification of all types of obligations as they please within the limits that the agreement must retain the legal characteristics of a contract; and must not offend against the equitable rule against

[367] Mitchell, *Interpretation of Contracts* (n 77) 111.

[368] In Re Sigma Finance Corporation (in administrative receivership) and In Re the Insolvency Act 1986 (Conjoined Appeals) [2009] UKSC 2.

[369] Morgan, *Contract Law Minimalism* (n 12) 236; ibid, [67].

[370] ibid.

[371] For example, see Mitchell, 'Commercial Contract Law and the Real Deal' (n 7) 49.

[372] It was held that the doctrine of fundamental breach did not play a role here and will not be considered further for purposes of this thesis. It should be noted that the contract was entered into before the passing of the UCTA.

> penalties; that is to say, it must not impose upon the breaker of a primary obligation a general secondary obligation to pay to the other party a sum of money that is manifestly intended to be in excess of the amount which would fully compensate the other party for the loss sustained by him in consequence of the breach of primary obligation. Since the presumption is that the parties by entering into the contract intended to accept the implied obligations exclusion clauses are to be construed strictly…[373]

The famous dictum delivered by Lord Wilberforce in *Photo Production Ltd v Securicor Transport Ltd* is used to support a less interventionist approach in sophisticated commercial contexts:

> in commercial matters generally, when the parties are not of unequal bargaining power, and when risks are normally borne by insurance, not only is the case for judicial intervention undemonstrated, but there is everything to be said for leaving the parties free to apportion the risk as they think fit and for respecting their decisions.[374]

This view accords with the approach to 'sophisticated parties' such as parties to a marine insurance contract. As argued in this thesis, the *Photo Production* approach is fact the correct one and courts should adopt a more formalist approach to contract law questions when interpreting contracts between sophisticated parties whereby freedom of contract is usually elevated over normative concerns.[375]

This approach has been alluded to in a number of cases, including, by the Court of Appeal in *Watford Electronics v Sanderson*[376] which concerned a contract for the purchase of software from the supplier, Sanderson, by the purchaser, Watford. The purchased software failed to perform and the purchaser claimed under the contract. The contract contained a clause that the contract represented the entire agreement between the parties. The contract also contained an exclusion and limitation of liability clause in Sanderson's

[373] *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 850.

[374] ibid. This approach has been alluded to in a number of cases, including by the Court of Appeal in *Watford Electronics v Sanderson* [2001] 1 All ER (Comm) 696; *Granville Oil & Chemicals Ltd v Davis Turner & Co. Ltd* [2003] EWCA Civ. 570.

[375] Miller, 'Contract Law, Party Sophistication and the New Formalism' (n 8) 501.

[376] *Watford Electronics v Sanderson* (n 417).

written standard terms of business and thus fell within UCTA 1977. At first instance, the limitation clause was held to be invalid for unreasonableness.

At first instance, the supplier sought to argue that the purchaser was itself a supplier of PCS and other electronic goods and therefore did not rely on the Sanderson's expertise in concluding this contract. The trial judge disagreed and drew upon evidence such as the brochure and correspondence to show that Watford did indeed rely on Sanderson. The judge relied on several factors inter alia that both parties were of equal bargaining power as they were both represented in negotiations by experienced representative; that Watson was aware of the clauses even though only at a later stage in the negotiations; that Watford had its own standard terms of business with a similar clauses but this was deemed irrelevant as they were different businesses; that Watson depended on Sanderson's expertise and the exclusion clauses had serious consequences for Watson. It was therefore held that Sanderson had not established that the clause was reasonable.

Sanderson appealed where Chadwick LJ stated:

> Where experienced businessmen representing substantial companies of equal bargaining power negotiate an agreement, they may be taken to have had regard to the matters known to them. They should, in my view, be taken to be the best judge of the commercial fairness of the agreement which they have made, including the fairness of each of the terms in that agreement. They should be taken to be the best judge on the question whether the terms of the agreement are reasonable…Unless satisfied that one party has, in effect, taken unfair advantage of the other – or that a term is so unreasonable that it cannot properly have been understood or considered – the court should not interfere.

Chadwick J disagree with the findings of the lower court. In doing so, Chadwick J said that since Watford had its own standard terms with a similar limitation clause, this meant that Watford was indeed aware that commercial considerations render this a common clause to be included by a supplier in its contract. Watford should also have been aware that a supplier's price determination is also influenced by its possible exposure to the risk of indirect or consequential losses should things not proceed according to plan. This was an important consideration in determining the reasonableness of the clause. Chadwick J found that it was impossible for Sanderson to have taken unfair advantage of Watford or

that Watford did not understand the effect of a limitation of liability clause. He therefore held that the clause was a reasonable and fair one to be included.

Similarly, in *Granville Oil & Chemicals Ltd v Davis Turner & Co. Ltd*,[377] the Court of Appeal, led by Tuckey LJ, said:

> The 1977 Act [UCTA] obviously plays a very important role in protecting vulnerable consumers from the effects of draconian contract terms. But I am less enthusiastic about its intrusion into contracts between commercial parties of equal bargaining strength, who should generally be considered capable of being able to make contracts of their choosing and expect to be bound by their terms.[378]

It appears that under English law contractual interpretation is to be contextual and with preference given to an interpretation that makes commercial common sense. Yet as Mitchell says not every opposition to contextualism is formalist. For example, the in *Mannai Investment Co Ltd v Eagle Star Assurance* the minority in the House of Lords saw the contract as concerned with the validity of the tenant's notice to terminate by considering if the 'formal requirements in the agreement had been satisfied'. [379] Whereas the majority saw it as a question of interpretation and, as Mitchell says, the majority were able to use a more flexible technique to override the formal requirements for termination that the parties had agreed in the documents.[380]

This introduces the potential for judicial intervention through interpretation and in relation to commercial contracts, some have questioned whether this is the correct approach. Hogg, for one, has asked whether a court should intervene and rescue a party from a bad bargain that was commercially insensible by imposing the court's more commercially sensible interpretation of what the bargain should have been. [381] Furthermore, the issue of judicial experience was also raised as judges are usually drawn

[377] *Granville Oil & Chemicals Ltd v Davis Turner & Co. Ltd* (n 417).

[378] This predated the CRA which now governs the consumer aspect that fell under UCTA 1977.

[379] Mitchell, *Interpretation of Contracts* (n 77) 96-7.

[380] ibid.

[381] Martin Hogg, 'Fundamental Issues for Reform of the Law of Contractual Interpretation' (2011) 15 Edinburgh LR 406.

from the ranks of advocates and therefore may lack the experience of what would be best commercial practices of businesses and contract drafting. [382] A textual approach is safer and more settled. As Neuberger LJ points out, judges are 'not always the most commercially minded, let alone the most commercially experienced of people' and should be very circumspect before intervening because they think a contract's plain meaning unreasonable or unwise.[383] It would be preferable for courts to take a settled textual approach to interpretation leaving it to the parties and their draftsman to ensure the commerciality of the transaction.[384]

On the other hand, others have welcomed the policing role which interpretation can play particularly through the commercial common sense rule. Mitchell has said that sensitivity to context addresses the bargaining power and information asymmetries between contracting parties which may not be addressed by a textual approach. [385] Like the approach adopted in *Woods v Capita*, Brownsword believes that context can be a tool to recognise a particular contracting culture and whether it has an individualist or co-operative ethic in nature.[386] Despite that some judicial decisions still defer to the need to protect party autonomy in certain types of contracts.

2.6.2 Case Studies

Even though contract law scholarship (and interpretation) have made a determined shift towards contextualism, the issue is whether English judges been influenced by this scholarship? In other words, can the theory discussed above be grounded in specific case examples or have judges remained formal in their approach to commercial contracts?

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[382] *Credential Bath Street Ltd v Venture Investment Placement Ltd* [2007] CSOH 208 para 24 (per Lord Reid); *Grover Investments Ltd v Cape Building Products Ltd* [2014] CSIH 43 para 10 (per Lord Drummond-Young, disagreeing with this view)

[383] Morgan *Contract Law Minimalism* (n12) 236.

[384] ibid.

[385] Mitchell 'Interpreting Commercial Contracts: The Policing Role of Context in English Law' in DiMatteo and Hogg (eds) *Comparative Contract Law: British and American Perspectives* (2016) 196.

[386] Adams and Brownsword, *Key Issues in* Contract (Butterworths 1995) 309.

Some case study examples will be considered.[387] First, the point was made above that minimalism is indeed consistent with relational theory. However by relying on Bernstein's RPN and EGN discussed above it was shown that the enforcement of relational norms is problematic (ie relational contract law) as it is at the stage of litigation when the relationship has already broken down.[388] *Emcor Drake and Scull Ltd v Sir Robert McAlpine Ltd*[389] is useful in recognising that litigation provides a different context to the relationship and this affects 'how relational norms and formal legal norms can intertwine in a commercial relationship'.[390]

The facts concerned a private finance initiative (PFI) for the construction of new buildings and for the refurbishment of an NHS hospital. SRM was the main contractor and the other party was EDS, who successfully tendered for the mechanical and engineering works. Following discussions between SRM and EDS for about a year, they then agreed a price of £34.25 million for the works. Eighteen months later, a dispute arose on the basis that EDS refused to undertake any further work without a formal subcontract. SRM claimed repudiatory breach arguing that there was a binding commitment to complete the entire installation for about £35 million which was evidenced by several documents, including an initial letter agreement and order contracts. EDS on the other hand argued that the series of order contracts was their only commitment to carry out any work and that there was no ongoing obligation to complete the entire project. The parties had never concluded a formal subcontract despite this having been anticipated.

The trial judge and the Court of Appeal concluded that without a formal subcontract EDS were not obliged to complete the work and there had been no repudiatory breach. This decision showed that there were both non-legal norms present in this relationship and contract formalities.[391] The former was represented by the fact that: the parties had worked together previously; SRM had told EDS that they were the preferred bidder even before the tender process; and for 18 months EDS completed the work and SRM paid

[387] While there are several cases that can be discussed, a few are chosen to reflect some of the core themes discussed previously and which are relevant to this thesis. See also Mitchell, 'Contracts and Contract Law' (n 132).

[388] This will be discussed further in Ch 4.

[389] [2004] EWCA Civ 1733.

[390] See Mitchell,' Contracts and Contract Law' (n 148) 695.

[391] See Mitchell,' Contracts and Contract Law' (n 148) 695.

even though there was no formal contract in place. Examples of formal norms include that EDS did not want to start work without short-term formal contractual protections in place, while the culture in the construction industry pointed to a preference for discretion.[392]

Mitchell says that the parties never thought that they would not reach agreement or that there would be a dispute about the very issues that arose, and she points out that the 'haggling' over formalities is what in large part caused the dispute to arise.[393] In this way she says that there are two interpretations of the parties' behaviour, which both 'have an element of truth'.[394] Mitchell adds:

> This seems to demonstrate the simultaneous importance (getting it right, and the several attempts made to get it right) and lack of importance (starting the work without the comprehensive planning documents in place) that parties attach to the formal contractual scheme.[395]

In my view, the decisions of both courts were correct. Mitchell's view only confirms what Morgan and Bernstein have said: that relational norms can exist with formal norms during the currency of the relationship, but once the relationship has broken down, formal norms take over. A formal contract was absent in this complex, high value, sophisticated project and the judges reached the correct decision. If the parties had committed themselves to a formal contract but included an express clause to allow for such relational factors to feature in any dispute, then the court is likely to have arrived at a different outcome (provided the clauses were not vague). Even if such a clause was included in the subcontracts (as opposed to the overarching main contract that was absent), it may have provided the impetus for a court to recognise the relational elements that the parties themselves expressly agreed to – even in the absence of a formal main contract. Mitchell is correct in saying that there are two interpretations of the parties' behaviour, but what

[392] ibid 696.

[393] ibid.

[394] ibid.

[395] ibid 696-7.

matters when a dispute arises (ie when the relationship has broken down) is the contract.[396]

Baird Textile Holdings Ltd v Marks and Spencer plc[397] was also considered an important case to give effect to relational elements [398] and is an example of a commercial relationship where formal contract measures were lacking. The Court of Appeal did not give effect to the tacit understandings between the parties, which arguably 'constituted an informal 'umbrella agreement' that governed the series of discrete contracts and created an obligation not to terminate the relationship without warning'.[399] Morgan agreed with that decision on the basis that Macneil's account of relational contracting cannot and should not translate into a relational contract *law*.[400] Mulcahy mentions a failing by the courts in such cases and suggests that a different interpretative approach is exactly what 'relationists' have called for.[401]

The recognition of relational contracts is, of course, at complete variance with *Baird Textiles.*[402] *Yam Seng v International Trade Corp Ltd is* seen as the exception as it is one of the few cases that gives explicit recognition to the concept of the relational contract.[403] In doing so Leggatt J held:

> that relational contracts may require a higher degree of communication, cooperation and predictable performance, and that the specific contractual context

[396] Similarly, in *Walford v Miles* [1992] 2 AC 128 the House of Lords emphatically rejected the suggestion from the Court of Appeal that English law might recognise the validity of an agreement to negotiate in good faith. Here Morgan agrees that the law should not *impose* duties of good faith, co-operation and trust upon the parties. See Morgan, 'In Defence of *Baird Textiles*' (n 72) 179.

[397] [2001] EWCA Civ 274, [2002] 1 All ER (Comm) 737.

[398] Mulcahy, 'Telling Tales about Relational Contracts' (n 142) 197.

[399] Mitchell, 'Contracts and Contract Law' (n 148) 697.

[400] ibid. Morgan, 'In Defence of *Baird Textiles*' (n 72) 169.

[401] Mulcahy, 'Telling Tales about Relational Contracts' (n 142) 198.

[402] [2001] EWCA Civ 274, [2002] 1 All ER (Comm) 737.

[403] [2013] EWHC 111. *Alan Bates and Others v Post Office Limited* [2019] EWHC 606 (QB) the court has implied a duty to act in good faith into a contract based on it being relational.

> may give rise to expectations of information sharing, such that a deliberate omission to disclose such information may amount to bad faith.[404]

Leggatt J recognised a duty of honesty in contract performance concerning a distributorship contract on the basis that the expectation of honest behaviour 'is so obvious that it goes without saying' and that '[s]uch a requirement is also necessary to give business efficacy to commercial transactions'.[405] The judicial approach in the *Yam Seng* has provided an interesting insight for relational theory and has found some continued support.[406]

Translating the minimalist approach into case law examples, Morgan says that '[r]ules should be applied without the court seeking to inquire into 'opportunism': *Arcos v Ronaasen* should remain the default approach'.[407] *Arcos* is one of the most criticised cases in the sale of goods and possibly in contract law.[408] The controversy stems from the approach to interpretation, where the House of Lords adopted a formal interpretation of the contract terms over a contextual interpretation, which some would have considered the more sensible and fair approach.[409] Contextualists criticism of *Arcos* is that it is reflective of 'the defects of the discrete contract, in essence, that it is absurdly formal and endorses an excessive individualism'.[410] Morgan, on the other hand, uses *Arcos* to explain the minimalist approach on the basis that a clear contract term ('delivery of timber ½

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[404] Tan, 'Disrupting Doctrine?' (n 150) 108. *Yam Seng* [2013] EWHC 111 (QB), [2013] 1 All ER 1321[141]–[142].

[405] ibid [137]. Leggatt J utilised both the traditional 'business efficacy' test as well as Lord Hoffmann's formulation in *Attorney General for Belize v Belize Telecom Ltd* [2009] UKPC 10 at 1993–1995, which sees the traditional criteria not as a series of independent tests, but as different ways of approaching what is ultimately always a question of construction.

[406] Tan, 'Disrupting Doctrine?' (n 150) 110 for case egs. *Alan Bates* (n 452).

[407] Morgan, 'In Defence of *Baird Textiles*' (n 72)178: In *Arcos v Ronaasen* [1933] AC 470 UKHL 1 the buyers rejected the goods on the grounds that the sizes of a substantial proportion of the staves did not conform to the sizes described in the written contract.

[408] Campbell, 'Arcos v Ronaasen as a Relational Contract' (n 16) 139.

[409] ibid 139. On the basis that such a formal interpretation should no longer be possible after *the ICS decision*). This effected a controversial revolution in contractual interpretation by reinforcing a more liberal approach to the construction of contracts. Campbell, 'Arcos v Ronaasen as a Relational Contract' (n 16) 163.

[410] Campbell, 'Arcos v Ronaasen as a Relational Contract' (n 16) 163.

thick') means what it says– unless the parties say otherwise.[411] Should parties want to allow some leeway they could easily stipulate for a certain tolerance and (according to the judges in *Arcos v Ronaasen*) they frequently do.[412]

A more detailed analysis of the contextualist critique of *Arcos* in necessary in order to frame how the debate informs insurance contract law. As discussed above, the debate is concerned with the secondary obligation (ie the consequences of breach of a contractual term) rather than with the primary obligation (ie the substantive obligation itself). Adam's and Brownsword's welfarist critique of *Arcos* is based on the point that the buyer's right in rejecting the goods trumped the seller's right as was protected in the contract.[413] They view *Arcos* as an example of 'economic opportunism' as the buyer rejected the goods not due to breach by the seller but because market prices had fallen. Thus, the buyer's economic self-interest prevailed over the contractual commitment, which they viewed as an instance of bad faith.[414] The corollary, they say, is that a good faith requirement in law that would have altered the outcome of the case as the consequences of breach of the primary obligation would have had to have been in line with good faith.[415] The House of Lords however saw no problem with such 'economic opportunism'.[416]

Campbell draws on Adams and Brownsword's criticism of *Arcos* to show the superiority of relational theory, not only to the classical law but also to the welfarist law.[417] He has argued that, from a relational theory perspective, *Arcos* is wrongly decided. Campbell's 'relational' criticism of Adam and Brownsword's welfarist critique of *Arcos,* is that they admit that the contract gave the buyer the right to reject the goods for any reason and they admit that there are some contracts in which the individualist ethic is appropriate, and if this is one such instance, then how can it be criticised for being too individualist?[418]

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[411] Morgan, 'In Defence of *Baird Textiles*' (n 72) 179.

[412] ibid.

[413] Campbell, 'Arcos v Ronaasen' (n 16) 157.

[414] ibid 155. See also Adams and Brownsword, *Key Issues in* Contract (Butterworths 1995) 226.

[415] Campbell, 'Arcos v Ronaasen' (n16).

[416] *Arcos* (n 457) 480.

[417] Campbell, 'Arcos v Ronaasen' (n16) See David Campbell, 'Reflexivity and Welfarism in Modern Contract Law' (2000) 20(3) OJLS 477, 498.

[418] ibid 157.

Therefore their argument that this is an instance of bad faith is only partially persuasive because they recognise that it is not bad faith to behave in this way.[419]

According to the 'relationists' pure individualism per se is not the problem, but relational theory shows that 'pure individualism can never be consistent in the way it grounds contracting'.[420] Campbell in highlighting the superiority of the relational theory over its rivals claims that 'this lack of consistency matters only if we see that even highly competitive contracting is never a matter of pure individualism but of the pursuit of self-interest within an appropriate relational framework'.[421]

Campbell explains the welfarist critique of Lord Atkin's view:

> It was that a market-individualist judge took the classical view that where one party is in breach [of the primary obligation]; the innocent party may legitimately take any legally available options irrespective of whether that is for self-serving economic advantage [the secondary obligation]. This view condones bad faith in the illegitimate exercise of contractual discretion even though this is driven by market playing reasons and is not compatible with respect for the co-operative ideal of contract law.[422]

He then explains why he believes the welfarist conception to be inadequate:

> Despite various restatements of their early opposition between the classical 'market-individualist' and the co-operative 'consumer-welfarist' law, their [Adams and Brownsword] conception of the criticism of the classical law remains one of a choice between two opposed sets of values. Not only does this mean that their criticism remains exogenous to the classical law and so can be, and has been, simply put aside by those committed to that law, but, to be frank, if this choice was the issue, I do not think the welfarist law is the one that should be chosen, for I believe that the market competition articulated by the classical law is the best economic system of which it is possible to conceive or rather it would be, if its values were, as Hegel would have put it, made actual. The lack of attractiveness

[419] ibid 163.

[420] ibid.

[421] Campbell, 'Arcos v Ronaasen' (n16) 163.

[422] Ibid 156. See also Adams and Brownsword, *Key Issues in* Contract (n 152) 228-9.

> of a welfarist law is inimical to market competition, is in my view, is the reason that welfarist reform of law of sale has not been able to eliminate *Arcos* from the sale of goods, because welfarism cannot adequately fill the gaps that the removal of *Arcos* would leave.[423]

Campbell supports relational theory as the strongest basis on which we can move towards a coherent awareness that even the simplest contract is not a subjective agreement between two parties, but is the result of their relationship objectively mediated by a third party, the state, which gives effect to only socially understood and politically endorsed intentions.[424] *Arcos* is useful in highlighting that the issue was not the primary obligation but the secondary obligation, that is, the approach that should be followed when determining the consequence of breach of the primary obligation. This is relevant when applied to insurance law in relation to the insurers right to be discharged from liability upon breach of a warranty irrespective of the reason for breach.

These cases highlight that there are clear dissenting views on whether a contextualist or formalist approach should prevail in judicial regulation.[425] Morgan is a minority voice in the UK but that does not diminish the value of the (neo) formalist view. Both are perspectives with their own benefits and limitations, and indeed minimalism has never claimed to be anything more than a better hypothesis for commercial contract law.

2.7 Conclusion

In England one does not typically associate applied contract theory with (marine) insurance contract law.[426] The former is viewed as too theoretical and the other is viewed as a practical contractual matter. This is even though insurance contract law is usually aligned with general contract law and they share a common contractual framework. The bottom line is that the application of contract theory remains underdeveloped in the insurance law literature in England. This chapter has provided a theoretical foundation to advance the main claims of this thesis. In doing so, it has demonstrated that there is a

[423] Campbell, 'Arcos v Ronaasen' (n16)140.

[424] ibid 164.

[425] See *Campbell v Gordon* [2016] UKSC 38.

[426] For example, Han (n 4) 26 and Clarke, *Policies and Perceptions* (n 24) though looked at in relation to insurance law generally.

theoretical underpinning that can be used to understand and explain modern marine insurance contract law even though the latter is typically viewed as inherently pragmatic.

The (neo) formalist/contextualist debate formed the centrepiece of this chapter. On the one hand, formalism calls for strict rules that give effect to the parties' written contracts. On the other hand are the core 'contextualist' theories –relational theory, the ideologies of market-individualism and consumer-welfarism, and Collins's regulatory/relational hybrid. The 'contextualists' critique stems from empirical research which highlights that contracts are viewed as distinct from the contractual relationship itself. The correct view, as espoused by contextualists would be for any analysis of the 'contract' to encompass the contractual relationship as well. This group of theorists view trust and co-operation as central to the relationship between contracting parties, and hence to the contract. These implicit dimensions, they argue, should be enforced over giving preference to the written terms of the contracts and in many instances, contract law should be reconfigured to account for these implicit dimensions.

A reaction to the dominance of these contextualist theories is found in the neo-formalist school of thought. Contract law minimalism as propounded by Morgan recognises the value of the social underpinnings of contractual relations. However, while trust and co-operation are essential to commerce, neo-formalists 'doubt the feasibility and desirability of this revisionist stance'.[427] Minimalism calls for a light touch to legal regulation and is the best way for commercial contract law to fulfil its social goals.[428] It suggests a preference for clear rules and limited judicial intervention – notions that are antithetical to relational contract.[429]

In relation to the debate, an important distinction was drawn in this chapter between law and scholarship – a thread that will continue through the following chapters. This chapter showed that that there has been a shift in the paradigms of legal regulation of commercial contracts towards a growing emphasis on 'contextualism' in contract scholarship, but contract law has remained largely formal. The (neo) formalist-contextualist debate is situated in relation to the available empirical evidence, but a caveat should be kept in mind that on both the contextualist and (neo) formalist side, generalisations must

[427] Morgan, *Great Debates* (n 143).

[428] Morgan, *Contract Law Minimalism* (n 12) xv.

[429] Feinman, 'Introduction' (n 111) 7.

sometimes be made. While 'these empirical studies necessarily draw upon small scale and isolated examples'[430] they are useful in relation to marine insurance, which is used as a proxy for other sophisticated markets. Minimalism is a perspective that is offered for the regulation of marine insurance contract law both through statute and the courts. It has been argued that minimalism is the more effective form of regulation for marine insurance contract law.

In providing an overview of the key insurance provisions, I have endeavoured to introduce the claims that will be expanded on in subsequent chapters, notably that the 2015 Act reflects a change from form to substance thereby embracing contextual tendencies, which is a marked departure from the type and design of legal regulation under the previous default regulation. The next chapter will provide a critical analysis of the substantive law changes introduced by the 2015 Act, which has effected a shift in marine insurance regulation. This will allow for an analysis and application of this theoretical framework for understanding the 2015 Act, and marine insurance contract law more broadly.

[430] Mitchell,' Contracts and Contract Law' (n 132) 679.

Chapter 3: The Regulation of Insurance Contract Law: Law Reform and the Insurance Act 2015

3.1 Introduction

The purpose of this chapter is to analyse the substantive law changes to the law of warranty, risk control terms and contracting out under both the Marine Insurance Act 1906 ('the 1906 Act') and the Insurance Act 2015 ('the 2015 Act').[431] The approach adopted in this chapter draws on current scholarship on the 2015 Act but also goes further by critically evaluating the 2015 Act. It builds on the theoretical framework discussed in Chapter 2 to highlight both the substantive law concerns and to lay the foundation for a normative analysis in Chapter 4. The substantive law changes introduced by the 2015 Act reveal something more about the nature of legal regulation in modern commercial insurance contract law and the potential reach of interpretation. This chapter will:

(i) situate the warranty in its historical context;
(ii) analyse the problems under the 1906 Act which prompted reform;
(iii) examine the English and Scottish Law Commissions' ('the Law Commissions') approach to the reform process, including how the Law Commissions envisaged the reforms and how the 2015 Act reflects those considerations, if at all; and
(iv) analyse and evaluate the provisions on warranties, risk control terms, and contracting out under the 2015 Act ('the case studies').

It is important to note the scope of this chapter. While my thesis considers the substantive changes to the law in detail, the focus is not on the law of warranties, risk control terms, and contracting out. It does not aim to set out the detailed changes to the law from its historical context to the present day as that task has already been done.[432] This approach is reinforced by the research questions posed in this thesis to which there are two parts. The first part uses the case studies to analyse the type of statutory regulation governing

[431] The Insurance Act 2015 ('the IA 2015'), s10 (warranties), s11 (risk control terms), and ss16-17 (contracting out).

[432] Including: Wenhao Han, 'Warranties in Marine Insurance: A Survey of English Law and Other Jurisdictions with a view to Remodeling the Chinese Law' (PhD thesis University of Southampton 2006); Baris Soyer (ed), *Reforming Marine and Commercial Insurance Law* (Informa London 2008); Baris Soyer, *Warranties in Marine Insurance'* (3rd edn, Routledge 2017).

marine insurance contract law (ie the 2015 Act). The second part examines how judges should approach the substantive law provisions in light of this new type of statutory regulation. This chapter therefore acts as a bridge between the theoretical framework (Chapter 2) and the analysis of statutory and judicial regulation under the 2015 Act (Chapter 4).

3.2 Marine Insurance Warranties

3.2.1 A Brief History of Marine Insurance Warranties

Marine insurance has an ancient pedigree dating back to the 12th century where it was developed by Lombard merchants in northern Italy before being imported to England as early as the mid-13th century.[433] Marine insurance warranties were originally used to define the risk by setting out the scope of cover rather than excluding specific causes of loss.[434] In other words, historically warranties 'were designed to describe and delimit the risk that insurers were prepared to run'.[435] The early warranties were aimed at protecting insurers' interests against loss of vessels and such warranties commonly required that vessels be neutral or to travel in convoy.[436] A typical example of an early marine insurance warranty is *De Hahn v Hartley*[437] in which the vessel sailed with 46 crew but warranted to sail with 50 crew on board. Even though more than the warranted number was subsequently recruited before the vessel was captured, the insurer was not liable for the claim.[438]

Historically, therefore, insurers were viewed as the party in need of protection. The roots of marine insurance are found in the need to facilitate international trade, and the parties to insurance transactions were experienced merchants who acted according to long

[433] John Hare, 'The Omnipotent Warranty: England v the World' in Huybrechts M and others (eds), *Marine Insurance at the Turn of the Millennium* (Intersentia: Groningen, Oxford 2000) 37.

[434] William R. Vance, 'The History of the Development of the Warranty in Insurance Law' (1910-1911) 20 Yale L.J 523.

[435] R Merkin, 'Reforming Insurance Law: Is There a Case for Reverse Transportation? A Report for the English and Scottish Law Commissions on the Australian experience of Insurance Law Reform' (English and Law Commissions 2006) <www.lawcom.gov.uk/app/uploads/2015/03/ICL_Merkin_report.pdf> accessed 14 June 2019) 59.

[436] *Jefferies v Legandra* (1692) 4 Mod. 58; *Lethulier's Case* (1692) 91 Eng Rep 384; *Gordon v Morley* (1693) Strange, 1265.

[437] *De Hahn v Hartley* (1786) 1 T.R. 343.

[438] See also *Hore v Whitmore* (1778) 2 Cowp 784.

established practices and customs of international trade.[439] The practice of insuring vessels and cargo while seaborne meant that 'there was a greater need for certainty and good faith as the transactions depended on factual representations that could not be verified'.[440] As Merkin says:

> If the risk as described to insurers was not that which they actually faced, it seemed right for them to treat themselves as discharged from future liability.[441]

The insureds occupied a stronger bargaining position as the material facts about the marine adventure were within their knowledge and thus they could alter the risk after cover had been provided.[442] As Herman Cousy stated, the principles of insurance were developed at a time when there was a need to protect the underwriter due to:

> an attitude of systematic suspicion toward the policyholder and the insured. In fact nearly all of the traditional principles of insurance law can (only) be understood and explained as originating in this basic suspicion of fear and abuse.[443]

Tied to this reasoning, the initial conception of a marine insurance warranty in the 18th century was that it defined the risk run by the insurer and thus removed the need for the insurer to prove that the loss was proximately caused by the breach of warranty.[444] This was important because prior to the decision in *Leyland Shipping v Norwich Union*[445] the proximate cause of the loss was the last cause in time. A breach of a warranty that was not the last cause in time could therefore have been regarded as irrelevant.[446] Hence the

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[439] James Oldham, *English Common Law in the Age of Mansfield* (University North Carolina 2004) 125.

[440] ibid.

[441] Merkin, *Reforming Insurance Law* (n 5).

[442] James Davey, 'Remedying the Remedies: The Shifting Shape of Insurance Contract Law' (2013) 4 Lloyd's Maritime and Commercial Law Quarterly 476, 477.

[443] Helmut Cousy, 'Insurance between Commercial Law and Consumer Protection' in H Heiss (ed), *Insurance Contract Law between Business Law and Consumer Protection* (Dike, Zurich/St Gallen, 2012), 516.

[444] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2018) [8-111].

[445] *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* [1918] AC 350 HL.

[446] *Colinvaux's Law of Insurance* (n 14) [8-043].

remedy developed that a breach of warranty automatically discharged the insurer of all prospective liability, irrespective of the reason for breach or how the loss was caused.[447]

3.2.2 The Nature and Function of Insurance Warranties

Lord Mansfield observed that a warranty 'is a condition on which the contract is founded'.[448] Warranties function as a means for insurers to properly circumscribe the risk and to guard against an alteration of the risk that would render it materially different from the risk assumed by the insurer. Non-marine insurance warranties can only be created expressly,[449] whereas marine insurance warranties can either be express or implied by law. The two main types of implied warranties are: a warranty of seaworthiness, and a warranty of legality of the marine adventure.[450]

Marine insurance contracts contain a variety of express terms that had different consequences under the 1906 Act. Warranties are a type of risk control term and was the only risk control term regulated by the 1906 Act. This position has changed under the 2015 Act.[451] The other risk control terms can be classified as follows:

(i) Condition precedents to the making of the contract or to the inception of the risk. If this type of condition is not complied with, the insurers do not come on risk.[452]

(ii) Condition precedents to liability of the insurer prevents a claim by the assured unless the condition has been complied with regarding any particular loss.[453]

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[447] ibid. This explanation was given by Lord Mance in *The Cendor Mopu* [2011] UKSC 5; [2011] 1 Lloyd's Rep 560.

[448] *Bean v Stupart* (1778) 1 Doug 11, 14.

[449] The Marine Insurance Act 1906 ('the MIA 1906'), s 35(2): 'An express warranty must be included in, or written upon, the policy, or must be contained in some document incorporated by reference into the policy'.

[450] The MIA 1906, s33 (2). This aspect is not considered in this thesis.

[451] Baris Soyer, *Warranties in Marine Insurance* (n 2) 4.

[452] The MIA 1906, ss 84(1) and 84(3)(a). *Colinvaux's Law of Insurance* (n 14) [8-006].

[453] ibid [8-012].

Unlike a breach of warranty, 'only the specific claim is lost and there is no adverse impact on future coverage'.[454]

(iii) Contractual conditions are conditions that are not conditions precedent. Such conditions are subject to general contractual rules. The innocent party is entitled on breach of this term to treat the contract as repudiated and to refuse to proffer or accept future performance.[455] This remedy is available in addition to a right to damages. An innominate term is where the rights of the innocent party depend on the seriousness of the consequences of any breach.[456]

(iv) Suspensory condition or terms 'descriptive of the risk' is a 'judge-made category',[457] which suspends the risk during periods of breach. The rationale was to mitigate the harshness of classifying a term as a warranty.

Prior to the 2015 Act warranties sat at the top of the hierarchy of importance for insurance terms. This hierarchical classification in insurance contract law differed from that which existed in general contract law. Conditions and innominate terms are as described above, but in general contract law a warranty is a term of minor importance, breach of which gives rise to a claim for damages.[458] In insurance contract law, warranties are a crucial defence for an insurer against a claim from the assured. It therefore operates as a 'shield against liability under the policy'.[459] In contrast, in the law of contract, warranties act as a 'sword to impose liability on one party to the contract'.[460] Section 33 (1) of the 1906 Act defines a warranty as:

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

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[454] Rob Merkin and Ozlem Gurses, 'Insurance Contracts after the Insurance Act 2015' (2015) 132 Law Quarterly Review 445, 446.

[455] *Colinvaux's Law of Insurance* (n 14) [8-002].

[456] *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26. *Colinvaux's Law of Insurance* (n 14) [8-002].

[457] ibid [8-003].

[458] For example, the Sale of Goods Act 1979, s 11(3).

[459] Soyer, *Warranties in Marine Insurance* (n 2) 3.

[460] ibid.

Section 33(1) grouped different types of warranty under the umbrella expression 'promissory warranty' [461] yet an important distinction exists between 'present' warranties[462] and 'continuing' warranties. A present warranty regulates the past or present state of affairs, whereby the insured states unequivocally that a certain state of affairs exists at the time of making the warranty. Such a warranty would state, for example, that a vessel has been surveyed in the last 12 months and has complied with the recommendations of that survey. If there is a breach of this warranty the risk does not attach, and the insurer never comes on risk.[463] A continuing warranty regulates what an insured may or may not do during the currency of the policy so as not to increase the risk undertaken. This type of warranty is aimed at maintaining the risk within certain prescribed parameters and therefore allows the insurer to price that risk. For example, a continuing warranty may require that the yacht must be fully crewed at all times; if the warranty is breached the risk terminates automatically.[464]

The relationship between the nature of a warranty and its function, however, became increasingly difficult to justify and was questioned by judges, [465] academics, [466] and practitioners. It was not the idea of warranties that was attacked but rather the sanction on breach and the resultant unfairness in how warranties were applied by insurers in modern times.[467] To put it differently, the concern was less about the primary obligation

[461] *Colinvaux's Law of Insurance* (n 14) [8-040].

[462] Also known as affirmative warranties.

[463] *Colinvaux's Law of Insurance* (n 14) [8-045].

[464] ibid.

[465] In *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852, 893–894 ('*Vesta v Butcher'*).

[466] TJ Schoenbaum, 'Warranties in the Law of Marine Insurance: Some Suggestions for Reform of English and American Law' [1999] Tulane MLJ 267; Hare, 'The Omnipotent Warranty' (n 3); Trine-Lise Wilhelmsen, 'Duty of Disclosure, Duty of Good Faith, Alteration of Risk and Warranties: An Analysis of the Replies to the CMI Questionnaire' [2000] CMI Yearbook 392; B Soyer, 'Marine Warranties: Old Rules for the New Millennium?' in DR Thomas (ed), *Modern Law of Marine Insurance* (Vol 2 LLP, London, 2002) 161; A Longmore, 'Good Faith and Breach of Warranty: Are We Moving Forwards or Backwards?' [2004] Lloyd's Maritime and Commercial Law Quarterly 158; B Soyer, 'Reforming Insurance Warranties – Are We Finally Moving Forward?' in B Soyer, *Reforming Marine & Commercial Insurance Law* (n 2).

[467] English and Scottish Law Commissions, *Insurance Contract Law* (Issues Paper 2: Warranties, Nov 2006) 33 ('the Law Commissions').

(ie the warranty itself) and more about the secondary obligation (ie the operation of the warranty on breach).

Notwithstanding that, the use of the warranty had mutated from a term defining the risk to instances where restrictions on cover were described as warranties. Therefore it was said that 'the original conception [of the warranty] has been abused'.[468] In other words, warranties in their original conception were that of the present fact warranty (ie do you have an alarm system fitted on the premises at the time of inception of the risk?) to the increasing use of continuing warranties (ie do you have an alarm system fitted on the premises at all times?). This was exacerbated by the use of warranties, 'many of which would have had no or little impact on the underwriting decision, such as the marine premium payment warranty'.[469] Clarke explained:

> A tension remains between the purpose of promissory warranties, to control the behaviour of policyholders, and one of the very purposes of insurance itself, to indemnify policyholders for the consequences of the carelessness which is only too normal among mere mortals.[470]

James Davey added that 'the extent to which the strictness of the continuing warranty is deemed acceptable has shifted appreciably'.[471] He drew on Clarke's identification of the shift from 1802 to 2007 to observe that, in 1802, 'if the insured did not mean to perform, he ought not to have bound himself to such a condition', [472] but in 2007: '[f]rom the viewpoint of policyholders and most courts, current law leaves too much unregulated discretion to insurers; and too little certainty of cover for policyholders'.[473] The manner and purpose for which warranties were initially conceived therefore no longer seemed to reflect modern commercial values.

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[468] Merkin, *Reforming Insurance Law* (n 5) 59.

[469] ibid.

[470] Malcolm Clarke, 'Insurance Warranties: The Absolute End' (2007) LMCLQ. 474, 478.

[471] James Davey, 'The Reform of Insurance Warranties: A Behavioural Economics Perspective' [2013] JBL 118, 131.

[472] ibid quoting J. Park, *A System of the Law of Marine Insurance* (5th edn, 1802) 319.

[473] Davey, 'The Reform of Insurance Warranties' (n 42) quoting Clarke, 'Insurance Warranties' (n 40) 478.

The asymmetry of information paradigm which influenced the development of marine insurance law, had changed considerably by the middle of the 20th century.[474] This coupled with the emergence of other forms of insurance, and particularly consumer insurance in the 20th century, saw the extension of the warranty beyond marine insurance.[475] Since the early days of the warranty, the concept of the consumer has evolved dramatically.[476] Initially this position was occupied by insurers and, in modern times, by assureds. The Law Commissions noted that the market of insurance has changed from one that was based 'on face-to-face contact and social bonds'[477] to one 'based on systems, procedures and sophisticated data analysis'.[478] The law was viewed as dated, not 'reflect[ing] developments in other areas of commercial contract law'.[479] The Law Commissions were therefore tasked with examining the consequences of modernity on commercial insurance contract law.[480]

3.2.3 The Problems with Warranties under the Marine Insurance Act 1906

3.2.3.1 Basis of Contract Clauses[481]

Basis of contract clauses were tied to how insurers used warranties. Such clauses converted answers in the proposal form to warranties – even though those terms may not

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[474] Robert Merkin and Ozlem Gurses, 'The Insurance Act 2015: Rebalancing the Interests of the Insurer and Insured' (2015) 78 (6) MLR 1004, 1005.

[475] Rob Merkin and Jenny Steele, *Insurance and the Law of Obligations* (OUP 2013) 55 which provide the examples of timely payment of premium or the installation of burglar alarms.

[476] David Hertzell, 'The Insurance Act 2015: Background and Philosophy' in Clarke and Soyer (eds), *The Insurance Act 2015: A New Regime for Commercial and Marine Insurance Law*, (Informa Law from Routledge 2017) 2-3.

[477] Law Commissions, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment* (Law Com CP No 353; Scot Law Com CP No 238, 2014) 3.

[478] ibid.

[479] ibid.

[480] Terminology borrowed from Gunter Teubner, 'In the Blind Spot: The Hybridization of Contracting' (2007) 8 Theoretical Inquiries in Law 51, where he asks '[w]hat are the consequences of modernity for the institution of contracting?'

[481] Basis of contract clauses will not be dealt with in detail as these clauses were not very popular in sophisticated markets. This relates back to the discussion in Section 1.3.2 in Ch 1 relating to

have been found within the policy itself. This allowed an insurer to avoid liability for both answers that were not material to the loss suffered and for any inaccuracy — however unimportant.[482] *Dawsons Ltd v Bonnin* demonstrates the effect of this clause: the insured company inadvertently gave an incorrect address about where the insured lorry would be parked by stating 'central Glasgow' instead of where it was actually parked, the 'outskirts of Glasgow'.[483] The lorry was destroyed by fire and Dawson claimed on the policy. The insurer relied on the basis of contract clauses; even though this did not increase the risk and arguably reduced the risk of loss, the insurer was entitled to refuse to pay all claims under the policy. This was because when the answers were declared to be the basis of contract, 'their truth [was] made a condition, exact fulfilment of which [was] rendered by stipulation as essential to its enforceability'.[484] These clauses were seen to operate as 'traps'[485] and had been widely criticised both academically and judicially.[486] The removal of such clauses was recommended in the 1980 report,[487] but they were still upheld in some instances,[488] until the advent of the Consumer Insurance (Disclosure and Representations) Act 2012 ('CIDRA 2012') and the 2015 Act.

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the broker nature of marine insurance and the use of the 'slip', which made such clauses infrequent in marine insurance contracts.

[482] Under section 20 of the MIA 1906, the insurer may only avoid the contract if a misrepresentation is 'material'. A basis of the contract clause goes beyond section 20.

[483] *Dawsons Ltd v Bonnin* [1922] 2A.C. 413.

[484] ibid, 425. Soyer, *Warranties in Marine Insurance* (n 2) 15.

[485] *Zurich General Accident & Liability Insurance Co v Morrison* [1942] 2 KB.

[486] *Anderson v Fitzgerald* (1853) 4 HL Cases 484; *Joel v Law Union and Crown Insurance Co* [1908] 2 KB 863 at 885; *Glicksman v Lancashire and General Assurance Co* [1927] AC 139; *Provincial Insurance v Morgan* [1933] AC 240; *Mackay v London General Insurance Co* [1935] Lloyd's Law Reports 201; *Zurich General Accident & Liability Insurance Co v Morrison* (n 55).

[487] Law Commission, *Non-Disclosure and Breach of Warranty* (Law Com CP No 104, 1980). *Dawsons Ltd v Bonnin* (n 53)

[488] *Unipac (Scotland) Ltd v Aegon Insurance* [1996] SLT 1197; *Genesis Housing Association Ltd v Liberty Syndicate Management Ltd for and on behalf of Liberty Syndicate 4472 at Lloyd's* [2013] EWCA Civ 1173, [2013] WLR (D) 368. Law Commissions, *Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties* (Law Com CP 204, 2012; SLC DP 155, 2012) 137.

3.2.3.2 Strict Liability

Warranties required strict compliance whether material to the risk or not,[489] which in many instances allowed insurers to escape liability for technical breaches that had no connection to the loss suffered. Lord Mansfield in *Pawson v Watson* said that: 'nothing tantamount will do, or answer the purpose'.[490] Similarly, as espoused in *De Hahn v Hartley*, substantial compliance with the terms of a warranty was not enough.[491] In the 18th century, Lord Mansfield viewed the liability of an insurer as an obligation 'dependent' on fulfilment of a warranty by the assured.[492] Mansfield said:

> A warranty in a policy of insurance is a condition or a contingency, and unless that be performed, there is no contract. It is perfectly immaterial for what purpose a warranty is introduced; but, being inserted, the contract does not exist unless it be literally complied with.[493]

This doctrine was codified in s33 (3) of the 1906 Act and read:

> 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.[494]

[489] In *Yorkshire Insurance Co Ltd v Campbell* [1917] AC 218, a horse was insured against marine perils and against risk of death during transit. The pedigree of the horse was stated incorrectly in the proposal form. On construction it was held that this term was a warranty and the inaccuracy of the information provided insures with a defence to the claim.

[490] *Pawson v Watson* (1778) 2 Cowp 785, 787.

[491] *De Hahn v Hartley* (n 7). See also *Hide v Bruce* (1783) 3 Doug K B 213 where a warranty that a ship has twenty guns does not additionally require that there is sufficient crew to man them.

[492] *Bond v Nutt* (1777) 2 Cowp 601.

[493] *De Hahn v Hartley* (n 7) 346. See also ibid.

[494] Non-compliance with a warranty is excused: (a) where owing to a change of circumstances the warranty is no longer applicable, and (b) where compliance would be unlawful owing to the enactment of a subsequent law (The MIA 1906, s 34(1)-(2)).

3.2.3.3 No Causal Connection Between Breach and Loss

The element of causation between loss and breach of warranty has been irrelevant in the defence of warranties since the very early days of marine insurance.[495] In *Hibbert v Pigou*[496] the insured ship warranted to sail with a convoy, however, the ship sailed without a convoy and went down in a storm. The underwriter was held not liable even though the breach had no connection with the loss. Howard Bennett has argued that this supports the view that the role of the warranty in a marine insurance contract is to 'define the risk covered and breach simply renders the adventure no longer that which the insurer agreed to cover'.[497]

Likewise, in *Forsikringsaktielselskapet Vesta v Butcher*[498] the owner of a fish farm failed to comply with a warranty which required that a 24-hour watch be maintained. This was found to be a breach and the insurer did not have to pay the claim arising for loss by storm damage. It was conceded by the insurer that the presence of the watch could not possibly have lessened the likelihood or degree of loss by storm.[499] In that case Lord Griffiths said:

> [i]t is one of the less attractive features of English insurance law that breach of a warranty in an insurance policy can be relied upon to defeat a claim under the policy even if there is no casual connection between the breach and the loss.[500]

3.2.3.4 No Possibility of Remedying a Breach

The above position subsisted even where a breach had been remedied before loss. In terms of ss 33(3) and 34(2) of the 1906 Act, a breach of warranty could not be remedied to put the insurer back on risk.[501] For example, a failure to comply with a warranty to pay a premium within a certain period of time or at a certain rate would discharge the insurer from liability. Similarly, recall *De Hahn v Hartley* where the fact that the required number of crew was subsequently taken on board did not remedy the breach.[502] This was

[495] *Pawson v Watson* (n 61).

[496] (1783) 3 Doug. K.B 213.

[497] H Bennett, *The Law of Marine Insurance* (2nd edn, London 2006) 549.

[498] *Vesta v Butcher* (n 35).

[499] B Soyer, 'Reforming Insurance Warranties' (n 36) 128.

[500] *Vesta v Butcher* (n 35) 893.

[501] Breach could only be excused in two situations under s34 (1).

[502] *De Hahn v Hartley* (n 7)

irrespective of whether the breach was trivial, for instance, if the premium had been paid a few days late. This aspect of the warranty regime was said to operate disproportionally as breach may have resulted in only a temporary alteration of risk, and once the breach had been remedied the risk would have been restored to its original level without any prejudice to the insurer.[503] Section 10 in the 2015 Act has effected sweeping change in this area and is considered below.[504]

3.2.3.5 Effect of Breach of Warranty

The effects of breach of warranties could be divided into two categories: a breach related to a period before the risk attached; and a breach related to a period after the risk had attached. The former required a warranty to be complied with before the risk attached. This could apply to both express and implied warranties. For instance, the implied warranty of seaworthiness in s39 (2) of the 1906 Act requires a vessel to be 'reasonably fit to encounter the ordinary perils of the port' at the commencement of the risk.[505] Express warranties can also relate to a period before the attachment of the risk, for example 'an express warranty of neutrality requires the vessel to be warranted neutral, that is, to have such a character at the commencement of the risk'.[506] The effect of breach of such a warranty is that the insurer never comes on risk.[507]

Turning to the latter, where the effect of breach of warranty related to a period after the attachment of the risk, Soyer says that:

> [s]ome warranties concerned the assured's future conduct and require him to do or not to do a particular thing, or fulfil some condition at some point after the attachment of risk.[508]

[503] Soyer, *Warranties in Marine Insurance* (n 2) 162.

[504] See Section 3.6.1.

[505] Soyer, *Warranties in Marine Insurance* (n 2) 167.

[506] ibid 167. See *Hore v Whitmore* (n 8)

[507] ibid 167. The MIA 1906, s84 (1). In such cases, the premium is likely to be refundable unless breach is fraudulent.

[508] Soyer, *Warranties in Marine Insurance* (n 2) 168. For example, the implied warranty of seaworthiness and most express warranties such as locality warranties, institute warranty (as to towage and salvage services) and laid up and out of commission warranties.

Breach of this type of warranty – because it related to a period after attachment of risk – did not have any effect on the existence of the contract. [509] The legal effect was that the insurer was discharged from all prospective liability, notwithstanding that the breach was not material and/or that the breach did not cause the loss.[510] This approach had been criticised as operating in a disproportionate fashion, with no middle ground: either the insured recovered in full or they recovered nothing.[511] In considering the relationship between the nature of the warranty and its function it became clear that the remedy of automatic discharge – without the possibility of remedying the breach – was severe.[512]

The effect of breach of warranties was uncertain both leading up to and following the enactment of the 1906 Act. It was conventionally believed that the insurer was entitled to elect to terminate the insurance upon breach of warranty,[513] until the decision of the House of Lords in *The Good Luck*.[514] In this case the vessel, *The Good Luck*, was owned by the Good Faith group, mortgaged to the appellant bank and insured with the respondent P&I club. The benefit of insurance was assigned to the bank and this was accompanied by a letter from the club that they would notify the bank promptly if 'the association ceases to insure' the vessel. The club rules included an express warranty prohibiting the vessel from entering certain prohibited areas. Notwithstanding that, the vessel navigated into such prohibited areas (the Arabian Gulf) without the knowledge of the bank or the club. In November 1981 the club discovered that the vessel was operating in these prohibited areas in contravention of the warranty but did not take any steps to notify the bank. In 1982 the owners of the *Good Luck* sought to increase its loan from the bank. While those negotiations were ongoing, and during her last voyage the vessel once again entered the prohibited areas and was hit by an Iraqi missile and became a constructive total loss. The owners of the *Good Luck* feigned ignorance of the breach and lodged a

[509] ibid.

[510] The MIA 1906, s33 (3).

[511] Special Public Bill Committee, *Insurance Bill* (HL 2014, 81) 95.

[512] Baris Soyer, 'Beginning of a New Era for Insurance Warranties?' [2013] Lloyd's Commercial and Maritime Law Quarterly 384, 385.

[513] Law Commissions, Issues Paper 2 (n 37) 4, referring to Law Commission, *Non-Disclosure and Breach of Warranty* (Law Com CP N0 104, 1980) [6.2].

[514] [1988] 1 Lloyd's Rep 514; [1990] 1 QB 818; [1989] 2 Lloyd's Rep 238 (CA); [1991] 2 Lloyd's rep 191 (HL); [1992] 1 AC 233.

fraudulent claim. While both the bank and the club knew of the loss, the bank did not however know of the breach of warranty.

In July 1982 the negotiations between the owners of the vessel and the bank were concluded and the bank extended the owners credit facilities.[515] The bank was operating under the mistaken belief that the vessel was insured and therefore the loss was covered. On 4th August, the club rejected the owners claim. However due to the breach of warranty, the loss was not covered and the bank sued the club for failing to provide prompt notice that they had ceased to insure the vessel. The bank claimed that the club was in breach of its letter of undertaking. The club claimed that the vessel was still insured until 4th August.

The Court of Appeal reviewed the pre-1906 authorities and agreed with the club, finding that a breach of warranty in marine insurance law was to be equated with a repudiatory breach in the general law of contract.[516] The Court of Appeal reached the conclusion that prior to 1906, breach of warranty did not automatically bring the risk to an end. Furthermore the 1906 Act, as a codification of the case law, had not intended to effect any change to that position.[517] The House of Lords, however, upheld a literal reading of the 1906 Act, reversed the Court of Appeal decision and held that breach of a warranty automatically discharges the insurer prospectively from liability.[518] As to the nature of a warranty in marine insurance, Lord Goff was determined to 'put the law back on the right path':[519]

> [I]f a promissory warranty is not complied with, the insurer is discharged from liability as from the date of breach of warranty, for the simple reason that fulfilment of the warranty is a condition precedent to the liability of the insurer.[520]

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[515] Howard Bennett, 'Good Luck with Warranties' [1991] JBL 592.

[516] [1990] 1 Q.B. 818, 876-882.

[517] ibid.

[518] Bennett, 'Good Luck with Warranties' (n 85) 593.

[519] Malcolm Clarke, 'The Nature of Warranty in Contracts of Insurance' [1991] Cambridge Law Journal 393, 394.

[520] *The Good Luck* (n 84) 262-3. Lord Goff based his reasoning on the *Thompson v Weems* (1884) 9 App. Cas. 684 case where Lord Blackburn held that compliance with warranties relating to the existing circumstances at the inception of the risk, viz present warranties, is a condition precedent to the attaching of the risk.

In its 1980 report the Law Commission said that a breach of warranty entitled the insurer to repudiate the policy.[521] In *The Good Luck*, Lord Goff criticised this formulation and said that 'it is more accurate to keep to the carefully chosen words'[522] of the 1906 Act and say that 'the insurer is discharged from liability as from the date of the breach'.[523] The insurer may, however, waive the breach and restore its liability. This highlighted a further problem with the remedy of automatic discharge in English law: it was conceptually incongruent with the position in relation to waiver under s 34(3) of the 1906 Act since it had 'the effect of waiving a dead contract back to life'.[524] Following *The Good Luck,* it appeared that waiver by election did not apply to breach of an insurance warranty. The reasoning of the court was that because breach of warranty automatically discharged the insurer from liability, the insurer had no election to make.[525] The courts have attempted to deal with the apparent contradiction by regarding waiver in this context as estoppel.[526]

The implication of this effect on the insurance contract was stated to be:

> What it does is (as section 33(3) makes plain) is to discharge the insurer from liability as from the date of breach. Certainly, [it] does not have the effect of avoiding the contract *ab initio.* Nor, strictly speaking, does it have the effect of bringing the contract into an end. It is possible that there may be obligations of the assured under the contract which will survive the discharge of the insurer from liability, as for example a continuing liability to pay a premium. Even if in the result no further obligations rest on either party, it is not correct to speak of the contract being avoided; and it is, strictly speaking, more accurate to keep to the carefully chosen words in section 33 (3) of the Act, rather than to speak of the contract being brought to an end, though that may be the practical effect.[527]

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[521] Law Commission, *Non-Disclosure and Breach of Warranty* (Law Com CP No 104, 1980) [1.3].

[522] *The Good Luck* (n 75) 263.

[523] ibid 263.

[524] Clarke 'Insurance Warranties' (n 41) 481.

[525] This view was confirmed by the Court of Appeal in *Kosmar Villa Holidays Plc v Trustees of Syndicate 1243* [2008] EWCA Civ 147.

[526] *HIH Casualty & General Insurance Ltd* v *AXA Corporate Solutions* [2002] EWCA Civ 1253. Soyer, 'Reforming Insurance Warranties' (n 36) 140.

[527] [1992] 1 AC 233, at 263

Lord Goff's view distinguished insurance warranties from the general condition in contract law. This did not have anything to do with repudiation of the contract or with a claim sounding in damages. The Law Commissions argued that there was no rationale for the difference in the nature of warranties in insurance law because it is out of line with general contract law whereby a breach of warranty is a minor term that only gives rise to damages. [528]

3.3 Judicial Regulation

Over the years, judges have found several ways to attack the unreasonable use of warranties and have attempted to remove perceived unfairness through innovative judicial approaches to interpretation. Some of the methods used by judges included construing the term: as a suspensive condition;[529] as a term descriptive of the risk;[530] as applying to only certain parts of the policy;[531] or as only being applicable to continuing warranties.[532]

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[528] Law Com Report 352; SLC Report 238, 2014 (n 47) 165.

[529] *Century Insurance Company of Canada v Case Existological Laboratories Ltd (The Bamcell II)* [1983] 2 S.C.R. 47.

[530] Including, *Farr v Motor Traders Mutual* [1920] 3 KB 669 (CA); *Provincial Insurance Co. v Morgan* (n 56); *De Maurier (Jewels) Ltd v Baston Insurance* [1967] 2 Lloyd's Rep 550; *CTN Cash & Carry Ltd v General Accident Fire & Life Assurance Corporation Ltd* [1989] 1 Lloyd's Rep. 299; *Agapitos v Agnew (The Aegeon) (No 2)* [2002] EWHC 1558; [2003] Lloyd's Rep. IR 54; *Eagle Star Insurance Co. Ltd v Games Co S.A and others (The Game Boy)* [2004] EWHC 15; [2004] 1 Lloyd's Rep 238.

[531] For example, in *Printpak v AGF Insurance Ltd* [1999] Lloyd's Rep IR 542, the insured had taken out a 'commercial inclusive' policy that covered a range of risks, including fire and theft. The theft section included a warranty that the insured would maintain a burglar alarm. Meanwhile Condition 5 stated that a failure to comply with any warranty would invalidate any claim. The insured suffered a fire while the alarm was not working. The Court of Appeal held that the policy was not a seamless document, but instead consisted of separate schedules, each concerned with a different type of risk.

[532] *Woolfall & Rimmer v Moyle* [1942] 1 KB 66; *Kennedy v Smith* 1976 SLT 110; *Hair v Prudential Assurance Co Ltd* [1983] 2 Lloyd's Rep 667; *Hussain v Brown* [1996] 1 Lloyd's Rep 627, the assured in the proposal form, which was said to be the basis of the contract, indicated that the premises were fitted with an intruder alarm. The statement was true at the time of the contract but the assured later failed to pay the charges and the alarm service was suspended. The Court of Appeal held that the warranty was not breached since the statement on the proposal form

Similarly the judiciary tried to instil procedural fairness by holding that the more unreasonable or draconian the effects of insurance terms are, the more unlikely it is that the parties could have intended it. Moreover, if parties intended to include such terms then it becomes more necessary that they should make the meaning clear.[533] The draconian effect of a warranty was also relevant in considering whether the literal words were consistent with a reasonable and business-like interpretation and therefore not inconsistent with other terms in the policy.[534]

The case studies of the 'crewing' warranties in marine insurance have been used by scholars and the Law Commissions to illustrate the differing judicial approaches and are therefore considered here too. In *The Milasan*[535] a motor yacht sank in calm weather and she had no professional skipper in charge of her at the time. The policy contained a warranty that required 'professional skippers and crew' to be 'in charge at all times' and the insurers said that the warranty was breached. Aikens J took into account the commercial purpose behind the warranty. He held that the words 'professional skipper' referred to a person who has some professional experience that qualified them to be regarded as skipper. He said the phrase that the crew had to be in charge 'at all times' was clear that there must a professional skipper and a crew that looks after the vessel the whole time and not intermittently.[536] The assured was therefore in breach.[537]

The *Newfoundland Explorer*[538] was an insured motor yacht that was damaged through a fire due to the vessel's side generator overheating. Like *The Milasan,* at the time of the casualty neither the captain nor the crew members were on board. The policy *inter alia* contained a provision: 'Warranted fully crewed at all times'. In determining the purpose of the warranty the court took into account the surrounding circumstances. The value of the yacht meant that having a crew member in attendance on board would protect the

related only to present fact and did not make a promise about the future. Soyer, *Warranties in Marine Insurance* (n 2) 176. Cf *The Aegeon* (n 100); *The Game Boy* (n 100).

[533] *Wickman Machine Tools Sales Ltd v Shuler AG* [1974] AC; *AC Ward & Sons v Catlin (Five) & Ors* [2009] EWCA Civ 1098.

[534] ibid.

[535] [2000] 2 Lloyd's Rep 458.

[536] ibid [18], [24].

[537] Soyer, *Warranties in Marine Insurance* (n 2) 23. See also *The Game Boy* (n 100).

[538] [2006] Lloyd's Rep IR 704.

yacht against risks such as vandalism, fire etc.[539] After a consideration of the circumstances, the trial judge then ascertained what the words would mean to a reasonable person who has the background knowledge that would reasonably have been available to the parties.[540] He held that the warranty required a crew member to be on board constantly[541] but that commercial sense required the literal meaning of the words to be qualified to two exceptions: emergencies requiring the evacuation of the vessel of the area; or the temporary departure for the purpose of performing crewing duties.[542]

Gross J said that 'fully crewed' means that at least one crew member must be on board, whatever they are doing.[543] 'At all times', according to Gross, 'means what it says – the whole time, not some of the time'.[544] The 'factual matrix' played a crucial role 'in determining the commercial justification for incorporating this particular warranty into the contract'.[545] While Gross J's decision was in accordance with that of Aikens J in *The Milasan,* the former stated that he reached his decision in the context of the particular wording and the particular contract rather than basing his decision on the *The Milasan.*[546]

The Milasan and *The Newfoundland Explorer* were distinguished in *The Resolute*.[547] The dispute centred on an express warranty: 'Warranted Owner and/or Owner's experienced Skipper on board and in charge at all times and one experienced crew member'. A fire occurred on the insured fishing trawler while berthed. At the time of the incident no crew members were on board and the insurer denied liability for breach of the warranty. The insurer relied on the two previous cases. Sir Anthony Clarke MR, who delivered the main judgment of the Court of Appeal, however, distinguished the two previous cases. He felt that *The Milasan* was of little assistance in this context as it related to a different clause in a policy, which insured a different type of vessel and in different circumstances.[548]

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[539] Soyer, *Warranties in Marine Insurance* (n 2) 20.

[540] *The Newfoundland Explorer* (n 108) [21].

[541] ibid [17].

[542] ibid [24].

[543] ibid [16].

[544] ibid.

[545] Soyer, *Warranties in Marine Insurance* (n 2) 21.

[546] *The Newfoundland Explorer* (n 108) [30].

[547] [2009] 1 Lloyd's Rep 225.

[548] ibid [17].

The Newfoundland Explorer also referred to a differently worded warranty in a different context.[549] Sir Anthony Clarke MR said that the natural inference was that the primary purpose of the warranty was to protect the vessel against navigational hazards[550] and it followed from this that the principal time when the vessel should be crewed was when it was being navigated.[551] He held that the warranty should be given a reasonable and business-like interpretation in the light of its context and purpose, and concluded that the clause was to be construed *contra proferentem*, that is, against the insurer, so there was no breach.[552]

Soyer's observations on *The Resolute* judgment are interesting as he felt that the judge interpreted the warranty in a manner that would protect the assured's interest because he was a fisherman occupying a weaker bargaining position and because the insured was assisted by professional brokers, presumably shifting some of the responsibility to them.[553] As mentioned earlier, the 'crewing' cases were often cited as a reason for justifying the need for reform. In contrast, the writers of Arnould believe that:

> the approach to the construction of warranties has evolved in line with the development of the approach to construction generally, and continues to follow well-established principles under the existing law.[554]

They disagree with the Law Commissions' view 'that warranty litigation is "uncertain', or leads courts to adopt strained interpretations of warranties'.[555] It is true that the courts in these cases have referred to general principles of interpretation when deciding these cases. However, I believe that the point that the Law Commissions were trying to get across is that arguably the courts' approach adopted a more realist approach[556] to interpretation which discouraged insurers from taking purely technical points or

[549] ibid [18].

[550] ibid [23].

[551] *The Resolute* (n 117).

[552] ibid

[553] Soyer, *Warranties in Marine Insurance'* (n 2) 29.

[554] Jonathan Gilman and others, *Arnould Law of Marine Insurance and Average* (19th edn, 2018) 19-10.

[555] ibid.

[556] This is part of the formalist/realist ideologies discussed in Section 2.4.2.2 in Ch 2.

attempting to use warranties in a wholly unreasonable way.[557] This has been said to bear a resemblance to the judicial approaches 'to combat the perceived unfairness of exemption clauses before the Unfair Contract Terms Act 1977' ('UCTA 1997').[558]

Turning away from crewing warranties for the moment, *Kler Knitwear Ltd v Lombard General Insurance Co Ltd*, was often cited as an example of the lengths to which courts would go to in order to circumvent the harshness in classifying a term as a warranty.[559] In this case an insurance policy included a term that the policyholders agreed to have their sprinkler system inspected 30 days after renewal.[560] The inspection was carried out about 60 days late but showed that the system was working. The factory later claimed for loss arising from storm damage to the property (which was wholly unconnected to the sprinklers). The clause was entitled 'warranty' and contained the phrase 'it is warranted that' and then set out the consequences: non-compliance would bar any claim 'whether it increases the risk or not'. Morland J re-classified the 'warranty' as a suspensive condition, stating that due to the draconian nature of a continuing warranty insurers should expressly contract for that protection if they want it. Furthermore, he said that it would be utterly absurd and make no rational business sense for a claim for property damage to be barred for a completely unrelated breach.[561] Therefore the plain meaning words of the contract were not indicative of the parties' intentions when forming the contract.

With respect, it was difficult to see how the insurer could have stipulated this as a warranty in any clearer terms.[562] Morland J's interpretation arguably went beyond merely resolving ambiguity in contractual drafting by replacing a consequence that he viewed as 'absurd' with one that was fairer to the insured.[563] Despite recognising that giving effect to the parties bargain should in most instances be decisive, even in the face of unfair

[557] Law Commissions, Issues Paper 2 (n 37) 20. This criticism has been levelled particularly at the Supreme Court of Canada decision, *The Bamcell II* (n 100).

[558] Soyer, *Warranties in Marine Insurance* (n 2) 178.

[559] *Kler Knitwear* [2000] Lloyd's Rep IR 47.

[560] ibid.

[561] ibid.

[562] J Birds and NJ Hird, *Birds Modern Insurance Law* (6th edn, Sweet & Maxwell 2004) 161.

[563] Howard Bennett, 'Reflections on Values: The Law Commissions' Proposals with respect to Remedies for Breach of Promissory Warranty and Pre-formation Non-Disclosure and Misrepresentation in Commercial Insurance' in Soyer, *Reforming Marine and Commercial Insurance Law* (n 2) 387.

consequences, he interpreted the clause in a manner that was a blow for freedom of contract as ordinary words used by parties have been trumped by the court's view of 'business sense'.[564]

In contrast to the 'crewing' cases, the writers of Arnould view *Kler Knitwear* and *The Bamcell II* as 'questionable decision,'[565] Overall a permeating issue was that there was indeed a lack of certainty in how warranties would be construed by judges or, at the very least, there was uncertainty due to the disjuncture between the 1906 Act and these varying judicial approaches – this caused practical difficulties. The above judicial analysis remains relevant as parties may contract out of the 2015 Act and make the warranty regime under the 1906 Act applicable to their contract. In such instances, courts may be tempted to adopt similar approaches to construction in those cases,[566] and more notably it is an indication of the kind of intervention that judges may adopt under the new legal regime.

3.4 The Regulatory Framework and the Marine Insurance Market

3.4.1 The Financial Services and Markets Act 2000 (FSMA 2000)

The notion of 'regulation' as it is used in this thesis focuses on private regulation, that is, regulation through (insurance) contract law.[567] The primary focus is therefore not on public regulation of the insurance industry. Notwithstanding that, this section discusses the public regulation aspect by providing an outline of regulation of the marine insurance market under the FSMA 2000 and the Financial Ombudsman Service (FOS) in order to frame the reforms and to feed into a later discussion on the extent to which the reforms have been motivated by public regulatory objectives.[568]

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[564] Bernard Eder, 'The Construction of Shipping and Marine Insurance Contracts: Why Is It So Difficult?' [2016] LMCLQ 220, 225. A similar issue arose in *Sugar Hut v Great Lakes Reinsurance (UK) Plc* [2010] EWHC 2636 yet the judge in this case considered and distinguished *Kler Knitwear* by adhering to a strict interpretation and classifying the term as 'true warranties' rather than suspensive conditions.

[565] *Arnould Law of Marine Insurance and Average* (n 124) 19-10.

[566] Soyer, *Warranties in Marine Insurance'* (n 2) 175.

[567] 'Regulation' was defined in S 1.3.4.

[568] Discussed in 4.2.2 and 4.2.3.

As the focus of this thesis is on merchant shipping in the London market, there are broadly three categories of marine insurers in this market: insurance companies, Lloyd's underwriters and marine Protection and Indemnity (or P&I) Clubs.[569] All three categories are subject to regulation under the FSMA 2000 as amended by the Financial Services Act 2012 ('FSA 2012') and which is administered by two regulators.[570] The regulators are the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) which replaced the Financial Services Authority in 2013. PRA is concerned with solvency of the insurance industry, whereas the FCA is concerned with market conduct and fair treatment of insureds in line with the PRA Handbook and FCA Handbook. [571] As mentioned previously, Lloyd's is regulated by both the FCA and PRA in terms of the FSMA 2000 (as amended by the FSA 2012)[572] although 'with a somewhat lighter touch than that which affects insurance companies'. [573]

The traditional UK approach to the public regulation of insurance markets was to ensure that insurers were in a financially sound position to pay claims rather than requiring insurers to make payment.[574] Regulation of policy terms 'has never been a feature of UK regulation'.[575] The latter is an issue arising from the private contract between the insured and insurer and this was governed by the common law principles which were partly codified in the 1906 Act. The FMSA 2000 (as amended by the FSA 2012) is broad ranging in nature and brings within its purview all financial services with particular focus on certain themes such as solvency, supervising conduct in insurance markets, the resolution of disputes through the FOS (discussed below).[576] A contrast can be drawn between the public regulation aspect which was concerned with regulating the solvency of insurers

[569] The Financial Services Act 2012 (Commencement No.2) Order 2013 (SI 2013/423). *Arnould Law of Marine Insurance and Average* (n 124) 4-01.

[570] ibid.

[571] Merkin and Steele (n 46) 80-1.

[572] Lloyd's brokers and regulated by the Financial Conduct Authority. *Arnould Law of Marine Insurance and Average* (n 124) 4-06.

[573] As Arnould says until the FSMA took effect from 1 December 2001 'Lloyd's was more or less entirely self-regulating. *Arnould Law of Marine Insurance and Average* (n 124) 4-06

[574] Merkin and Steele (n 46) 88.

[575] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn, Vol 3 Sweet & Maxwell 2018) D-0901

[576] Merkin and Steele (n 46) 80-1.

versus the largely under-emphasised substantive law control of insurance contracts. [577] The common law rules which were developed for marine insurance were later applied to other spheres of insurance, including that of consumers. Over time it became clear that these eighteenth-century commercial principles were not suitable when applied in the consumer sphere, and intervention was required. This came initially through administrative regulation under the FSMA 2000 and the FOS. As Merkin and Steele say:

> What is noteworthy…is how it has been left primarily to public law administrative processes to resolve the difficulties and iniquities arising from private law.[578]

Merkin and Steele make two noteworthy points in this regard. First that the FSMA 2000 (as amended by the FSA 2012) is a 'combination of public law, private law, and self-regulation' [579] and secondly, that these highlight the significance of the 'spread of regulation from solvency to substantive law.[580] The principles that claims should be handled fairly is given statutory force under the FSMA 2000 as the regulator (ie the FCA) was authorised to create the Insurance Conduct of Business Rules (ICOBS) which established the Financial Ombudsman Service. Despite these regulatory measures, marine insurance law itself remained static codified in the 1906 Act.[581]

Statutory regulation through the reforms of the English and Scottish Law Commissions (discussed below) have attempted to go beyond the regulation of 'solvency and prudential conduct' of insurers. Statutory regulation, through the Consumer Insurance (Disclosure and Representations) Act 2012 and the 2015 Act have attempted to 'mitigate the rigours of the common law in the relationship between insurer and assured'.[582] As the purpose of this thesis is to consider the extent to which (insurance) contract law through the 2015 Act is increasingly embracing public law concerns such as fairness and welfarism, it is prudent to examine to what extent have these (public) regulatory principles impinged on the parties' contractual relationship.[583]

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[577] Merkin and Steele (n 46) 78.

[578] ibid.

[579] ibid 80-1

[580] ibid.

[581] Merkin and Gurses, 'The Insurance Act 2015' (n 1)1005.

[582] Merkin and Steele (n 46) 92.

[583] Discussed in 4.2.2 and 4.2.3.

3.4.2 The Financial Ombudsman Service

During the reform process the FOS was discussed by the Law Commissions to show the strides which have been taken through public regulation to reform insurance law and practise.[584] However, during the reform process, it was also acknowledged that the reforms implemented through FOS were insufficient and legislative reform was necessary both in relation to consumer and commercial insurance. At this juncture in discussing the reform process it is therefore necessary to examine the role of FOS and its limitations in the context of commercial insurance, particularly in sophisticated commercial insurance markets.

The FOS approach is discussed here as it bears similarity to a trend that is prevalent in US academic scholarship which is the distinction that is drawn (or at the very least encouraged) between sophisticated and unsophisticated parties in adjudication.[585] Party sophistication, in the US, 'is of increasing importance and represents a significant aspect of the new formalist trend in contract law'.[586] The distinction between sophisticated and unsophisticated parties is an approach that is adopted by FOS in relation to small businesses. In UK scholarship there is current discussion that in adjudication judges should act more as 'regulators'.[587] What this means and would entail is a moot point and remains unclear given the dearth of scholarship on this point. This thesis engages with the above debate and puts forward a minimalist perspective by drawing a distinction between sophisticated and unsophisticated parties (explored in Chapter 4) as a means for judges to control the wide ambit of s11 and the contracting out provisions of the 2015 Act. It should be emphasised that it is by no means intended in this thesis that the FOS approach can – or indeed should – be translated into law.

For many years the insurance industry has accepted that the rules set out in the 1906 Act are unsuitable for consumer insurance. This led to initiatives by insurance companies to improve this position. First was the Statements of Insurance Practice introduced by the

[584] Special Public Bill Committee, *Insurance Bill* (HL 2014, 81).

[585] A discussion of the US position is beyond the scope of this thesis.

[586] Meredith Miller,' Contract Law, Party Sophistication, and the New Formalism' (2010) 75(2) 493, 518.

[587] Discussed at the Contract Law and the Legislature Workshop, York, 11th & 12th January 2019

Association of British Insurer in 1977 and which was aimed at general and long-term insurance.[588] This initiative was 'a response to the exemption of the insurance industry from the Unfair Contract Terms Act 1977'. [589] The Statements offered relief – even though it was not legal enforceable - to consumers by preventing insurers from refusing to pay out claims unless the insured was acting unreasonably.[590] This initiative was bolstered by the Insurance Ombudsman Bureau (IOB) in 1981 and the object was to address and settle complaints received having regard to the contract, applicable law and general principles of good insurance practice. The IOB's membership increased which now included Lloyd's and by the passing of the FSMA 2000 'there was effectively a parallel regime in operation for the resolution of consumer disputes, and such disputes all but disappeared from the courts'.[591]

FSMA 2000 gave statutory effect to both the Statements of Insurance Practice and the IOB, with the ombudsman scheme being merged and given a statutory basis as the Financial Ombudsman Service (FOS).[592] As a measure to temper the strictness of the 1906 Act, consumer disputes have generally been resolved by the FOS.[593] The FOS was set up by the FSMA 2000 to help resolve individual disputes between consumers and businesses 'quickly and with minimum formality by an independent person'.The FOS considers complaints from consumers[594] and microenterprises[595] and may give binding awards up to a set threshold. Recent changes have been made to the eligibility criteria

[588] Merkin and steele p88-89

[589] Merkin and Steele (n 46) 88-89.

[590] FSMA 2000, s225(1) as amended by the Financial Services Act 2012.

[591] Merkin and Steele (n 46) 88-89.

[592] The Financial Ombudsman Service ('the FOS') is regulated by ss 225-232 and Sch 17 of the FSMA 2000.

[593] Hertzell (n 47) 3.

[594] The Insurance Conduct of Business Services ('ICOBS') Handbook, s2.1.1 G3. <www.handbook.fca.org.uk/handbook/ICOBS.pdf > accessed on 02 June 2019. A 'consumer' is defined as any natural person acting for purposes outside his or her trade, business or profession.

[595] A term covering the smallest businesses with an annual turnover of up to two million euros and fewer than ten employees <www.financial-ombudsman.org.uk/publications/pdf/Micro-enterprise-complaints-Aug-2015.pdf> accessed December 2018.

regarding who can complain to the FOS and also to the financial threshold.[596] This was explained by the Financial Conduct Authority ('the FCA'):[597]

> From 1 April 2019, the current £150,000 limit will increase to £350,000 for complaints about actions by firms on or after that date. For complaints about actions before 1 April that are referred to the Financial Ombudsman Service after that date, the limit will rise to £160,000. The new award limit will come into force at the same time as the extension of the service to larger small and medium-sized enterprises (SMEs). These are firms with an annual turnover of under £6.5 million, an annual balance sheet total of under £5 million, or fewer than 50 employees. An additional 210,000 SMEs will be able to complain to the Financial Ombudsman Service.[598]

The FOS determines disputes based on what in the opinion of the ombudsman is 'fair and reasonable in all the circumstances of the case'[599] which may mean that the FOS is not bound to apply the law in a strict sense. The FOS draws a distinction between sophisticated and unsophisticated businesses and usually treats unsophisticated businesses as consumers.[600] This distinction is drawn by considering all the circumstances, such as whether the business was professionally advised and is viewed as justifiable given that sophisticated businesses should be judged by stricter legal standards.[601] In the Law Commissions' 2007 Consultation Paper they described a case in which the policyholder was a firm of insurance brokers. The FOS decided that the inequality of bargaining power often present between small businesses and insurers did not apply. Instead, the complainant's size, status and knowledge of insurance law meant that it would be appropriate to apply normal legal principles.[602]

The FCA Handbooks are used as a guiding principle in the FOS decisions and the Insurance Conduct of Business Sourcebook (ICOBS) is part of the regulatory structure

[596] Law Com CP 204, 2012; SLC DP 155, 2012 (n 59) 233.

[597] The Financial Conduct Authority (FCA) regulates financial services.

[598] Financial Conduct Authority, *Increasing the Award Limit for the Financial Ombudsman Service*, <https://www.fca.org.uk/publication/policy/ps19-08.pdf> accessed November 2018.

[599] Law Com CP 204, 2012; SLC DP 155, 2012 (n 59) 232. The FSMA 2000, ss 225(1), 228(2).

[600] ibid 233.

[601] ibid.

[602] ibid.

governing insurance business.[603] The rationale of ICOBS is to ensure that parties which fall within its jurisdiction are treated fairly in relation to insurance claims. Notably, ICOBS aims to ensure that insurers do not unfairly reject insurance claims and leave consumers and small businesses without any protection. There are specific provisions in the ICOBS that regulate breach of warranty.[604] Rule 8.8.1 reads that:

> for contracts entered into or variations agreed before 1 August 2017, a rejection of a consumer policyholder's claim is unreasonable, except where there is evidence of fraud:
>
> (3) for breach of warranty or condition unless the circumstances of the claim are connected to the breach and unless …
>
> (b) the warranty is material to the risk and was drawn to the *customer's* attention before the conclusion of the contract.

Rule 8.8.2 reads that cases where rejection of consumer's claim is unreasonable for contracts on or after 1st August 2017:

> (1) Cases in which rejection of a *consumer's* claim would be unreasonable (in the FCA's view) include, but are not limited to rejection:
>
> (b) where the claim is subject to the *Insurance Act 2015*, for breach of warranty or term, or for fraud, unless the *insurer* is able to rely on the relevant provisions of the *Insurance Act 2015*
>
> (2) The *Insurance Act 2015* sets out a number of situations in which an *insurer* may have no liability or obligation to pay. For example:
>
> (a) section 10 provides situations in which an *insurer* has no liability under a *policy* due to a breach of warranty;
>
> (b) section 11 places restrictions on an *insurer's* ability to reject a claim for breach of a term where compliance is aimed at reducing certain types of risk; …

[603] Currently in force as of 6th January 2008.

[604] R8.8.1 and R8.8.2

The FOS therefore prevents insurers from rejecting claims for issues that are unconnected to the loss.[605] If a warranty or term is onerous or unexpected, the FOS will ascertain if this term was drawn to the insured's attention at the time of entering into the contract or at the time of renewal. Additionally, the term needs to be clear and unambiguous and if this is found to not be the case, then the FOS will interpret the term contra proferentem. This position applies irrespective of the characteristics of the insured, that is, whether they are deemed to be sophisticated or unsophisticated.

In the event of an insurance dispute where the claim has been rejected by the insurer on the basis of breach of a warranty, the FOS will establish if a connection exists between the breach and the loss. If no such connection exists, the insurer will have to pay the claim. This approach is particularly adopted in relation to consumers or small businesses who are deemed to be unsophisticated. On the other hand, where parties are deemed to be sophisticated, a connection is not generally required between the breach and loss. The FOS will nevertheless consider whether the type of loss suffered is one that can be related to the warranty or the term that was breached. For example, an insurer rejects a claim for loss arising from water damage, when the warranty/term related to ensuring that the insured's vehicle was locked at all times when unattended, would be viewed as a loss of a different type.

The issue of regulation via the FOS was discussed in the Special Committee Report but it was said (or rather raised as a question) that it would be better for 'the actual documents that set out the contract of insurance to cover matters without having to rely on the regulator to come in and sort things out'.[606] This was found to be pertinent in relation to the FOS, which is a complaints-based mechanism – the FOS is only relevant where there has been a failure to settle a complaint and it is referred to them. Therefore, it was said that a law cannot be drafted on the basis that the FOS is going to make 'it fair and reasonable for a particular sector of the insured community'. [607]

FOS has had an impact on private rights under insurance policies where disputes fall within FOS's jurisdiction.[608] ICOBS as 'a part of the regulatory structure governing

[605] Law Com CP 204, 2012; SLC DP 155, 2012 (n 59) 152-3.

[606] SPBC *Insurance Bill* (n 82) 21.

[607] ibid.

[608] Merkin and Steele (n 46) 89.

insurance business limits the impact of 2015 Act, 'in that insurers are not permitted, as against consumers and small businesses, to reject claims unfairly'.[609] FOS will have a limited impact in marine insurance markets given that its jurisdiction is limited to consumers and small businesses. An example of a marine insurance complaint that could be heard by FOS would relate to where a *consumer* complains that the insurer rejected his claim on the basis of non-disclosure of information that had been requested by the insurer when the policy was concluded. This would be a consumer complaint as the boat in question that was insured was used for private purposes such as sailing or a speed boat was rented out by the consumer. This is outside the scope of this thesis as it deals with consumer insurance.

FOS has jurisdiction over small businesses as set out above. A commercial example, would be where an insured yacht, which is used for commercial purposes to provide pleasure rides around the local harbour, takes on water and sinks. The owner claims from the yacht's insurer but after inspecting the yacht, the insurers find that there was corrosion on the hull because it had been in sea water for long periods of time over winter. The insurer consequently rejects the insured's claim on the ground that the yacht was not seaworthy. The insured argues that he could not have known about the corrosion in any case as it was below the yacht's waterline and he only used the yacht in the summer months.

In this instance, FOS is unlikely to treat the insured as a sophisticated party given that he runs a small business and the FOS would ask the insured for all maintenance records over the years. FOS will look at the knowledge and expertise which the insured should have been expected to have in determining whether it was reasonable for him to have been unaware of the corrosion due to not undertaking surveys on a regular basis. Even though this is a marine insurance claim, this thesis is not concerned with commercial marine insurance covering small businesses. Rather the focus is on merchant marine insurance markets which fall outside the jurisdiction of FOS.

It is interesting to note two aspects that flow from the manner in which the FOS resolves disputes that is relevant for later analysis. The first is the distinction drawn between sophisticated and unsophisticated parties, which influences how the FOS decides breach of warranty cases. Secondly, that the FOS is likely to take a less interventionist stance when dealing with breach of warranty between sophisticated parties, but in relation to

[609] *Arnould Law of Marine Insurance and Average* (n 124) 3-40.

whether the term in question was brought to the party's attention, the FOS will decide in favour of the policyholder regardless of whether the policy is sophisticated or not. It should be emphasised that the distinction drawn between sophisticated and unsophisticated parties by FOS must be viewed in light of FOS's limited jurisdiction to consumers and small businesses – which is not within the scope of this thesis. Thirdly, it should be noted that *contra proferentem* is not used much in marine insurance cases.[610]

3.5 The Reform of Commercial Insurance Contract Law

3.5.1 The 1980 Report

Largely following on from the work of the British Insurance Law Association in 2002 and the 1957 and 1980 reports of the English Law Commission, the Law Commissions launched an ambitious project in 2006 to reform insurance law.[611] There was greater demand for reform in consumer insurance law and this resulted in the CIDRA 2012.[612] In relation to marine and commercial insurance law, while there was support for reform there was a lack of consensus on the proposals and their suitability.[613]

The 1980 report concluded that the law was 'undoubtedly in need of reform'[614] and provided both a procedural and substantive solution (although these were never implemented).[615] The former solution dealt with how warranties are created and was relevant to deal with the problem of how insurers used warranties. The solution proposed was to abolish basis of contract clauses and determine that all warranties should be contained in a written document.[616] The substantive proposal was to control the secondary

[610] See Section 1.2.2.2 in Ch 1 which discussed the broker nature of marine insurance.

[611] British Insurance Law Association, *Insurance Contract Law Reform* (September 2002). Abolition was first proposed by the Law Commission, *Fifth Report of the Law Reform Committee* (Law Com CP No 62, 1957). Law Com CP N0 104, 1980 (n 58). See Section 1.1 in Ch 1.

[612] The Act came into force on 6th April 2013.

[613] For a comprehensive analysis of the proposals, see Clarke 'Insurance Warranties' (n 41); Soyer, 'Reforming Insurance Warranties' (n 36).

[614] Law Com No 104 (1980) (n 83). Reform was also urged in a report published by the National Consumer Council in 1997 National Consumer Council, *Insurance Law Reform: The Consumer Case for Review of Insurance Law* (May 1997).

[615] Law Commissions, *Issues Paper 2* (n 37) 11; Law Commissions, 'Insurance Contract Law: A Joint Scoping Paper' (Jan 2006) 3.

[616] ibid.

obligation regarding the consequences of breach of warranty by establishing a connection between the breach and the risk. Importantly, marine, transport and aviation (MAT) were excluded from the reforms as it was felt that these sophisticated markets did not warrant the same kind of regulation as other markets.[617] The reforms were also limited to warranties and did not extend to other terms.

The 1980 report proposed three possible scenarios in the event that an insurer refused a claim: first, to show that the breach was immaterial to a particular risk (ie the warranty did not relate to a material matter);[618] secondly, the warranty was meant to safeguard against a risk that did not include the event that gave rise to the claim;[619] thirdly that breach could not have increased the risk that the event that gave rise to the claim would occur in the way that it did.[620] In these proposals can be seen the origins of s11 of the 2015 Act in two respects: first, by focusing on the category of loss; and secondly, by establishing a connection between the warranty and the loss. In 2006 the Law Commissions re-considered these procedural and substantive proposals. On the former they held that simply requiring the warranty to be in writing does not go far enough. Formal compliance does not equate to understanding as the term could still be buried in a host of fine print.[621] On the latter point, the Law Commissions felt that this proposal was unduly complex and broad as it gave an insured three possible options on refusal of a claim as discussed above.

3.5.2 The Framing Objectives and Policy Considerations of the Insurance Act 2015

Turning to the Law Commissions' reform agenda in 2006, the main concern was to relieve the unfairness and harshness surrounding the traditional regime on warranties,

[617] Law Com CP No 104, 1980 (n 58) [2.8]. The Law Commission concluded that the reforms should not extend to marine, aviation and transport insurance ('MAT'). They based their decision on several factors, notably that, they did not want 'to disturb this basis of legal certainty by making substantial changes to the 1906 Act' in view of the London market's position as a leading centre for MAT. The added that [t]he contracts falling within MAT are generally effected by 'professionals' who operate according to well-known rules and practices and that they can reasonably be expected 'to be aware of the niceties of insurance law'.

[618] Law Com CP No 104, 1980 (n 58); Draft Bill, clause 8(1).

[619] ibid, Draft Bill, clause 10(5)(a).

[620] ibid, Draft Bill, clause 10(5)(b). Law Commissions, *Issues Paper 2*: Warranties (n 37) 11.

[621] ibid 12.

particularly ensuring that warranties were not abused by insurers, and to do so they had to tackle the issue of basis of contract clauses.[622] The idea was to address the primary obligation (ie the warranty) by ensuring that that policyholders were aware of the existence of warranties in their policies. Importantly, they also needed to address the secondary obligation pertaining to the consequences for breach of warranty and sought to temper the strictness of the law by tying the loss to the commercial function of the warranty (ie a connection between breach and loss) and to allow an insured to recover where the breach had been remedied and no prejudice suffered.

What emerges from the consultation papers and issues paper to the 2015 Act is a preference for a principles-based approach to regulation that would put more control in the hands of the courts to develop the law to adapt to modern situations.[623] This approach is reflected in the design of the 2015 Act, notably s11 and the provisions on contracting out.[624] The objective underlying legislative reform was to introduce reform 'in an evolutionary rather than revolutionary way'[625] by creating a more balanced regime between the insured and insurer, with greater emphasis on fairness than legal certainty and with more procedural safeguards when incorporating 'unfair' terms into insurance policies.

Under the 1906 Act the way to control unfair terms was through judicial regulation, as discussed above.[626] The legislature has on occasion adopted the technique of setting statutory standards of fair dealing in general contract law but insurance contracts are excluded from the scope of the UCTA 1977.[627] The Law Commissions therefore felt that it was time to consider an unfair terms approach for insurance contract law.[628] The Law Commissions explored the idea of mandatory rules (ie immutable rules) in business insurance, for example, in relation to the 'causal' connection requirement in warranties — but that was soon dismissed. Mandatory rules can be justified in consumer insurance,

[622] CIDRA 2012, s6(2) abolished these in consumer insurance contracts. The same line has been taken in marine and commercial insurance contracts under the IA 2015, s9.

[623] SPBC, *Insurance Bill* (n 82) 3.

[624] The design of the IA 2015 is discussed in more detail in Section 4.2 in Ch 4.

[625] SPBC, *Insurance Bill* (n 82) 1.

[626] Law Commissions, *Issues Paper 2* (n 37) 97.

[627] The UCTA 1977, s1(2) and Sch 1.

[628] ibid.

but it was difficult to justify such controls in business insurance. Inequality of bargaining power (ie a power imbalance) in contractual dealings is a core reason for justifying protection of the weaker party in contractual transactions but it is more difficult to justify when dealing with sophisticated parties.[629]

It is clear that the 2015 Act is a different creature from the 1906 Act, which was 'a piece of commercial legislation largely concerned with shipping'.[630] The 1906 Act as a codifying statute merely purported to restate the existing law (with minor alterations) laid down by the courts in the preceding 150 years, rather than to change its substance.[631] The Victorian codification movement subscribed strongly to the principle of commercial certainty but certainty is not concerned with the substance of the law but rather with predictability and consistency.[632] To that end, the legislative method under the traditional legal regime was redolent of the need to simplify legal reasoning that therefore disfavoured judicial discretion in determining relevant legal principles or indeed how they applied to the facts of the case. As Howard Bennett says:

> much insurance contract law litigation has been an exercise in statutory interpretation rather than in the gradual, incremental development of common law in the manner characteristic of the majority of general contract law.[633]

The Law Commissions recognised that '[t]he market for consumer insurance had developed in a different way to business insurance'[634] and decided to separate the reforms into consumer and business, but any further divisions were determined to be too

[629] See S Macaulay, Non-contractual relations in Business: A Preliminary Study, (1963) 28(1) American Sociological Review 55–67.

[630] Hertzell (n 47) 2.

[631] R Ferguson, 'Legal Ideology and Commercial Interests: The Social Origins of the Commercial Law Codes' (1977) 4 Brit J Law & Soc 18.

[632] ibid.

[633] Bennett, 'Reflections on Values' (n 134) 156.

[634] Hertzell (n 47) 4. For example: 'different insurance products and how they were sold, social policy, IT developments, the reduction in the asymmetry of information, the resolution of disputes typically through the FOS and the fact that a separate jurisprudence was developing not based on the 1906 Act'.

complicated.[635] Unlike the 1980 report the Law Commissions determined that there were no particular reasons for marine insurance to be subject to a different legal regime.[636] The Law Commissions aimed to draft a law that would sit in the middle between the large scope of businesses that the 2015 Act was meant to cover. As explained in the Special Committee Report:

> At the more sophisticated end, we expect businesses to take care of themselves, as they do now with their individual contracts, and at the less sophisticated end we have the Financial Ombudsman Service. This legislation is intended to be focused on the mainstream commercial marketplace. We expect the people who operate outside that marketplace to contract on different terms, as they do now. It is a default regime that essentially seeks to achieve as neutral an outcome as possible for its various participants.[637]

Recognising that contracting parties in commercial insurance are a heterogeneous group, the 2015 Act was meant to regulate a large range of risks and contracts. The idea was that the entire area of commercial insurance law would be reformed but industries that fall outside the 'mainstream commercial market', such as marine insurance would still have the option to contract out of the reforms. This was intended to preserve their freedom and ensure that any issues that were not specifically thought through in relation to marine insurance could then be resolved by reference to a case of 'avoid the reforms' by contracting out.

The reform of insurance contract law was to bring it in line with developments that had taken place in general contract law. Since the mid-twentieth century there has been an increasing emphasis on paternalism in contract law with the underlying objective being to protect weaker parties from unequal bargaining power and information asymmetries. This justified a more interventionist approach by the law into contractual relationship and justified restrictions on freedom of contract. This was particularly marked in relation to consumer contracts but also, more broadly, by refusing to give effect to certain types of

[635] The Law Commissions initially drew a distinction between consumer and small business ('CSB') and medium and large businesses ('MLB') to explore whether 'small businesses' should be afforded the same protection as consumers. Law Commission, 'Joint Scoping Paper' (n 191) 5.

[636] ibid [A30-A31].

[637] SPBC, *Insurance Bill* (n 82) 3.

contractual terms. This approach was achieved through the passing of various statutes in general contract law.[638] Likewise the 2015 Act is intended to mirror such statutory developments in general contract law.

3.6 The Insurance Act 2015

3.6.1 Section 10: Warranties

3.6.1.1 Function and Rationale

The Achilles heel of the law on warranties was the secondary obligation that follows on breach of the primary obligation. Put differently, the criticism of the law was directed at the disproportionate remedy of automatic discharge on breach of the warranty. The purpose of s10 is to retain warranties and to replace that remedy with the remedy of suspension of the insurer's liability from the time of breach.[639] Section 10(2) therefore reflects a new default rule regulating the secondary obligation: the sanction on breach of warranty.[640] If the breach is remedied, liability will reattach.[641] This would reverse the decision in *De Hahn v Hartley*[642] as once the insured remedied the breach, the insurer would be back on liability. Section 10 reads:

> **10 Breach of warranty**
>
> (1) Any rule of law that breach of a warranty (express or implied) in a contract of insurance results in the discharge of the insurer's liability under the contract is abolished.
>
> (2) An insurer has no liability under a contract of insurance in respect of any loss occurring, or attributable to something happening, after a warranty (express or implied) in the contract has been breached but before the breach has been remedied.
>
> (3) But subsection (2) does not apply if—
>
> (a) because of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract

[638] Eg the Unfair Contract Terms Act 1977, and the Consumer Rights Act 2015.

[639] The IA 2015, s10(1) and s10(2).

[640] The IA 2015, s10(4), s10(5) and s10(7)(b).

[641] ibid.

[642] *De Hahn v Hartley* (n 7).

(b) compliance with the warranty is rendered unlawful by any subsequent law, or

(c) the insurer waives the breach of warranty.

(4) Subsection (2) does not affect the liability of the insurer in respect of losses occurring, or attributable to something happening—

a. before the breach of warranty, or

b. if the breach can be remedied, after it has been remedied.

(5) For the purposes of this section, a breach of warranty is to be taken as remedied—

(a) in a case falling within subsection (6), if the risk to which the warranty relates later becomes essentially the same as that original contemplated by the parties,

(b) in any other case, if the insured ceases to be in breach of the warranty.

(6) A case falls within this subsection if—

a. the warranty in question requires that by an ascertainable time something is to be done (or not done), or a condition is to be fulfilled, or something is (or is not) to be the case, and

b. that requirement is not complied with.

(7) In the Marine Insurance Act 1906—

a. in section 33 (nature of warranty), in subsection (3), the second sentence is omitted,

b. section 34 (when breach of warranty excused) is omitted.

In 2007 the Law Commissions initially considered repudiation as a remedy, but in 2012 changed to the remedy of suspension of liability.[643] The remedy of suspension of liability has its roots in motor cases and was a judicial device where courts construed future warranties as suspensory. The effect being that the insurer was off-risk during periods of breach, and once remedied, the risk re-attached.[644] Merkin and Gurses add that:

[643] Law Commissions, *Issues Paper 2* (n 37) 4.

[644] *Colinvaux's Law of Insurance* (n 147) [8-003].

> Exactly when a clause was a true warranty or merely suspensory was unclear, and later decisions extending the principle to property[645] and marine[646] policies were unable to derive a sensible rationale for the distinction other than judicial instinct based in part upon the width (warranty) or restricted (suspensory provision) nature of the exclusion. That analysis is fortunately no longer necessary [due to s11].[647]

In doing so, the Law Commissions proposed a fundamental shift in the nature of the remedy away from an 'order of performance' model and towards a mitigatory standard.[648] There is little controversy with the remedy of suspension of liability and this remedy was generally welcomed.[649] This seemed to be a sensible approach given the relationship between the nature of the warranty and its function. A breach of warranty is said to alter the risk assumed by the insurer, but if the breach can be remedied or is only temporary with no prejudice suffered by the insurer, then it makes sense for the insurer to come back on risk once the breach has ceased.[650]

3.6.1.2 The Scope of Section 10

Section 10 only applies to warranties (terms that are not 'warranties' are regulated by s11)[651] and is applicable to implied warranties, including warranties of seaworthiness in

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[645] Suspensory provisions, other than held covered clauses, were rarely express. *CTN Cash and Carry* (n 101*)*; *Kler Knitwear Ltd* (n 130).

[646] *The Bamcell II* (n 100); *Bueno v Marac Fire and General Insurance Ltd unreported 26 August 1984 HCNZ*; *Martin Maritime Ltd v Provident Capital Indemnity Fund Ltd (The Lydia Flag)* [1998] 2 Lloyd's Rep. 652; *The Newfoundland Explorer* (n 108). The suspensory argument was unsuccessfully put forward by the insurers in *The Resolute* (n 117).

[647] Merkin and Gurses, 'Insurance Contracts' (n 24) 451.

[648] Davey, 'Remedying the Remedies' (n 12) 491.

[649] Baris Soyer commented that reform of this type 'is not likely to create any serious difficulty'. Law Com CP No 204; Scot Law Com CP No 155, 2012 (n 58) 181. The marine insurance market welcomed this reform, SPBC *Insurance Bill* (n 82) 19.

[650] Baris Soyer, 'Risk Control Clauses in Insurance Law: Law Reform and the Future' (2017) 75(1) Cambridge Law Journal 109, 113. Soyer, 'Beginning of a New Era for Insurance Warranties?' (n 83) 386.

[651] The definition of warranties remains that in the MIA 1906, s 33(1) as the IA 2015 does not contain a new definition. See Arnould, *Law of Marine Insurance and Average* (n 124) 19-27 where the writers add that 'warranty' in s10 should be construed as referring to a promissory

voyage policies and warranties of legality.[652] The type of warranty however influences the effect of breach under s10. Recall that an affirmative warranty relates to a period before attachment of the risk and its function is to assist the insurer in rating the scope of the risk – the insurer relies on that contractual undertaking, which forms the basis of such a warranty.[653] Where there is a breach of that type of warranty, the insurer is misled, as the extent of the risk and the effect of s10 is that the insurer will not come on risk at all.[654] For example, if a warranty to the effect that 'an insured yacht is registered in Australia' is not true when the policy attaches, then 'cover will be suspended from the outset without any possibility to remedy this kind of breach'.[655] In relation to continuing warranties (ie warranties that need to be complied with after the attachment of the policy), these are discussed below in relation to s10(5) and (6) as there are different options regarding when a breach of this type of warranty is deemed to be remedied.

3.6.1.3 The Functionality of Section 10

Where a term is construed as a warranty the effect is that the insurers are not liable for any loss occurring after the warranty has been breached but before it has been remedied.[656] This does not however affect the insurer's liability for losses before breach.[657] In addition, insurers are not liable where the loss occurs after the warranty has been remedied but is 'attributable to something happening' while the assured was in breach of warranty.[658] The Law Commissions' Explanatory Notes explain that the words 'attributable to something happening' in s10(2) caters for the scenario in which 'loss arises as a result of something that occurred during suspension of liability, but is not

warranty as defined in the above-mentioned section of the MIA 1906. See also Merkin and Gurses, 'The Insurance Act' (n 1) 9.

[652] Merkin and Gurses, 'The Insurance Act' (n 1) 1017.

[653] Soyer, *Warranties in Marine Insurance* (n 2) 179. See also *Arnould Law of Marine Insurance and Average* (n 124) 19-27.

[654] Soyer, *Warranties in Marine Insurance* (n 2) 179.

[655] ibid. This analysis has not changed and strictly speaking, the insurer never comes on risk. This type of warranty is viewed as a condition contingent to the attachment of the risk.

[656] The IA 2015, s10(2). Except in the cases provided for in s10(3), and more importantly, subject to the possibility of liability being imposed under s11.

[657] ibid, s10(2) is subject to the exception in s10(4)(a).

[658] ibid, s10(4)(b).

actually suffered until after the breach has been remedied'.[659] An example would be where a vessel suffers damage to her propellers while being traded within a prohibited area in breach of warranty, which leads to a casualty being sustained after the vessel has left the area.[660] Soyer says in such instances it is essential to show that 'the risk has acquired new characteristics as a result of the breach, and the loss that results after the breach is remedied is attributable to these new characteristics'.[661]

The next question then must be: in what circumstances is a breach of a warranty taken to have been remedied? The answer lies in ss10(5) and (6). Section 10(5) contemplates two situations when a breach is deemed to be remedied:

(a) if the risk to which the warranty relates later becomes essentially the same as that originally contemplated; or
(b) if the insured ceases to be in breach of the warranty.[662]

Point (a) refers to 'time-specific warranties' in s10(6)[663] and point (b) are 'general warranties'.[664] Time-specific warranties require something to be done (or not done), or a condition to be fulfilled, or something is (or is not) to be the case *by an ascertainable time*.[665] As Soyer says:

> The special regime for time-specific warranties takes into account the fact that the time factor in such warranties is critical, and that non-compliance within a

[659] UK Parliament, *Explanatory Notes to the Insurance Bill* (2015) 130 <https://publications.parliament.uk/pa/bills/cbill/2014-2015/0155/en/15155en.htm> accessed 16 June 2019 [90].

[660] LC Report no 353 (England) and Report no 238 (Scotland) (2014) (n 47) [17.25]. See *Arnould Law of Marine Insurance and Average* (n 124) 19-30 where the writers elaborate by saying that the 'something happening' is limited to circumstances arising from when the assured was in breach. It does not extend to circumstances where an incident occurs after breach such as '[i]f a vessel meets a storm after leaving a prohibited area which she would have escaped had she not visited the area in the first place'.

[661] Soyer, *Warranties in Marine Insurance* (n 2) 180.

[662] The IA 2015, s10(5)(a) and s10(5)(b) respectively.

[663] ibid, s10(6).

[664] LC Report no 353 (England) and Report no 238 (Scotland) (2014) (n 47) [17.31].

[665] ibid [17.41]. See also *Explanatory Notes to the Insurance Bill* (n 235) [91].

> specified period could potentially alter the risk beyond the bounds of acceptability from the insurer's perspective.[666]

Premium payment warranties requiring instalments of premium to be paid by specified dates are an example.[667] This section only applies to warranties pertaining to the future, that is, where something is to be done or not done in the future.[668] This would exclude warranties as to past and present.[669] Applying this to the facts of *De Hahn v Hartley*[670] and assuming that the warranty relates to the future, that breach would have been remedied under point (a) once the required number of crew members subsequently came on board hours of the vessel's having left Liverpool.[671]

To fall within the purview of s10(6) a time-specific warranty must be of the right kind.[672] It is a specific type of warranty and, as the writers of Arnould say, a requirement that a warranty should be complied with during 'ascertainable periods of time' is unlikely to fall within the scope of a time-specific warranty.[673] Drawing on the example of the *Vesta* case those facts requiring a watchman during daylight hours would not constitute this type of warranty in s10(6).[674] Those types of warranties are better classified as general warranties to which (b) above is to be applied as they do not relate to 'a specific point in time that can be ascertained from the terms of the policy'.[675]

In relation to point (b), the initial consideration is whether the breach can in fact be remedied. Some breaches cannot be remedied.[676] For example, a warranty requiring the insured corporation to maintain confidentiality in their business dealings cannot be

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[666] Soyer, *Warranties in Marine Insurance'* (n 2) 181-2.

[667] *Arnould Law of Marine Insurance and Average* (n 124) 19-33.

[668] ibid.

[669] ibid.

[670] *De Hahn v Hartley* (n 7).

[671] *Arnould Law of Marine Insurance and Average* (n 124) 19-34.

[672] ibid 19-33.

[673] *Arnould Law of Marine Insurance and Average* (n 124) 19-33.

[674] *Vesta v Butcher* (n 35).

[675] *Arnould Law of Marine Insurance and Average* (n 124) 19-33.

[676] ibid 19-29. The writers of Arnould provide the following examples: 'such as those relating to the age or deadweight capacity of a vessel, or age of the insured or named drivers under a motor policy, would be incapable of being remedied'.

remedied once confidentiality has been compromised.[677] If a breach can be remedied, then the insurer is back on risk when the insured ceases to be in breach of that warranty. A prime example would be a warranty such as that in the leading case of *The Good Luck*,[678] discussed above, prohibiting entry into a war zone. If the vessel had escaped unscathed and had suffered a casualty after leaving the prohibited area instead of being destroyed by a missile within the area, s 10(5) is expected to have the effect that the breach would have been taken to have been remedied before the loss. The remedy in s10 is meant to apply more generally to all warranties relating to the future other than those requiring continuous observance throughout the policy period'.[679]

In summary, s10 provides that the insurer cannot rely upon a breach of warranty after it has been cured. But s10 is said to only provide a partial solution as it does not prevent insurers from relying on a breach of warranty that has nothing to do with the loss in question. For instance, if the warranty states that a vessel is not allowed to undertake towage or salvage services under a contract previously arranged, the assured will not be able to recover for loss arising from an unrelated fire which occurs at a time when the vessel is performing towage services. Section 11 of the 2015 Act has been designed to improve the position of the assured in such a case.[680] That falls within the remit of s11 and here we turn to s11(4), which 'picks up where section 10 leaves off, and focuses on the period where the assured is in breach'.[681]

3.6.2 Section 11: Risk Control Terms

3.6.2.1 Function and Rationale

Section 11 is the most controversial provision in the 2015 Act and was a surprise addition to the bill.[682] While problems were noted these were largely overlooked as being capable of resolution by the courts in the absence of a better alternative.[683] It reads:

[677] Soyer, 'Risk Control Clauses in Insurance Law' (n 226) 113.

[678] *The Good Luck* (n 75).

[679] *Arnould Law of Marine Insurance and Average* (n 124) 19-29.

[680] Soyer, 'Risk Control Clauses in Insurance Law' (n 192) 118.

[681] Merkin and Gurses, 'The Insurance Act' (n 1) 1020.

[682] ibid. See text to note 64 and 66 in Ch 1.

[683] SPBC *Insurance Bill* (n 81) 58-9.

11 Terms not relevant to the actual loss

(1) This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole, if compliance with it would tend to reduce the risk of one or more of the following—

(a) loss of a particular kind,

(b) loss at a particular location,

(c) loss at a particular time.

(2) If a loss occurs, and the term has not been complied with, the insurer may not rely on the non-compliance to exclude, limit or discharge its liability under the contract for the loss if the insured satisfies subsection (3).

(3) The insured satisfies this subsection if it shows that the non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

(4) This section may apply in addition to section 10.

The purpose of s11 can be said to be two-fold: first, to catch other risk control terms that might fall outside the remit of s10; and secondly, to prevent insurers relying on irrelevant warranties (terms) where there is no connection between breach and loss.[684] The rationale in relation to the first purpose was to ensure that the reforms in s10 were not circumvented by insurers classifying a warranty as something else such as a condition or exception.[685] For example, a warranty that the insured vessel shall not enter a prohibited can instead be phrased as 'losses caused while the vessel is in a prohibited area are excluded from cover'.[686] This would have fallen outside the scope of s10.[687] The stated rationale in relation to the second purpose was that the intention of s11 is 'to enable an objective

[684] Law Commissions, *Issues Paper 2* (n 37) 13

[685] ibid; Birds (n 132) 36. The 1980 report did not extend beyond warranties and this was a major difficulty.

[686] Soyer, *Warranties in Marine Insurance'* (n 2) 184.

[687] ibid.

assessment of the 'purpose' of the provision by considering what sorts of loss might be less likely to occur as a consequence of the term being complied with.[688]

The rationale of s11 is:

> to shift the emphasis, at least in part, from form to substance, so that the consequences of non-compliance with a term depends not upon how the term is classified but rather by virtue of the substantive effects of non-compliance for the risk.[689]

While the rationale of s11 seems clear enough, there are a host of problems with its functionality (discussed below). Section 11 'regulates triggers of coverage and continuing obligations'[690] – in other words, the basis for intervention is that s11 prohibits an insurer relying on a contractual term if the requirements of s11 are met (ie if the breach could not have increased the risk of loss that actually occurred in the circumstances in which it did).

Section 11 resembles developments that have taken place in general contract law, in particular, innominate terms. An innominate term was recognised as a further category of contractual terms by the Court of Appeal in *Hong Kong Fir Co Ltd v Kawasaki Kisen Kaisha Ltd* .[691] The authors of Chitty describe it as terms:

> which are neither an essential term which discharge the insurer from all liability under the contract or merely a term the breach of which results in damages, but terms which give the insurer different rights depending on the seriousness of the breach.[692]

Breach of an innominate term entitles the non-defaulting party to repudiate the contract in certain circumstances only. These include: if the other party has thereby renounced his obligations under the contract, or rendered them impossible of performance, in some essential respect or if the consequences of the breach are so serious as to deprive the innocent party of substantially the whole benefit which it was intended that he should

[688] *Explanatory Notes to the Bill* (235) [94].

[689] *Colinvaux's Law of Insurance* (n 147) [8-001].

[690] Merkin and Gurses, 'Insurance Contracts' (n 24) 453.

[691] *Hong Kong Fir Shipping Co ltd v Kawasaki Kisen Kaisha Ltd* {1962] 2 Q.B. 26.

[692] *Chitty on Contracts* (33rd edn, Sweet & Maxwell) 42-078.

obtain from the contract.[693] Section 11 by focusing on the category of loss and the connection between breach and loss is intended to resemble innominate terms by focusing on the impact of the breach rather than on a strict classification of the term. This thesis has claimed that s11 is a factual enquiry and entails a threshold enquiry. The authors of Chitty have likewise described the innominate term in similar way:

> The bar which must be cleared before there is an entitlement in the innocent party to treat itself as discharged is a "high"one which requires the court to engage in a fact-sensitive inquiry, involves "a multi-factorial assessment"and the use of various "open-textured expressions".[694]

3.6.2.2 The Scope of Section 11

Section 11 applies to a term that, if complied with, would tend to reduce the risk of losses of a particular kind, location or time.[695] It also applies to warranties since some warranties are designed to reduce a particular risk. For example, warranties that restrict insured vessels from entering areas of high piracy are designed to reduce the risk of loss of the vessel by attack and capture by pirates,[696] and hot works warranties are designed to reduce the risk of fire.[697] But not all warranties are aimed at reducing particular risks and these will be caught by s10 alone.[698]

Briefly, s11 does not apply to the following terms:

(i) Terms unrelated to the risk, such as the use of conditions precedent in respect of claims.[699]

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[693] ibid 13-034.

[694] ibid.

[695] The IA 2015, s11 (1).

[696] For example, this occurred in *The Good Luck* (n 75) where the vessel sailed into a prohibited area and was struck by a missile and sunk.

[697] Law Com CP 204 and SLC DP 155, 2012 (n 59) 184.

[698] Some address moral hazard, for example those relating to a policyholder's criminal record. Some define the whole contract, such as a term restricting cover to a farming business (and not tourism), terms which have no bearing on the risk of a loss, such as premium payment warranties. Law Com CP 204 and SLC DP 155, 2012 (n 59) 184.

[699] Merkin and Gurses, 'The Insurance Act' (n 1) 1019.

(ii) Terms that have no bearing on the risk of loss. For example, a premium warranty where it is warranted that the premium will be paid by a certain date. If payment is not made by that date the cover will be suspended until such time as the breach is remedied. If any loss occurs during the period of breach and before it is remedied, the assured will not be entitled to its claim.[700]

(iii) A warranty (term) that serves 'the purpose of describing the limits of the cover as a whole is excluded on the premise that such a term will have a general limiting effect not linked to a specific risk sector'.[701] This includes affirmative warranties as they are not aimed at a specific type of loss but are used for the purposes of describing the risk generally at the outset.[702]

3.6.2.3 The Functionality of Section 11

The way in which s10 and s11 operate together is that if the assured is in breach of a warranty at a time when the loss occurs, the assured cannot rely upon the suspensory provision in s10 but is able to argue that the breach is irrelevant to the loss so that s11 may potentially come to the rescue.[703] To seek refuge in this section, the assured in light of the loss arising must first establish that the warranty (or term) that is breached is intended to reduce the risk of loss of a particular type, at a particular location or at a particular time ('the category of loss test').[704] For example, a warranty (or term) which prohibits a vessel from leaving a sheltered port during a storm warning is meant to guard against particular types of losses (eg damage or sinking of the vessel in inclement weather). Secondly, where any loss is suffered the insurer will not be able to rely on non-compliance if the insured discharges the onus by showing 'that the non-compliance with the term could not have increased the risk of the loss which actually occurred in the

[700] Soyer, *Warranties in Marine Insurance* (n 2) 185.

[701] LC Report no 353 (England) and Report no 238 (Scotland) (2014) (n 48) at [18.35]. The IA 2015, s11(1).

[702] Clarke, 'Insurance Warranties' (n 41) 475. E.g. a warranty that a vessel remains at all times during the duration of the cover with a particular classification society. Soyer, *Warranties in Marine Insurance* (n 2) 185.

[703] *Colinvaux's Law of Insurance* (n 147) [8-097].

[704] Soyer, *Warranties in Marine Insurance* (n 2) 183, s11(1).

circumstances in which it occurred' ('the connection test').[705] This is the crucial and controversial aspect of s11.

The Law Commissions followed the approach taken to insurance law reform in Australia and New Zealand to establish a 'connection' between breach of the term in question and loss.[706] The initial proposal of the Law Commissions, which required a causal connection test between the breach and the loss, was rejected on the basis of increased investigation and litigation costs and the difficulties of proof.[707] It was also pointed out that a causation test would not be appropriate for all warranties since some may be relevant to the loss without having a causal connection with it. For example, a past claim does not cause (or even contribute to) a future claim but it may be highly relevant to the insurer's assessment of the likelihood of future claims.[708] The recommendations consequently moved away from the requirement of a causal link between the breach and the loss and focused on the category of loss with which the warranty or term was concerned.[709]

This has raised the issue of whether s11 introduces causation into the enquiry – despite the protestations by the Law Commissions that it does not. The Law Commissions said that causation is irrelevant because the test is purely objective– this will be considered below.[710] The Explanatory Note states that:

> In the event of non-compliance with such a term, it is intended that the insurer should not be able to rely on that non-compliance to escape liability unless the

[705] The IA 2015, s11 (3).

[706] The Bill in the Law Commission's 1980 Report required the insured to prove that the breach did not 'increase the risk' that the event giving rise to the claim would occur in the way it did. Under the New Zealand Act, the insured must prove that the event did not 'cause or contribute to' the loss. In Australia the insured need only prove that it did not 'cause' the loss. Law Commissions, *Issues Paper 2* (n 37) 75.

[707] Law Com CP No 204; Scot Law Com CP No 155, 2012 (n 59) 170.

[708] ibid 173.

[709] ibid 193. The inspiration for that was drawn from the 1980 report. Law Commissions, 'Issues Paper 2' (n 37) 3.

[710] *Explanatory Notes to the Bill* (235) [97].

> non-compliance could potentially have had some bearing on the risk of the loss which actually occurred.[711]

The Explanatory Notes continues:

> A direct causal link between the breach and the ultimate loss is not required. That is, it is not relevant whether or not breach of the term actually caused or contributed to the loss which has been suffered. The clause is intended to provide that the insurer will not be liable for any loss falling within the particular category of loss with which the warranty or other term is concerned.[712]

There were several voices of dissent to the Law Commissions' claim that s11 is not a question of causation. Merkin and Gurses believe that this will be a causation enquiry.[713] Lord Mance was of the view that the section did not eliminate causation, and the Lloyds Maritime Association referred to s11 as 'introducing causation by the back door'.[714] The authors of MacGillivray were also not entirely persuaded that s11(3) does in fact dispense with arguments about causation.[715] Rix said that although it could be accepted that s11(3) is just about 'a theoretical risk evaluation rather than [an]… assessment of cause and effect',[716] it seems that it is impossible for courts to avoid requiring a causation test because a theoretical risk is necessarily based on issues of causation. This thesis aims to highlight that there may well be interpretative difficulties with s11. This does not mean that judges will not interpret the section as the Law Commissions intended, but as was seen when interpretation was discussed in 2.6.1, judges do not always agree on what the correct approach to interpretation should be. Given the interpretative difficulties with s11 as highlighted in the Special Committee Report and by various scholars commenting on the reforms, there is indeed a strong possibility that there may not be consistency amongst

[711] ibid [92].

[712] ibid [96].

[713] 'It would be interesting to know what this statement refers to, if not causation'. Merkin and Gurses, 'The Insurance Act' (n 44) 1022.

[714] *Colinvaux's Law of Insurance* (n 147) [8-120].

[715] Birds and others, MacGillivray on Insurance Law (14th edn, Sweet & Maxwell 2018) 10-126.

[716] Bernard Rix, 'Conclusion: General Reflections on the Law Reform' in Clarke and Soyer, *The Insurance Act 2015* (n 47) 121.

judges in how they interpret s11 – at least in the early stages.[717] Causation will be examined next.

3.6.3 The Anticipated Problems with Section 11 (and Section 10)

3.6.3.1 Determining the Scope of s11 and the Category of Loss Test (s11 (1))

The scope of s11 has been discussed above but the difficulty arises when a court has to determine if a term serves the purpose of describing the limits of cover as a whole (and is excluded from s11),[718] or whether it is aimed at reducing a particular risk-increasing event/circumstances (within the ambit of s11).[719] This highlights the first difficulty encountered by s11: 'identifying the terms caught by the provisions which can only be resolved on a case by case basis'.[720] This can be compounded through drafting techniques where a term is phrased as a risk definition term in the policy to ensure that s11 is not applicable.

For example, a term that requires that the insured vessel refrain from a specific geographic location[721] versus 'that cover is excluded when the insured vessel navigates in East Asian waters north of 46 degrees N Lat'[722] and this is stated in the policy under 'risk definition'. The former falls within s11 as it aims to reduce risks associated with the vessel encountering different perils in that area which may alter the insured risk. In the latter instance it is arguable that this is a term defining the risk as a whole and s11 has no role to play.[723] The Law Commissions have accepted that this is a measure to circumvent s11 and this awaits judicial determination.[724] The Law Commissions would prefer that in

[717] Such as Merkin and Gurses, 'The Insurance Act ' (n 1); Soyer, 'Risk Control Clauses' (n 226); Merkin and Gurses, 'Insurance Contracts' (n 24).

[718] The writers of *Arnould Law of Marine Insurance and Average* (n 124) at [19-40] add that in relation to marine policies the following would also fall outside the purview of s11: matters relating to the vessel's age, flag, classification etc.

[719] Soyer, 'Beginning of a New Era for Insurance Warranties?' (n 83)392.

[720] Merkin and Gurses, 'The Insurance Act 2015' (n 1) 1020.

[721] Soyer, 'Beginning of a New Era for Insurance Warranties?' (n 83) 391-2.

[722] ibid.

[723] ibid.

[724] Merkin and Gurses, 'Insurance Contracts' (n 24) 457.

such an instance judges should interpret in a manner that preserves the objective of s11 by recognising attempts to circumvent the objective and applicability of s11.

However this creates uncertainty as to whether courts will adopt this approach when interpreting for as Brownsword once said '[a]t the roots of the law of contract lie two frequently competing principles' [725] that of freedom of contract and the other a paternalistic principle. The former gives effect to the right of parties to conclude their contract and for that to be respected, and the latter recognises that regardless of the terms of the contract the court should produce a reasonable settlement of the dispute.[726] These are not always a dichotomy and can be reconciled, as Brownsword has done through his contract law ideologies of consumer-welfarism and market-individualism. Yet, it does create the possibility that judges may not interpret this provision as the Law Commissions intended given that there is a lack of clarity at this stage.

Secondly, s11 (1) reads: 'whether compliance with a term would tend to reduce the risk of loss of a particular kind, at a particular location or at a particular time'.[727] In this thesis, this test is referred to as 'the category of loss' test because the Law Commissions have said that the focus is meant to be on the category of loss so as to prevent insurers relying on irrelevant warranties.[728] A major challenge with s11 is the difficulties that arise with its interpretation and application.[729] It was said by the Law Commissions in their July 2014 Report that:

> There is undoubtedly a degree of uncertainty relating to how the courts will interpret a 'type of loss', a 'loss at a particular place' and 'a loss at a particular time'. Often the questions will have common sense answers, but we are aware that sometimes they will not.[730]

[725] Roger Brownsword, 'Schuler A.G v Wickman Machine Tool Sales Ltd: A Tale of Two Principles' 1974 (87)MLR 104.

[726] ibid. The courts can claim that the latter is an application of the principle of 'freedom of contract'.

[727] The IA 2015, s11(1)(a)(b)(c).

[728] Law Com CP No 353; Scot Law Com CP No 238, 2014 (n 48) 86.

[729] MacGillivray (n 293) 10-126.

[730] *Colinvaux's Law of Insurance* (n 144) [8-106].

Under the 1906 Act the scope for disputes centred on determining if a term was a warranty and if so the scope of that warranty.[731] Soyer says that:

> While s11 is likely to reduce disputes concerning characterisation and interpretation of warranties, it is very likely that the battleground will shift to issues concerning what particular objective the warranty (or term) intends to serve and this can only be determined on a case-by-case basis.[732]

But the authors of Arnould say that the Law Commissions changed its approach from:

> …questions about what policy terms were designed to do or as to their purpose, to making the process of applying the policy aim of preventing insurers from relying upon terms that were wholly irrelevant to the actual loss so far as possible an objective exercise…[733]

The authors of Arnould say that it is not about the purpose of the term but about the type of losses that the term would tend to reduce.[734] Confusingly, the Explanatory Note reads that s11(1) 'is intended to enable an objective assessment of the *'purpose'* of the provision, by considering what sorts of loss might be less likely to occur as a consequence of the term being complied with'.[735] In highlighting the distinction between purpose and the loss, the authors of Arnould add that 'the purpose of a burglar alarm is to reduce the risk of intruders entering the property; they may cause any kind of loss but theft is the particular kind of loss that would usually be expected to result if they gain entry'.[736]

A further example would be a warranty (term) of locality which requires the insured vessel to refrain from entering certain geographical areas. The purpose is to reduce the risk of loss of or damage to the vessel by entering an area of higher risk than that covered by the policy. The kind of losses that may result could be any number of potential losses depending on the locality, including sinking, damage to the vessel, capture by pirates.

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[731] Soyer, *Warranties in Marine Insurance* (n 2) 233. See *Hide v Bruce* (n 61) and *Hussain v Brown* (n 102)

[732] Soyer, 'Beginning of a New Era for Insurance Warranties?' (n 83) 399.

[733] *Arnould Law of Marine Insurance and Average* (n 124) 19-38.

[734] ibid 19-43.

[735] *Explanatory note to the Insurance Bill* (N 235) 94.

[736] *Arnould Law of Marine Insurance and Average* (n 124) 19-43.

Hence, more than one kind of loss can result from the same term but that does not detract from the fact that compliance with the term would still reduce the risk of loss of a particular kind under s11.[737]

It seems unlikely that s11(1)(a) will be interpreted as being confined to cases where compliance with the term in question would be perceived as tending to reduce the risk of only one kind of loss. Consider for example a cargo policy where there is a term relating to the packaging of the insured cargo.[738] This can reduce the risk of a number of potential losses, such as 'breakage, or pilferage or of their being damaged by water'.[739] A term can therefore tend to reduce the risk of more than one type of loss as being likely to occur. Again, the focus is not on the purpose of the term as that is not what was intended by the Law Commissions.[740] But at some point the term will be drafted in too broad terms that could tend to reduce the risk of a number of types of losses and in that instance, the above approach would not be a viable one to adopt.[741] For example the warranty of seaworthiness would be too broad to tend to reduce the risk of particular kinds.[742]

From the above it is clear that s11 is a very technical section to which there is no clear idea regarding how it should be interpreted. The authors of Arnould have said that a term can 'tend to reduce' the risk of more than one type of loss and the section should not be read as limited to one particular type of loss.[743] That does seem sensible, especially when considered from the perspective of the packaging of insured cargo example described above – all the losses of breakage, pilferage and so forth are likely scenarios with neither being objectively more predominant.

Notwithstanding the useful expositions on s11 that are emerging, there are still grey areas that can only be determined through case law over time. It is the 'grey areas' and the case by case approach of s11 which raises particular problems given the different interpretative approaches which can result in a different outcome. It is not so much the case that judges will not interpret the section as the Law Commissions intended, but more the case that

[737] *Arnould Law of Marine Insurance and Average* (n 124) 19-43.

[738] ibid.

[739] ibid.

[740] ibid.

[741] ibid.

[742] ibid. Although this warranty is excluded by s11 as a term defining the risk.

[743] ibid.

there is general uncertainty amongst scholars and stakeholders involved in the consultation process regarding the applicability and interpretation of this section in particularly when faced with 'hard cases'. This uncertainty and difficulty is therefore likely to also be experienced by judges when they face the first cases on this section. But until that stage, what is important (and why the approach of this thesis matters) is that these issues of interpretation raise broader normative considerations, as will be discussed in Chapter 4. For the purposes of this chapter it is important to note that both the 'category of loss' and the 'connection tests' in ss11 (1) and (3) respectively are a matter of context.

Consider the example where an insurance policy contains a term that the vessel will not sail out of sheltered port when there is a storm warning at that port and where the vessel's intended route may be in the path of the storm. Even if the purpose of the term is to prevent loss of or damage to the vessel caused by a storm, what would constitute a storm warning? Would this apply to a general storm warning or would the warning also have to explicitly state that vessels should not sail? What if the vessel sailed in the opposite direction to where the storm was expected but the storm nevertheless veered into the direction of the vessel and resulted in loss? More than one interpretation seems very likely and how the courts might resolve that uncertainty cannot be predicted with confidence. This is a threshold question which will be discussed further below and expanded on in Chapter 4.

3.6.3.2 'The Connection Test' in s11 (3)

Section 11 (3) is one of the most complicated sections in the 2015 Act and is reproduced here:

> (3) The insured satisfies this subsection if it shows that the non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

Section11 (3) can be broken down into three categories which highlight the problems:

(i) The purpose of the term (warranty);
(ii) The existence of a connection between the term and the loss; and
(iii) The type and the degree of connection between the term and the loss.

It is helpful to explain this section using examples. Suppose a term (warranty) requires that a vessel shall not sail into a particular geographic area due to ice conditions. One day the vessel takes a shorter route and sails into such area and whilst in that area a fire breaks out on the vessel due to repairs being conducted on the vessel by the crew. Clearly the insurer should be liable, since non-compliance with the term could not have increased the risk of a fire occurring. Consider further if the fire was caused by the crew trying to seal the cargo holds due to inclement weather in that area which posed a risk of damage to the cargo. In these circumstances the insured would find it difficult to show that the breach of the term in question (to not sail in the ice prohibited area) could not have increased the risk of loss/damage arising from such inclement weather. Here it is not the particular kind of loss suffered that is pertinent (loss through fire damage), but rather, to quote s 11(3) again, 'the circumstances in which it [the loss] occurred'.

It is useful to start with the Law Commissions' view on the operation of s11 (3). The Law Commissions say that this section is concerned with the category of loss (i.e. loss or damage from ice conditions) that relates to the warranty (term) in question (i.e. to not sail into ice prohibited areas).[744] The first step is said to be objective in determining the purpose of the term, that is, if breach of it would tend to reduce the risk of a loss of a given type.[745] Indeed the Explanatory Note to the 2015 Act seems to imply a broad approach as the focus is on the general nature of the loss rather than on the particular circumstances.[746] The courts could focus on the general nature of the loss (e.g. losses occurring from being in the prohibited area in the above example), in which case the element of causation is irrelevant.[747] Seemingly this means that s11 (3) is concerned with the probability of loss in that category, rather than awareness of the actual loss that occurred. In other words, the purpose of the term is potential control of the type of losses rather than looking at the actual loss (i.e. fire).

The problem with the Law Commissions' explanation was that it does not accord with the wording of this section. The Law Commissions were adamant that this section is not meant to focus on 'the way' in which the loss occurred.[748] The focus, they say, is meant

[744] ibid.

[745] *Colinvaux's Law of Insurance* (n 147) [8-120].

[746] SPBC *Insurance Bill* (n 82), Stakeholder Note: Terms Not Relevant to the Actual Loss [1.17].

[747] Merkin and Gurses, 'The Insurance Act' (n 1) 1022.

[748] SPBC *Insurance Bill* (n 81), Stakeholder Note: Terms Not Relevant to the Actual Loss [1.17].

to be forward-looking from when the risk was underwritten, not backwards from the circumstances of the claim.[749] The authors of MacGillivray say that s11 (3) has both prospective and retrospective elements.[750] The former pertains to 'could not have increased the risk of loss' and this occurs at the time of agreement. The latter pertains to 'which actually occurred in the circumstances in which it occurred' and this will only arise at the time of loss/claim. Both stages therefore ask very different questions and the norms governing the relationship between insured and insurer at this stage is also different. This will be considered in detail in Chapter 4.

Considering the design of s11 (3) in more detail, it should have stopped at 'the loss that actually occurred'. 'Actually' is a factual interrogative – it necessarily implies that the section must consider the loss that actually occurred rather than how the loss was occasioned. In our example above, the loss that 'actually occurred' could arguably be loss by fire, or, loss by fire occasioned by steps taken to guard against icy weather conditions. The former would imply that the loss is in a different category to the term and hence the insurer should be liable. The latter would imply the same category and hence the insurer should not be liable. Disputes are inevitable on this point given the adversarial nature of litigation. This seems to be compatible with the Law Commissions' thinking and is the lesser of two evils when one considers the phrase, 'in the circumstances in which it occurred'. By adding this phrase, it invites a much more detailed factual enquiry into the way in which the loss occurred (what 'caused' the fire). The phrase requires a consideration of the conditions affecting the situation, or a modification or qualification of the loss. 'Circumstances' is often synonymous with facts, and this contradicts the Law Commissions' explanation that s11 (3) is not concerned with the way in which the loss occurred.

While this may not mean causation in its usual sense, it does indicate some other kind of connection and that is where s11 (3) is unclear: the type and degree of connection that is required to satisfy this section. Is it meant to be a strong or weak connection? The section itself seems to speak of a strong connection and insureds are likely to enforce this kind of approach. The Law Commissions said that it must be a general (or weak) connection and this is likely to be the approach that insurers will enforce to catch a broader spectrum of

[749] ibid [1.16].

[750] MacGillivray (n 293) [10-131].

losses connected to the term.[751] It is likely that the assured in most instances would be tempted to argue that compliance with a particular warranty would tend to reduce the risk of loss in a narrow fashion, with insurers taking a different stance.[752]

This thesis has highlighted that there may well be a risk that s11 will not be interpreted as the Law Commissions intended. There are several reasons for this view. The fact that scholars have highlighted the difficulties that arise with the interpretation and applicability of s11, implies that judges will not be immune from these difficulties when faced with the first cases on s11. To that end, as mentioned above several scholars have asserted that it would be difficult to separate s11(3) from a causation enquiry. As this thesis has highlighted, the wording of s11(3) and the intention of the Law Commissions are not compatible. The former appears to invite a causation enquiry even though the Law Commissions have explicitly said that it is not. It is therefore a possibility that the 'connection' test may not be interpreted as the Law Commissions intended, or at the very least, it is yet to be seen how the courts will interpret s11(3) in a manner that separates it from a causation enquiry. For that reason, this thesis has highlighted that there could be risk that the section will not be interpreted in the manner envisaged by the Law Commissions.

This wording appears to set the bar at a high level and the academic approaches to this section have not been consistent in agreeing on how courts should interpret s11. It is not sufficient for the purposes of s11 (3) for the assured to show on a balance of probability that their non-compliance *did not* contribute to the loss or increase the risk of it happening. They must show on a balance of probability that it *could not* have done so. The idea behind this is that this is not a causation enquiry and it is meant to prevent insurers relying on irrelevant warranties that could have had no link to the actual loss suffered.[753]

[751] The Law Commissions were aware of the difficulties in this section and admit that there might be borderline cases that turn on their particular facts (LC CP No 204; SCL DP No 155; 2012 (n 59) 186.

[752] Soyer, *Warranties in Marine Insurance* (n 2) 184. Soyer says the Law Commissions considerably downplayed the difficulties that can arise with respect to several types of promissory warranties.

[753] *Arnould Law of Marine Insurance and Average* (n 124) 19-47.

3.6.4 Contracting Out

3.6.4.1 The Marine Insurance Act 1906

Under the 1906 Act there was somewhat of a *laissez–faire* attitude to contracting out. There was little if any legislative interference with freedom of contract[754] as the 1906 Act contained no specific mechanism for 'contracting out'. All that was needed was the expression of a contrary intention and judges were happy to displace the default rule,[755] which is illustrative of the values underpinning the Victorian codification of commercial law.[756] In marine insurance, the well-known held-covered clause served as a contracting out measure.[757] Early examples of held covered clauses date back to the early cases in the 19th century[758] and many modern Institute clauses provide for a mitigation of the alteration of risk doctrine.[759] The 1906 Act did not touch upon the held-covered clauses. Indeed, s33 (3) of the 1906 Act declares that the consequence of a breach of warranty is subject to any express provision in the policy and it is suggested that s31 (2) of the 1906 Act acknowledged the possibility of it implicitly.[760] As a result it is agreed that held-covered clauses are entirely a question of contract.[761] Both held-covered clauses and contracting out amounts to a partial or complete variation of the statutory default regime. Howard Bennett explains the function of held covered clauses:

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[754] Merkin and Steele (n 46) 49.

[755] The MIA 1906, s33(3) of the 1906 Act is subject to any express terms of the policy.

[756] Ferguson, 'Legal Ideology' (n 196) 18.

[757] It is suggested that the h/c clauses are widely used in marine insurance and they represent a convenient and flexible way to provide protection to an assured in circumstances when the policy cover is inadequate, unavailable or subject to termination or repudiation. As a generic group, they cover a wide range of different held covered events other than breach of warranties, like risk arising outside the policy cover, the underwriters being entitled to elect to avoid the insurance, or breach of policy terms not being warranties. Here the discussion will be confined to the particular issues concerning warranties.

[758] *Simon v Sedgewick* [1893] 1 QB 303; *Greenock Steamship Co and Maritime Insurance* Co Ltd [1903] 1 KB 367, appeal was dismissed [1903] 2 KB 657; *Hyderbad (Decan) Company v Willougby* [1899] 2 QB 530.

[759] H Bennett, *The Law of Marine Insurance* (n 68) 556.

[760] *Simon Israel & Co. v Sedgwick* [1893] 1 Q.B 303; *Hyderabad (Deccan) Co. v Willoughby* [1899] 2 Q.B 530.

[761] Cf D.R. Thomas, 'Held Covered Clauses in Marine Insurance', in Thomas (ed) *The Modern Law of Marine Insurance* (Vol. II LLP, 2002).

> [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.[762]

The nature of a held-covered clause is related to the function of insurance warranties.[763] A held-covered clause is a contractual arrangement to alter the statutory default rule (i.e. breach of warranty) and as an altering rule it is meant to temper the strictness of the statutory default[764] for breach of warranty.[765] In doing so, it allows for the continuation of cover provided the insured gives notice, and the parties reach agreement on additional premium and/or terms.[766]

3.6.4.2 The Insurance Act 2015

An insurance policy - like any other contract – embodies not just primary obligations but secondary obligations as well. Much of the reform of risk control terms, as seen with sections 10 and 11 of the 2015 Act, was directed at the secondary obligation: the consequences of breach of a risk control term. Both primary and secondary obligations may be modified by agreement and it is this aspect that the contracting out provisions seek to regulate – in particular, circumstances in which an insurer has the right to avoid its obligations of payment of a claim upon breach of warranty.

The 2015 Act consists of default rules with parties free to contract out (except for basis of the contract clauses).[767] The requirements for contracting out are that:

(i) A term of a non-consumer insurance contract that would put the insured in a worse position than under the 2015 Act regarding the rules of breach of warranty and other risk management clauses and remedies ('the

[762] Bennett, 'Law of Marine Insurance' (n 67) [18.111].

[763] Davey, 'The Reform of Insurance Warranties' (n 42) 129-130.

[764] See Ian Ayres, 'Regulating Opt Out: An Economic Theory of Altering Rules' (2012) 121 Yale LJ 2032.

[765] See *Liberian Insurance Agency Inc v Mosse* [1977] 2 Lloyd's Rep 367, 374.

[766] Davey, 'The Reform of Insurance Warranties' (n 42) 119.

[767] The IA 2015, s16 (1).

disadvantageous term') is to that extent of no effect, unless the requirements of section 17 have been satisfied in relation to the term.[768]

(ii) 'A disadvantageous term' may be enforced if the insurer takes 'sufficient steps to draw the disadvantageous term to the assured's attention before the contract is entered into' and it is 'clear and unambiguous as to its effect'[769] ('the transparency requirements').

(iii) In determining if the requirements in (ii) have been satisfied, the characteristics of insured persons of the kind in question, and the circumstances of the transaction, are to be taken into account ('the qualifying transparency requirements').[770]

(iv) In case the insurer fails to meet the requirements of section 17 the term may still be enforced if the assured (or its agent) had actual knowledge of the disadvantageous term when the contract was made.[771]

In other words, the first step when a court is confronted with this situation would be to ascertain whether the requirements for contracting out of the 2015 Act have been satisfied. If not, the provisions of the 2015 Act will be applicable, that is, the remedial provisions of ss10 and 11. If so, the court will have to approach this provision from a normal contractual interpretation perspective of incorporation and interpretation rather than statutory approaches.[772] This would preclude discussion on the fairness of the term in question. Whilst contractual and statutory interpretation are travelling in the same direction, there is no unified grand theory of interpretation, especially as there are aspects peculiar to insurance contracts.

[768] ibid, s16 (2). The rules relating to a fair presentation of the risk – fraudulent claims are also included. The aspect regarding 'worse position' part is taken from CIDRA 2012, s10 (contracting out).

[769] The IA 2015, s17 (2) and (3) respectively. The latter adopts the test on contractual incorporation of terms, but goes further. The incorporation test is principally concerned with whether reasonable notice of the existence of the term has been given rather than with whether the customer ought to have been aware of its existence.

[770] ibid, s17 (4).

[771] ibid, s17 (5).

[772] James Davey, 'Utmost Good Faith, Freedom of Contract and the Insurance Act 2015' (2016) 27 ILJ 253.

Points to note on the above include, firstly, contracting out is only triggered if the clause puts the assured in a worse position than it would be under CIDRA 2012 or the 2015 Act, and that can only be tested 'by comparing the actual effect of the clause and then the legislation on the rights of the assured in respect of the claim in question'.[773] As a mandatory statutory provision, parties would not be able to contract out of the 'contracting out' provision. Secondly, contracting out in favour of the underwriter must be done explicitly and this entails two requirements as set out in (ii) above. It is uncertain exactly what would satisfy the criteria that the disadvantageous term must be 'clear and unambiguous'. For instance, would it suffice to simply say that 's11 of the 2015 Act is not applicable to this contract?' or would the exact consequences of the disadvantageous term have to be set out?[774]

There are conflicting views in answering this question. The authors' of Arnould posit that it would not be necessary to explicitly refer to sections of the 2015 Act.[775] But they add that the 2015 Act expressly states that the consequences of the disadvantageous term must be clear and unambiguous.[776] The Law Commissions are of the view that it would be necessary to stipulate the legal effect of contracting out of various sections of the 2015 Act.[777] Soyer, however, disagrees with the viewpoint of the Law Commissions[778] and provides an example where standard clauses are the norm in a market, such as marine insurance, and given that the:

> typical assured is likely to be a corporate entity who is assisted by in-house lawyers and brokers, it is difficult to see why a mere reference indicating the provisions of the 2015 Act that are displaced should not be adequate. [779]

[773] *Colinvaux's Law of Insurance* (n 147) [8-126].

[774] Soyer, *Warranties in Marine Insurance* (n 2) 188. Law Com Report 352; SLC Report 238, 2014 (n 48) [29.50].

[775] *Arnould Law of Marine Insurance and Average* (n 124) 20A-10.

[776] ibid.

[777] Soyer, *Warranties in Marine Insurance* (n 2) 188. Law Com Report 352; SLC Report 238, 2014 (n 48) [29.50]. Jonathan Gilman (et al), *Arnould Law of Marine Insurance and Average* (n 124) 20A-10.

[778] Soyer, *Warranties in Marine Insurance* (n 2) 188.

[779] ibid.

Given these conflicting views, insurers may be well advised to be as thorough as possible so as not to leave any room for doubt until at least there has been judicial pronouncement on this matter. In the light of this explanation, it seems that there is no bright line between the two aspects of the transparency requirements. Arnould says that:

> Despite the wording, what appears to be contemplated is not so much clarity and a lack of ambiguity, but the giving of an explanation as to consequences *within the term itself*. It is not easy to understand why this is required, given the separate requirement that the relevant term—including, in an appropriate case, its consequences—must be drawn to the insured's attention.[780]

The first part of the transparency requirements - that the disadvantageous term should be drawn to the assured's attention before the contract is entered into -[781] reflects the test for contractual incorporation of term, whereas the second aspect pertaining to the effect of the term is new. The counter-argument is that the contracting out provisions simply aims to make consent less thin by incorporating elements of informed consent. In doing so it simply reflects the position in English contract law where contracting out is intended to regulate the formation process of contracts thereby ensuring that 'weaker' parties are protected from onerous terms – both in terms of the effects of such terms and also in terms of being aware of the inclusion of these terms in their contracts. In that respect, insurance contract law is merely catching up to that trend in general contract law. As Arvind states:

> There is no general rule applicable to all onerous terms nor is there any general theoretical or doctrinal basis that the various restrictions imposed by law have in common. Instead the rule setting limits of freedom of contract are particularistic, being addressed to specific subject matters, types of terms or parties. They do share a common concern- that weaker parties lack the ability to effectively protect themselves in the course of contracting and that can have an adverse effect on parties and on public interest.[782]

It is well known that freedom of contract is not unlimited, and even in commercial contracts, reasons may well exist for freedom of contract to be limited due to public policy concerns. Marine insurance, like other areas of private law, is not immune to these

[780] *Arnould Law of Marine Insurance and Average* (n 124) 20A-10.

[781] The IA 2015, s17(2).

[782] TT Arvind, *Contract Law* (2nd edn OUP 2019) 373.

considerations.[783] However, as this thesis claims, the contracting out provisions infringe on party autonomy more so than under the 1906 Act. Yet the Law Commissions have built measures into the contracting out provisions that allow for a more lenient approach in relation to sophisticated parties – discussed below.

Importantly, if the disadvantageous term is insufficiently clear or is ambiguous, it is rendered entirely ineffective to the extent that it places the insured in a worse position.[784] In that event, the default regime set out in the 2015 Act will apply. Thirdly, in determining the application of the above transparency test, the characteristics of the assured of the kind in question, and the circumstances of the transaction, are to be taken into account.[785] The Law Commissions' thinking was to intentionally draft the provisions in broad terms to capture the broad spectrum of commercial insurance.[786] The examples given of the extremes at each end of the 'full range' are:

> a sole trader buying standardised retail public liability insurance' (thought to be very unsophisticated), and 'a charterer purchasing a voyage policy at Lloyd's using a broker (evidently regarded as the most sophisticated form of purchaser in the market).[787]

In relation to the smaller commercial interests, the Law Commissions thought that they should be treated as 'quasi-consumers'.[788] In applying the 'transparency requirements' and the 'qualifying transparency requirements', this 'sliding scale' approach gives substantial latitude to courts as to how they interpret the contracting out provisions. Over time, courts will undoubtedly establish criteria in the application of these tests and some preliminary ideas would include: the relative bargaining strength, even within commercial parties; the level of sophistication in relation to each other; consent/knowledge proved by satisfying the transparency requirements; the possibility of

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[783] Soyer, *Warranties in Marine Insurance* (n 2) 88.

[784] The IA 2015,s16(2). See also Law Com Report 353; SLC Report 238, 2014 (n 48) [29.49].

[785] The IA 2015, s17 (4). This borrows the terminology from s3(4) of CIDRA 2012, which reads:

> If the insurer was, or ought to have been, aware of any particular characteristics or circumstances of the actual consumer, those are to be taken into account'.

[786] SPBC *Insurance Bill* (n 82) 3.

[787] *Arnould Law of Marine Insurance and Average* (n 124) 20A-10. Law Com Report 352; SLC Report 238, 2014 (n 48) [29.41].

[788] Law Com Report 352; SLC Report 238, 2014 (n 48) [29-29].

inducement; the type of contract – is it a standard form contract or bespoke; were intermediaries, like brokers, used; and particularities of the trade in question. Some industry context may be valuable to a court in developing the above factors, such as the manner of contracting in certain industries, like marine insurance. Furthermore, factors such as the practice of the industry in including such terms or why they are included. It can readily be seen that there is potentially scope for considerable argument over whether, in a given case, the 'consequences' of a particular term have been expressed in a manner that is sufficiently 'clear and unambiguous'.[789]

If an insurer is unable to satisfy the transparency and the qualifying transparency requirements ,insurers may still rely on the disadvantageous term if they can prove that the insured (or its agent) had actual knowledge of the disadvantageous term when the contract was entered into.[790] The requirement is for actual knowledge which means that constructive knowledge i.e based on what a reasonable broker would have done would not suffice for this section. Consider the common scenario where brokers are used to buy insurance versus insurance being purchased directly from the insurer. In the former situation it is likely that bringing the clause to the attention of the broker would be sufficient to satisfy this section, and the onus is likely to be on the broker to ensure that they have reviewed and understood the term in question.[791]

But when dealing directly more may be required from the insurer in ensuring that the insured understands the purpose and consequence of the term. If a small business owner obtains insurance cover for their premises online, it may not be adequate to satisfy the transparency requirements by having the disadvantageous terms included with all other standard terms.[792] In the context of a marine policy negotiated through several brokers in the Lloyd's market, attracting the attention of the placing broker to the disadvantageous term should be deemed sufficient.[793] This provides an additional safeguard to sophisticated insurers as less would be needed to satisfy the contracting out provisions.

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[789] *Arnould Law of Marine Insurance and Average* (n 124) 20A-10.

[790] The IA 2015, s17(5)

[791] George Leloudas, 'Contracting Out of the Insurance Act 2015 in Commercial Insurance Contracts' in Clarke and Soyer (eds), The Insurance Act 2015 (n 46) 98. Law Com Report 352; SLC Report 238, 2014 (n 48) at [29.64] [29.65].

[792] Soyer, *Warranties in Marine Insurance* (n 2) 188.

[793] ibid 187.

Two tentative conclusions can be drawn in relation to the new transparency requirements. First, while the rationale behind the contracting out provisions is plausible, it is unclear what exactly would amount to successful contracting out. The section therefore gives rise to uncertainty and is expected to be one of the most litigated sections – at least in the early stages of the 2015 Act. Secondly, insureds therefore have to ensure that brokers draw disadvantageous terms to their attention, and that they have recourse against the broker should they fail to do so. It is unclear what impact this section will have on brokers and their liability.[794] In order to avoid potential exposure, brokers may have to be particularly astute in reconsidering their role when drawing disadvantageous terms to the attention of assureds.[795] Indeed, as the authors of Arnould say of these provisions:

> unless and until the transparency requirements have been considered by the Courts, it will remain uncertain whether the Commissions' expectations set the bar too high, or indeed veer in the opposite direction.[796]

The Law Commissions did not want to be seen as interfering with party autonomy, particularly in relation to sophisticated markets like marine insurance which could interfere 'the smooth running of the insurance market".[797] But they also needed to ensure that the reforms were not set aside through the contracting out provisions. As noted previously, there is a link between the default rules and the contracting out provisions. The extent to which contracting out is permitted is not restricted, for example, parties may restore the former position that existed under the 1906 Act. The focus is rather ensuring informed consent and awareness of contracting out to a more disadvantageous position. The contracting out provisions leave much of the determination to the courts through the qualifying transparency requirements and in so doing, was intended to effect a 'political compromise to water down the opposition to the reform of sophisticated insurance markets'. [798]

[794] *Arnould Law of Marine Insurance and Average* (n 124) 20A-13. This is outside the scope of this thesis.

[795] ibid.

[796] ibid 1.5-21.

[797] Law Commission Report, at [29.29]. Leloudas (n 374) 96.

[798] Leloudas (n 374) 97.

3.7 An Evaluation of the New Legal Regime

In the absence of case law, evaluating the merits and shortcomings of the 2015 Act is not an easy task. Soyer has suggested that one way in which to judge the merit of any reform, and therefore the 2015 Act, is against considerations, such as whether the Act protects party autonomy, furthers legal certainty, reduces transaction costs, seeks to advance more balanced remedies between the insured and insured, or promotes confidence in the market.[799] These are overlapping considerations and hence any law reform project would necessitate a balancing act between these different considerations.

There has been a re-arrangement of values underpinning commercial (marine) insurance contract law. Legal certainty and party autonomy, whilst still important, have been relegated to concerns that did not need to be actively encouraged in the reforms – fairness and protection of the policyholder have superseded those. The overall aims of ss10 and 11 was to substitute the punitive remedy on breach of a warranty (term) with a fairer one and to prevent an insurer threatening to rely on irrelevant warranties respectively.[800] The contracting out provisions sought to strike a balance between freedom of contract and the protection of policyholders.[801] In addition to removing unfairness it was hoped that this would also increase confidence in the market by creating a better perception of English law.[802]

The Law Commissions were aware that any change to the default rules may be ineffectual since parties could simply contract out of the default position as parties could easily restore the former statutory provisions.[803] There is therefore a link between the Law Commissions' approach to default rules and the contracting out provisions. The manner of contracting out under the 2015 Act is unfamiliar in other commercial contracts and will be among the first sections of the 2015 Act to attract judicial attention.[804]

The Law Commissions Report explained that whilst consideration was given to applying different requirements to different classes of business insurance, that suggestion was

[799] Soyer, 'Beginning of a New Era for Insurance Warranties?' (n 83) 398.

[800] *Colinvaux's Law of Insurance* (n 147) [8-094].

[801] Law Com Report 352; SLC Report 238, 2014 (n 48) [29.17]–[29.24].

[802] *Colinvaux's Law of Insurance* (n 147) [8-094].

[803] Law Commissions, *Issues Paper 2* (n 37) 72.

[804] Leloudas (n 374) 95.

overwhelmingly rejected by those consulted in relation to the proposals.[805] This means, as the Commissioners pointed out, that any provisions relating to contracting out must be workable for a large range of risks and contracts. Marine insurance was specifically identified as a 'sophisticated market' in which it was 'expect[ed] that contracting out will be more widespread'.[806]

In marine insurance, the fact that brokers are frequently involved means that actual knowledge of the consequences of breaching a disadvantageous term is likely to be present in a significant portion of cases. The Law Commission recognised the importance of not unnecessarily interfering with freedom of contract and limited such interference to the way in which contracting out is done i.e ensuring informed consent and awareness of the term in question. These considerations will be satisfied if the broker has actual knowledge of the disadvantageous term. This provides an added measure of flexibility when sophisticated parties attempt to contract out of the 2015 Act. As will be discussed in Chapter 4, it is important that courts recognise this when interpreting the contracting out provisions.

Asymmetry of underwriting information was pivotal to the development of marine insurance in those early days. In modern times, where consumer law has risen in importance, it is surprising to discover that under traditional insurance law it was the insurer who was seen as the party in need of protection. The insured was viewed as the party who had knowledge of the risk and therefore had a responsibility to transfer this knowledge to the party who did not (the insurer)[807] – 'traditional insurance law can therefore be said to be a business law in the sense that it is supportive of the business of insurance'.[808] Changes in the way the insurance market operates in modern times has changed the asymmetry of information dichotomy. The role of the insurer is required to be a more active one. As the professional, the insurer has the responsibility to source information on the risk, and to warn the insured of onerous terms.[809] Yet in some

[805] Law Commissions, 'A Joint Scoping Paper' (n 191).

[806] *Arnould Law of Marine Insurance and Average* (n 124) 1.5-12 - 13. Law Com Report 352; SLC Report 238, 2014 (n 48) [29.25]..

[807] Cousy (n 13) 124-5.

[808] ibid.

[809] ibid.

insurance markets, such as marine insurance, the insurer is not the only professional in that commercial transaction.

In drawing parallels with contract law, this thesis claims that the 2015 Act bears resemblance to 'protective' statutes, such as the Consumer Rights Act 2015 ('the CRA 2015'),[810] the Unfair Contract Terms Act ('the UCTA 1977'),[811] and CIDRA 2012. Under the CRA 2015 a term is unfair if 'it is contrary to the requirement of good faith, it causes significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer'.[812] Whether a term is fair is determined by 'taking into account the subject-matter of the contract', and 'by reference to all the circumstances when the term was agreed...'[813] A term is excluded from the assessment of fairness if it is 'transparent and prominent'.[814] Transparency' means the term should be in 'plain and intelligible language' and prominent means that it 'is brought to the consumer's attention in such a way that an average consumer would be aware of the term'.[815]

The test of putting' the insured in a worse position' than s/he would be under the 2015 Act bears resemblance to the CRA 2015 and to the CIDRA 2012.[816] As stated previously, there is an additional requirement in the contracting out provisions which does not simply require that the disadvantageous term is brought to the insured's attention at the time of formation of the contract but that it must also be 'clear and unambiguous as to its effect'[817] It is curious to note that the Law Commissions' approach to consumer insurance is, in

[810] The Consumer Rights Act 2015 ('the CRA 2015') also applies to marine insurance policies involving insureds as consumers. However CRA 2015 is unlikely to have much effect on marine insurance contracts where the terms of the contract would fall within the provisions of the IA 2015 or the MIA 1906.

[811] UCTA 1977 no longer regulates terms in contracts between consumers since this is now dealt with by the CRA, s1(3) and ss2-7. Insurance contracts are excluded from the scope of UCTA 1977, s1(2) Sch 1.

[812] The CRA 2015, s62(4).

[813] ibid, s62(5)(a) and (b).

[814] ibid, s64(2).

[815] ibid, s64(3) and (4).

[816] The IA 2015, s16(2).CIDRA s10

[817] ibid, s17(2) and (3).

many ways, also found in commercial insurance. The Law Commissions observed in relation to *consumer* insurance:

> For consumer insurance… [t]he insurer should take specific steps to bring the obligation to the insured's attention… Like the FOS, a court should only enforce a specific obligation on the consumer if the insurer took sufficient steps to bring it to the consumer's attention. Given the FSA's current emphasis towards a more principles-based approach, with fewer detailed rules…'[818]

UCTA 1977, on the other hand regulates unfair terms in standard written business contracts.[819] The test for fairness in UCTA 1977 says that when a business is dealing on its written standard terms of business, it cannot rely on a clause as entitling it to render a contractual performance substantially different from that which was reasonably expected, unless the clause is fair and reasonable.[820] It imposes a reasonableness test, that is, whether 'the term shall have been a fair and reasonable one to be included having regard to the circumstances…when the contract was made'.[821] In examining whether a term was fair and reasonable, the court would need to take into account both the extent to which the term was transparent and its substance and effect.[822] The application of UCTA 1977 is relevant to determine if a term was reasonable to incorporate into the contract, whereas under the 2015 Act the approach is one of reliance, that is, whether an insurer can rely on the term at the stage of a dispute. A detailed comparison between UCTA 1977 and the 2015 Act is beyond the scope of this thesis but it is germane to consider these differences and similarities given that insurance contract law is aligned with general contract law.

As was discussed in Chapter 2 there are overlapping boundaries between consumers and commercial parties and accordingly, the law which governs will invariably bear some similarities. This thesis claims that the 2015 Act furthers the ideology of consumer-welfarism as discussed in Chapter 2. Consumer-welfarism is a consumer protection orientated ideology that furthers principles, such as, reasonableness, ensuring a fair deal between contracting parties, fairness, relieving against harsh or unconscionable bargains

[818] Law Commissions, 'Issues Paper 2' (n 37). My emphasis.

[819] UCTA 1977, s3(1).

[820] The UCTA 1977, s3(2).

[821] ibid s11(1).

[822] The UCTA 1977, schedule 2.

and the principle of reasonable reliance.[823] As a consumer protection measure it protects the weaker party from exploitation at the hands of the stronger contracting party. It has paternalism as its underlying basis and is part of the realist ideologies of contract law as opposed to the formalist ideologies. The mechanism of the FOS and CIDRA 2012 are consumer-welfarist as they enhance consumer protection objectives and promote the above-mentioned features in contracts involving consumers or SMEs. Likewise in relation to the 2015 Act, the case studies also reflects 'consumerist' principles. For instance, s11 is intended to further the principle of reasonable reliance where insurers are precluded from relying on warranties in what are viewed as unconnected circumstances. This reinforces the view that an insurance contract is a relationship of security.[824]

Given the similarities between consumers and commercial parties, and the fact that the 2015 Act has provisions which also applies to consumers, it has to be recognised that consumer-welfarism and market-individualism are not polar opposites.[825] For instance, the requirement that the contracting out provisions which require the disadvantageous term to be brought to the attention of the insured, has been said to be in line with 'the marketist limb of the realist ideology'[826] in that it lets parties know where they stand.[827] This is particularly the case when contrasted with the approach to contracting out in relation to consumer insurance which prevents any contracting out that puts the assured in a more disadvantageous position. While that may be viewed as consumer-welfarist, the contracting out provisions in relation to non-consumer insurance may be viewed as market-individualist.

The point however, is that both these ideologies exists on a spectrum rather than being a dichotomy. If more emphasis is placed on values such as fairness, then the 2015 Act leans

[823] Adams and Brownsword, *Understanding Contract Law* (2007) 38-39.

[824] Jay Feinman, 'Contract and Claim in Insurance Law' (2018) 25 Connecticut Insurance Law Journal 159, 181. See also Clarke, *Policies and Perceptions of Insurance Law in the Twenty-First Century* (OUP 2005) 3-4.

[825] John Wightman, 'Reviving Contract' (1989) 1 MLR 115, 127-32.

[826] YongQiang Han, 'The Relevance of Adams and Brownsword's Theory of Contract Law Ideologies to Insurance Contract Law Reform in Britain: An Interpretative and Evaluative Approach' (PhD thesis University of Aberdeen 2013) 126; Adams and Brownsword, *Understanding Contract Law* (2007) 193.

[827] ibid.

closer towards consumer-welfarism. If freedom of contract is still viewed as a core value, then the Act leans more towards market-individualism. This is closely related to the question of the type and level of intervention that is appropriate in commercial markets. At least in the early stages, the 2015 Act is ripe with uncertainty. As Merkin and Gurses observe, 'to enforce a warranty after 12 August 2016, no less than seven questions have to be answered'.[828] Given these early interpretative difficulties it is unclear how effective the reforms will be in reducing transaction and legal costs.[829]

It may very well be said that any new piece of legislation is bound to have teething difficulties that will generate uncertainty, but this will be resolved over time as courts provide guidance and develop guidelines. That is true, but I would add that the design of the provisions of the 2015 Act, particularly s11, and the higher threshold for contracting out also speaks to the nature of legal regulation in modern commercial insurance contract law and the potential reach of interpretation.

Influenced by considerations of fairness, the design of the 2015 Act is reflective of a 'contextual' turn that the Law Commission probably actioned in order to assert 'the facilitative character of commercial contract law'. [830] By 'contextual' I mean the introduction of somewhat open-textured rules with an uncertain threshold (s11) and a higher threshold for contracting out, until such time as this is refined through case law. This will explained further at S 4.2.1.1 As Mitchell says, 'there is less emphasis on the rules and doctrines and more on the broad process of interpretation'.[831] This will require a reconceptualization of the judicial role in modern commercial (marine) insurance contract law.

With the reforms, it has been said that there could be a danger of fracture between judges familiar with the current model of insurance law who might not view such a clause as unusual or onerous (non-interventionist stance); compared to a judge who was critical of the 1906 Act system and may attempt to read down attempts to reinstate the prior position

[828] Merkin and Gurses, 'Insurance Contracts' (n 24) 461.

[829] Soyer, *Warranties in Marine Insurance* (n 2) 184.

[830] ibid.

[831] Catherine Mitchell 'Obligations in Commercial Contracts: A Matter of Law or Interpretation?' (2012) 65 Current Legal Problems 456.

(interventionist stance).[832] Although 'the precise contours of the legal role, and the specific design of the rules that will best facilitate commerce remain matters of debate', minimalism is the preferable option both for statutory and judicial regulation of marine insurance contracts.

3.8 Conclusion

This chapter has examined the substantive changes to the law of warranty and contracting out under the 1906 Act and the 2015 Act. It was shown that under the 1906 Act warranties were a crucial defence in an insurer's armoury to defend a claim, but in doing so, it exacted a draconian and punitive outcome. The most serious criticisms levelled against warranties was that there was strict liability with no possibility of remedying a breach, and once a warranty was breached it triggered the remedy of automatic discharge of all prospective liability irrespective of whether there was any causal connection between the breach and loss. This period was further characterised by conflicting judicial approaches: some judges chose to enforce a warranty strictly whereas others took a more interventionist stance to alleviate perceived unfairness.

At first glance, historical and policy considerations have rendered the reforms both welcome and fairly uncontroversial. The Law Commissions' tried to implement developments in general contract law in the reform of insurance contract law. The primary concern was to alleviate unfairness pertaining to warranties and to ensure that contracting out of the 2015 Act could only be done explicitly. In examining the provisions of the 2015 Act it was noted that the remedy of suspension of liability was generally welcome, but s11 remains one of the most controversial provisions of the 2015 Act until such time as there is clarity through judicial determination.

Section 11 has two primary tests: 'the category of loss test'[833] and 'the connection test'.[834] The interface between the purpose of the risk control term and the type of losses that may result is not entirely clear. The 'connection test' also asks how the threshold should be set, in other words, are judges likely to take a broad or narrow approach to the

[832] James Davey, 'Utmost Good Faith, Freedom of Contract and the Insurance Act 2015' (2016) 27 ILJ 253.

[833] The IA 2015, s11(1).

[834] ibid, s11(3).

interpretation and application of s11. This is important because the approach that is adopted is not just 'interpretative', rather the 'interpretative' approach will set the tone for the type of intervention that is appropriate in sophisticated commercial marine insurance contracts, which has implications for party autonomy.

The contracting out provisions consist of two tests: 'the transparency requirements'[835] and 'the qualifying transparency requirements'.[836] These tests have increased the threshold for contracting out and diluted party autonomy in sophisticated marine insurance markets. The Law Commissions have also provided insurers with the option of proving that the insured or its argent had actual knowledge of the disadvantageous term. It is yet to be seen what will amount to successful contracting out. Some commentators may argue that the 2015 Act has effected a relatively benign change to the law. This chapter has analysed the case studies under the 2015 Act to show that the substantive changes are not just important for understanding the changes to the law, but they serve a more crucial role: analysing the type of regulation that is the 2015 Act and how judges are likely to interpret and apply the 2015 Act. As Chapter 4 will demonstrate, the 2015 Act as seen through these case studies has engendered a new type of legal regulation that reflects 'contextualist' tendencies.

[835] The IA 2015, s17(2) and (3).

[836] ibid, s17(4).

Chapter 4: A Minimalist Reappraisal of Statutory and Judicial Regulation of Marine Insurance Contract Law

4.1 Introduction

The purpose of this chapter is to provide an important new normative perspective for commercial (marine) insurance contract law – both for the design of legislation and the judicial development of legislation and doctrine. This chapter develops two themes that were discussed in the previous chapters and, a new third theme:

(i) Statutory regulation and the design of default rules in commercial (marine) insurance contracts;
(ii) The rise of broader public law concerns in commercial insurance contract law and its sphere of activity; and
(iii) The implications of the Insurance Act 2015 ('2015 Act') on judicial regulation in relation to marine insurance contract law and practice.[1]

Point (i) can be divided into two streams: the first (seen in Chapter 3) pertains to the problems/uncertainties that arise with the interpretation and application of the provisions on warranties, risk control terms, and contracting out ('the case studies'). Most scholarship in this area[2] has focused on this stream and has viewed the case studies as a remedy to the identified problems in these areas.[3] Such scholarship has, however, not looked beyond such an approach to determine the nature of these statutory provisions in their own right as well as their place in commercial contracting. Consequently, there is an important second stream with which this chapter is now concerned: the regulation of marine insurance contracts. This second stream is important because it underpins the

[1] Judicial regulation refers to the development of case law through the interpretative approach that courts adopt in relation to statutes. Judicial regulation, as it is used here, does not deal with the making of new common law rules.

[2] For example, Robert Merkin and Ozlem Gurses, 'The Insurance Act 2015: Rebalancing the Interests of the Insurer and Insured' (2015) 78 (6) MLR 1004; Baris Soyer, 'Risk Control Clauses in Insurance Law: Law Reform and the Future' (2016) 75 (1) 109; Robert Merkin and Ozlem Gurses, 'Insurance Contracts after the Insurance Act 2015' (2016) 132 (3) Law Quarterly Review 445; Malcolm Clarke and others (eds), *The Insurance Act 2015: A New Regime for Commercial and Marine Insurance Law* (Informa 2017).

[3] See Section 3.2.3 in Ch 3.

approach to the first stream. In other words, understanding the type of statutory regulation (or what that regulation ought to be) in marine insurance markets allows courts to determine how to interpret and apply the case studies (judicial regulation). The provisions on risk control terms and contracting out concern new elements in the regulation of commercial insurance contracts: they introduce a new type of regulation that restricts party autonomy.[4]

Point (ii) claims that this new type of regulation reflects a contextualist turn in commercial insurance law. As was demonstrated in Chapter 3, insurance law has evolved from the era of Victorian codification of the Marine Insurance Act 1906 (the '1906 Act') to financial regulation through the Financial Ombudsman Service to the new statutory dispensation of the 2015 Act.[5] Society has changed and law cannot and should not remain static but should instead reflect modern developments. The reform of insurance contract law also follows on the heels of developments in general contract law There has accordingly been a re-arrangement of values underpinning commercial (marine) insurance contract law. Legal certainty and party autonomy (whilst still important) have been relegated to concerns that did not need to be actively encouraged in the reforms – fairness and protection of the policyholder have superseded those values. The reforms sought to strike a balance between freedom of contract and the protection of policyholders.[6] It would however be incorrect to assume that this thesis suggests that the 2015 Act reflects values that are entirely misplaced in commercial contexts. Indeed, there are few who would advocate for untrammelled party autonomy or legal certainty – even in sophisticated commercial markets like marine insurance.[7]

What is important to take away from the re-orientation of values underlying commercial insurance law is that the dichotomies highlighted in the previous chapters (such as public/private, protectionism/party autonomy, consumer/commercial,

[4] The Insurance Act 2015 ('the IA 2015'), s 11 (risk control terms), and ss 16-17 (contracting out).

[5] The Insurance Conduct of Business Services ('ICOBS') Handbook <www.handbook.fca.org.uk/handbook/ICOBS.pdf> accessed 12 May 2019.

[6] Special Public Bill Committee, *Insurance Bill* (HL 2014, 81) 3. B Soyer, 'Beginning of a New Era for Insurance Warranties' [2013] LMCLQ 384, 398.

[7] See 1.3.2 in Ch 1 for the definition of 'sophisticated' as it is used in this thesis and why marine insurance is deemed to be a sophisticated market.

contextualism/minimalism) are not 'either/or' categories. Rather, these dichotomies are a matter of degree in that they exist as a continuum rather than being polar opposites. During this transitional phase of the doctrinal development of insurance contract law, courts and the legislature are engaged in a partnership to reconstruct fundamental values and principles in insurance contract law; it is therefore essential to articulate the role of judges in giving effect to the work of the legislature.

Point (iii) will be considered from a theoretical perspective by revisiting the debate between contextualism and (neo) formalism discussed in Chapter 2. However, the focus for this chapter is on the fault-lines both between and within each school of thought pertaining to judicial regulation. In theory it reaffirms that the neo-formalist school of thought is better suited to the marine insurance market. It then considers 'the law' perspective by drawing on case examples to show how judges ought to approach the case studies.[8] In doing so, it demonstrates that the contextualism versus (neo) formalism debate is not binary – it would be reductive to say that the approach boils down to a matter of text versus context, or depends on whether 'the underlying judicial philosophy is textualism or contextualism'.[9] Minimalism does not preclude a contextual interpretation. In framing the debate in an insurance context, this chapter proposes that minimalism means an approach of least judicial interference in sophisticated commercial insurance contracts, such as marine insurance.

The approach adopted here is both original and relevant as scholarship to date on the 2015 Act has adopted a 'wait and see' approach.[10] Contemporary scholarship rightly accepts that the provisions of the 2015 Act introduce a measure of temporary uncertainty (particularly in relation to s11) due to the 2015 Act being a recent development, but that that will be cured in due course as judges interpret and give meaning to the provisions. However, the difference between that scholarship and this thesis lies in happens during that 'gap period' while awaiting judicial pronouncements. By adopting a reactive approach, contemporary scholarship has placed the entire burden of giving shape to the legislative provisions on the judiciary and has failed to recognise the important advisory

[8] The IA 2015, s10 (warranties), s11 (risk control terms), and ss16-17 (contracting out).

[9] Zhong Xing Tan, 'Beyond the Real and the Paper Deal: The Quest for Contextual Coherence in Contractual Interpretation' (2016) 79(4) MLR 623, 624.

[10] (n 2).

role that academics serve.[11] All it takes is an overly interventionist approach from the Court of Appeal when interpreting s11 in relation to marine insurance policies and this early case will set the judicial tone for later cases.[12] The 'gap period' is therefore important as, due to the precedent system, the early cases will effectively cement the judicial approach to intervention in marine insurance contracts and have broader implications for contracting in that market.

The structure of this chapter is as follows. First, it will examine the type of statutory regulation, making two important claims: (i) that s11 is regulation and that it deprives insurers of a contractual defence where the requirements of s11 have been met;[13] and (ii) that the nature of s11 is such that it denies or dilutes party autonomy in *all* commercial insurance contexts. Even though s11 is said to mirror developments in relation to innominate terms, the observation made in this thesis is that s11 has expanded the legislative boundaries of marine insurance law beyond formal, strict rules and introduces 'a more serious regulatory role on judges'.[14] The interface between s11 and the contracting out provisions[15] is examined as the latter also creates a new regulatory threshold before parties can successfully contract out of provisions of the 2015 Act.

Secondly, even though no clear-cut distinction exists between commercial and consumer, it is submitted that the regulatory objectives of the 2015 Act have brought the dividing lines between commercial and consumer insurance closer together. Thus the question arises of whether commercial insurance contract law is displaying symptoms of becoming a hybrid. Although there may be disagreement amongst scholars as to the nature and reasons for this hybridity, there is a clear shift away from the classical model of contract

[11] For example, there was a recent conference on 'Impact and Law Reform' co-organised by the SLS and SLSA at the Institute of Advanced Legal Studies in June 2019 discussing such topics.

[12] Marc Galanter, 'Why the "Haves" Come out Ahead: Speculations on the Limits of Legal Change' in R Cotterrell, *Law and Society* (Adershot, Dartmouth 1994).

[13] To reiterate, s11(3) precludes an insurer relying on a contractual defence if the insured is able to prove that breach of that risk control term could not have increased the risk of loss that actually occurred in the circumstances in which it did.

[14] Roger Brownsword and John Adams, 'The Unfair Contract Terms Act: A Decade of Discretion' [1988] Law Quarterly Review 94, 113.

[15] Which requires a court to take into account the characteristics of the insured and the nature of the transaction when determining if the provisions have been satisfied.

law, towards a blending of public (ie welfarist concerns) and private law (ie commercial insurance contract law) as discussed in Chapter 2. Scholars such as Hugh Collins, Catherine Mitchell and Jay Feinman have called for judges to take a more contextual/relational approach in developing the law. Morgan has however restated a neo-formalist approach. The target of this scholarship is on the consequences of breach of a contractual term rather than on the substantive term itself. This part of the chapter engages with the above scholarship to address the strengths and weaknesses of these views and suggests why minimalism is the better perspective for the repositioning of future doctrine in relation to marine insurance contracts.

Thirdly, as was made clear in Chapter 2, there is a distinction between scholarship and law. Contextualism is the more popular and mainstream school of thought in contract law *scholarship,* whereas courts have exercised restraint by remaining largely doctrinal. There have been recent judicial developments in commercial contract cases that require a reconsideration of freedom of contracts in commercial contexts[16] and relational theory.[17] This part examines the issue now facing the judiciary regarding whether the threshold in s11 and the contracting out provisions should be set low or high because of the nature of commercial contracting. The shaping exercise required of the judiciary requires an answer to the question: 'how contextual and, above all, which context?'[18] The judicial approach adopted in relation to the 2015 Act will importantly shape judicial attitudes to party autonomy in commercial insurance markets, like marine insurance.

Finally, a formalist restatement of commercial (marine) insurance contract law is made, which reaffirms why Morgan's minimalism sets a viable normative standard for courts to apply in shaping the development of the legislation (i.e. the 2015 Act) and the development of insurance contract doctrine.

[16] For example, a recent conference on 'The Contents of Commercial Contracts: Terms Affecting Freedoms' organised by the UCL Centre for Commercial Law in May 2019.

[17] *Alan Bates and Others v Post Office Limited* [2019] EWHC 606 (QB).

[18] Jonathan Morgan, *Contract Law Minimalism: A Formalist Restatement of Commercial Contract Law* (CUP 2013) 233.

4.2 Statutory Regulation and Commercial Contracting

4.2.1 The Insurance Act 2015

4.2.1.1 Sections 10 and 11: Regulation and Party Autonomy

As was stated by Lord Diplock in *Photo Production*, parties are largely free to agree and determine what primary obligations they will insert into their contracts.[19] Secondary obligations flow from breaches of primary obligations and may even entitle the other party to be relieved from further performance of its own primary obligations.[20] The contract is therefore both a source of primary and secondary obligations – both obligations, of which, may be modified by agreement between the parties.[21] A warranty in an insurance contract would be a primary obligation (eg a description of the subject matter or an obligation which an insured is required to fulfil or something that the insured is required not to do). For example, a warranty which requires the insured to not sail the insured vessel into areas prohibited under the insurance contract, or, a warranty requiring an insured to ensure that the vessel is surveyed, and the recommendations of the survey have been complied with before the voyage. Secondary obligations would arise on breach of the warranty (ie the primary obligation), such as that the insurer is discharged from all prospective liability, or, the insurer's liability is suspended until breach is remedied (if possible).[22]

The 2015 Act is a default regime which means that parties can contract out of the regime. At first glance this seems uncontroversial as a default regime implies a sense of choice – by implication it is not a mandatory regime. Coupled with the ability to contract out of the regime it also implies freedom of action – to not be subject to the default regime or to vary it. As this chapter will show, there are more layers to the simple characterisation of the 2015 Act as a default regime.

One of the layers relates to how immutable rules and default rules are neither conflicting paradigms nor are they diametrically opposed to each other; instead default rules and immutable rules exist on a continuum. Even though the case studies are classified as default rules,[23] this chapter claims that s11 and the contracting out provisions (unlike

[19] *Photo Production Ltd v Securicor Ltd* [1987] 1 AC 827 (HL) [20]. See S 2.6.1.

[20] ibid.

[21] ibid.

[22]. *Chitty on Contracts* (33rd edn, Sweet & Maxwell) [37-233].

[23] The contracting out provisions cannot be contracted out off.

section 10) are regulatory. Section 10 amended the effect of breach of warranty from automatic discharge of all prospective liability to suspension of liability, whereas s11 limits an insurer's right to rely on the defence (breach of warranty/risk control term). Section 11 therefore does not explain the effect of contractual provisions but rather deprives insurers of a contractual defence where the requirements of s11 (3) have been met.

This chapter claims that s11 is a 'one size fits all'[24] rule as it is not just geared towards weaker parties who require this protection but assumes that all parties that fall within the ambit of s11 are vulnerable and require that protection. It is the manner in which the secondary obligation is regulated that is new. Put differently, the consequences of breach of a risk control term is now more regulated as it permits an insurer to avoid its obligations under a narrower, controlled set of circumstances. This is the crux of the argument raised in this thesis and is used to support the claim that the 2015 Act (as viewed through the case studies) reflects a new type of statutory regulation for marine insurance It is also telling in relation to why the judicial approach matters in sophisticated commercial contracts, such as marine insurance. The debate -particularly that of the relational contract theory and contextualism - as applied to insurance law is concerned with the right of an insurer to avoid its obligations on breach of a risk control term, rather than with the underlying substantive obligation itself. The judicial approach will be discussed below.

The Unfair Contract Terms Act 1977 ('UCTA 1977') [25] serves as a useful comparison to s11 of the 2015 Act for two reasons: first, UCTA 1977 and the 2015 Act are both products of the Law Commissions; secondly, both give courts the power to regulate unfair contract terms in contracts and insurance contracts respectively. Insurance contracts are excluded from the ambit of the UCTA 1977 and prior to the 2015 Act insurance warranties were viewed as an unfair term, which insurers relied on as a defence to a claim by insureds.[26]

[24] SPBC (n 6) 95.

[25] The Unfair Contract Terms Act 1977 ('UCTA 1977') statutorily prevents the exclusion of contractual (and tortious) liability in contracts in certain circumstances for business liability. Parties who deal as consumers are no longer regulated by UCTA 1977 but fall within the ambit of the Consumer Rights Act 2015 ('the CRA 2015').

[26] Howard Bennett, 'Reflections on Values: The Law Commissions' Proposals with respect to Remedies for Breach of Promissory Warranty and Pre-formation Non-Disclosure and Misrepresentation in Commercial Insurance' in Baris Soyer (ed), *Reforming Marine and*

It is interesting to note that UCTA 1977 was viewed as 'innovative, even revolutionary, in its time',[27] yet the 2015 Act has been viewed as a 'revolutionary non-revolution'.[28]

The 'reasonableness test' in UCTA 1977 asks whether or not the term is a fair and reasonable one to have included in the contract in light of all circumstances known at the time of contracting[29] – this is said to be 'a very broad test'. Schedule 2 of UCTA 1977 provides a non-exhaustive list of factors to shape the ways in which judges apply and interpret the reasonableness test. UCTA 1977 is discretionary because of this aspect: 'judges are left to employ whatever presumptions they wish',[30] although that 'leeway' is channelled in a particular direction by Schedule 2.[31] Section 11 is different: the nature of the tests renders s11 as an open-textured rule, which creates a fixed, uncertain threshold until such time as certainty is established through case law.[32]

Commercial Insurance Law (Informa 2008) 158 and the UCTA 1977, s3. This section is not about the law of unfair contract terms.

[27] Hector MacQueen, 'Contract Law Reform by Statute in Common Law Systems' (Contract Law and the Legislature Workshop, York, 11th & 12th January 2019).

[28] Bernard Rix, 'Conclusion: General Reflections on the Law Reform' in Clarke, *The Insurance Act 2015* (n 2) 121.

[29] UCTA 1977, s11. See Hugh Beale (ed), *Chitty on Contracts* (33rd edn, Sweet & Maxwell) 15-097.

[30] Brownsword and Adams, 'The Unfair Contract Terms Act' (n 14) 102. A contrast should be drawn with the discretion in s2(2) of the Misrepresentation Act 1976

[31] UCTA 1977, s11(2). UK Parliament, *Explanatory Notes to the Insurance Bill* (2015) 130 <https://publications. parliament.uk/pa/bills/cbill/2014-2015/0155/en/15155en.htm> accessed 16 June 2019. The Explanatory note in the IA 2015 does not perform a similar channelling function since the wording of s11 is not congruent with the intended function of the Explanatory Note. To recap from Chapter 3, the Explanatory Note seems to imply a broad approach by looking at the general nature of the loss rather than on particular circumstances. But s11(3) does not accord with that – the inclusion of the words 'in the circumstances in which it did' implies some kind of connection but it is left to the courts to determine the type and degree of connection that is required to satisfy this section.

[32] The IA 2015, s11(1): 'whether compliance with a term is aimed at reducing the risk of a particular kind, at a particular location or at a particular time (the 'category of loss test') and s11(3): 'non-compliance with the term could not have increased the risk of loss which actually

Open-textured is defined as 'the failure of natural language to determine future usages, particularly the ability of predicates to permit the construction of borderline cases'.[33] From a legal perspective it is defined in jurisprudence as 'a term that describes the phenomenon that legal rules, being a function of language, are similarly subject to constant deferral of meaning'.[34] It is also a term of art that is used by scholars to define open-ended concepts such as good faith. For example, when discussing *The Yam Seng*, Simon Whittaker supported Lord Steyn's proposition that contract law should give effect to reasonable expectations, but he added that an 'open-textured' standard to regulate conduct would further uncertainty.[35] Likewise, Mitchell in describing Bernstein's empirical work said that Bernstein's work revealed that in private dispute resolution, traders preferred 'hard-edged formal trade rules (incorporated into contracts) rather than open-textured standards such as good faith'.[36]

For purposes of this thesis, 'open-textured' refers to a statutory rule that is not formal or strict; rather how it will be interpreted and relied on in future is uncertain. Section 11 is 'open-textured' because it is uncertain how exactly will courts determine if the 'category of loss test'[37] and 'connection test'[38] have been satisfied, and it will remain open -textured until a body of judicial precedent has been established. Section 11 is open-textured because it is also more regulatory than a discretion as it obliges a court to act. If the requirements of the 'category of loss test'[39] and 'connection test'[40] have been satisfied, courts are obliged to prevent an insurer relying on its contractual defence.

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occurred in the circumstances in which it did ('the connection test')'. See Sections 3.6.2 and 3.6.3 in Ch 3.

[33] Collins Dictionary < https://www.collinsdictionary.com/dictionary/english/open-texture> accessed 28 November 2019

[34] The Free Legal Dictionary <https://legal-dictionary.thefreedictionary.com/open-texture. accessed 18 November 2019.

[35] Simon Whittaker, 'Good Faith, Implied Terms and Commercial Contracts' (2013) 129 LQR 463, 463. *Yam Seng v International Trade Corp Ltd* [2013] EWHC 111 (QB), [2013] 1 All ER 1321

[36] Catherine Mitchell, *Interpretation of Contracts* (2nd edn, Routledge-Cavendish) 117-118.

[37] ibid.

[38] ibid.

[39] ibid.

[40] ibid.

Yet, the fact-specific nature of these tests makes it unclear in what circumstances it will be satisfied. It creates an uncertain threshold because the precise contexts that the Law Commissions had in mind in relation to s11 are not clear and there may well be situations in which s11 can be applied beyond the contexts that were intended by the Law Commissions or not applied to some contexts that it should have applied too. This further enhances the argument discussed in Chapter 3 that there may be a risk that s11 may not be interpreted as the Law Commissions intended. Indeed, one of the strongest criticisms levelled against s11 is the uncertainty surrounding its interpretation and application. Section 11 is not about whether the primary obligation is fair but rather whether the secondary obligation is fair. It is about the circumstances which would justify the right of an insurer to unilaterally avoid its obligations when a risk control term is breached.

Consider the example discussed in Chapter 3 where a cargo insurance policy contains a warranty that the goods are to be packaged in a particular way to minimise damage to the goods. One day there is a breach of that warranty (ie some of the goods have not been packaged correctly). It is uncertain how wide the ambit of that warranty extends and what type of losses would fail within its purview. Should the warranty apply to narrow contexts such as losses arising only from damage to the improperly packaged goods, or would it apply more broadly to include theft of all the goods (both that properly and improperly packaged) because the improper package allowed thieves to identify that there were valuable goods inside the (improper) packaging?

The Law Commissions say that it must be a broad (or weak) connection and this is likely to be the approach that insurers will enforce to catch a broader spectrum of losses that are connected to the term.[41] It is likely that the assured in most instances would be tempted to argue the opposite that compliance with a particular warranty would tend to reduce the risk of loss in a narrow fashion (or a strong connection).[42] Evidently this does not mean that such open-textured rules becomes infinite but the point is that much will be left to

[41] The Law Commissions were aware of the difficulties in this section and admit that there might be borderline cases that turn on their particular facts. English and Scottish Law Commissions, *Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties* (Law Com CP 204, 2012; SLC DP 155, 2012) 186.

[42] Baris Soyer, *Warranties in Marine Insurance'* (3rd edn, Routledge 2017) 184. Soyer says that the Law Commissions considerably downplayed the difficulties that can arise with respect to several types of promissory warranties. ibid.

the courts to determine where the threshold for s11 lies. This is the central issue regarding how judges should approach s11 and the determination of that threshold.

The debate discussed in Chapter 2 is intended to present differing views on the consequences of breach of a risk control term and the right of an insurer to avoid its obligations. The differing views centre on the right of an insurer to avoid its obligations, rather than on the substantive obligation itself (ie on the secondary than the primary obligation). The application of contract theory provides a useful tool in this determination as the judicial approach adopted will have implications for party autonomy and contracting in marine insurance markets. Contextualism and relational theory require context and, in particular, the social context of the contract to be a central consideration when considering the consequences on breach which permits party autonomy to be relegated to an ancillary concern. Minimalism, on the other hand, is critical of contextualism and relational theory and sees the contract (and therefore party autonomy) as the core aspect when determining the consequences for breach.

The point has been made that s11 is akin to regulation as even though the contract has provided for a contractual defence, the law has now intervened to prevent reliance on such a defence. That position subsists in relation to all non-consumer insurance contracts despite the diverse range of participants in commercial insurance.[43] In doing so, it dilutes party autonomy in markets that are more sophisticated, such as marine insurance.

4.2.1.2 Contracting Out and its Interface with Sections 10 and 11

The above position subsists where parties do not contract out of s11 and the default regime will then be applicable to their contract. Contracting out regulates not the primary obligation (ie the substantive term/warranty) but *awareness* of the primary obligation and, importantly, the secondary obligation (ie awareness of the consequences of breach of the term). Section 11 is a default rule whereas the contracting out provisions are a type of immutable rule.[44] To reiterate, it is important to recognise that these are not opposites but rather exist on a continuum. Default rules imply that parties can freely contract out of

[43] From Small to Medium Sized Enterprises to sophisticated marine insurance parties. See 1.3.1 in Ch 1.

[44] Default and immutable rules were discussed in Section 2.4.2.4 in Ch 2.

defaults. However, a more accurate view is that the law can place obstacles in how parties' contract out of default rules – a good example of that is the contracting out provisions in the 2015 Act.

To put it differently, s11 is not mandatory but the contracting out provisions are. Parties can contract out of s11, but they cannot contract out of the contracting out provisions. It was expected that contracting out of s11 would be widespread in markets such as marine insurance.[45] Much of the acceptance of s11 is also tied to the contracting out provisions on the basis that because sophisticated parties can contract out, s11 is not seen as an imposition. In doing so, party autonomy is upheld but parties are also protected by being made aware of any attempts to contract out through the requirements of contracting out being met.

The contracting out provisions only trigger when there is an attempt to put the assured in a worse position than it would have been under the 2015 Act. As the writers of Arnould state, '[f]or this reason, the 2015 Act seeks to limit the extent to which contracting out is permitted'.[46] But the significance of the interface between s11 and the contracting out provisions is more apparent when one considers the consequence of failing to satisfy the contracting out provisions. In that instance, the 'disadvantageous term' is rendered ineffective and is not simply interpreted *contra preferentem*.[47] Consequently, the default regime (ie s11) will then apply.[48]

Section 11 is applicable to all parties that fall within the ambit of s11 unless parties elect to contract out of that provision. Given the expectation that s11 will result in many sophisticated markets contracting out of that provision, the contracting out provisions are also now more regulatory. The relevant tests to contract out of s11 to a more onerous

[45] Marine insurance was specifically identified as a 'sophisticated market' in which it is 'expect[ed] that contracting out will be more widespread'. *Arnould Law of Marine Insurance and Average* (n 37) 20A-08. As was discussed in Chapter 3, The Lloyd's Market Association (LMA) has produced a suite of standard clauses, designed for use by insurers who wish to contract out of those aspects of the new Act where contracting out is permissible. The complete set of clauses can be found at <www.lmalloyds.com/actclauses> accessed 25 April 2018.

[46] ibid 20A-01.

[47] ibid.

[48] This will be elaborated on further when analysing the type of default rules in Section 4.2.3.

position are the 'transparency requirements' [49] and the 'qualifying transparency requirements'.[50] The former test requires that when contracting out, the term has to be drawn to the other party's attention and that it is clear and unambiguous as to its effect.[51] In assessing those requirements, the latter test requires that the characteristics of the parties and the circumstances of the transaction are taken into account.[52] The Explanatory Note to the 2015 Act provides little guidance to courts on how to interpret the 'qualifying transparency requirements', except to say that, '[w]hat is sufficient for one type of insured may not be sufficient for another'.[53]

The Law Commissions provided a 'fall back' option where insurers are unable to satisfy the 'transparency requirements' and the 'qualifying transparency requirements'. Insurers may still rely on the disadvantageous term if they can prove that the insured or its agents had actual knowledge of the consequences of breaching the term.[54] In marine insurance, brokers are frequently used and therefore this would mean that actual knowledge is present in a considerable portion of cases.

The point has been made that s11 is akin to regulation as even though the contract has provided for a contractual defence, the law has now intervened to prevent reliance on that defence. This position applies to all commercial insurance parties and consequently dilutes party autonomy in commercial insurance contracts. This thesis has claimed that this dilution of party autonomy through s11 should not be found in sophisticated markets, such as marine insurance. Similarly, the contracting out provisions were an attempt to balance freedom of contract and protection of policyholders[55] and were therefore meant to 'be workable for a large range of risks and contracts.'[56]

[49] The IA 2015, s17(2) and (3).

[50] ibid, s17(4).

[51] The IA 2015, s17(2) and (3).

[52] ibid, s17(4).

[53] UK Parliament, *Explanatory Notes to the Insurance Bill* (2015) 130 <https://publications.parliament.uk/pa/bills/cbill/2014-2015/0155/en/15155en.htm> accessed 16 June 2019.

[54] The IA 2015, s17(5).

[55] *Arnould Law of Marine Insurance and Average* (n 47) 20A-13.

[56] ibid.

The contracting out provisions constitutes a greater intervention into freedom of contract than under the 1906 Act which simply required that a contrary intention be expressed to contract out of that Act. Yet it is increasingly recognised that freedom of contract is not absolute and the law is justified in placing limits on freedom of contract, such as where there are information asymmetries between contracting parties. The contracting out provisions are an attempt to make consent 'less thin' by ensuring that there is informed consent to the inclusion of any disadvantageous terms in the contract. Yet the Law Commissions recognised that in relation to sophisticated markets the:

> insurers' contractual freedom is one of the (worth preserving) advantages of the UK insurance market: "[t]he enormous value of the UK insurance market depends on the existence of a flexible legal regime … Given the range of risks which may be covered by the non-consumer regime, parties may need freedom to agree bespoke arrangements in their contracts."[57]

Both s11 and the contracting out provisions represent new types of regulation for marine insurance that restrict party autonomy in these sophisticated markets. There may well be disagreement with the view postulated above that s11 and the contracting out provisions are regulatory. Catherine Mitchell, for instance, has said that the rules of contract law are being increasingly repositioned so that:

> the role of the rules is not to function as independent external standards that regulate the agreement, but to assist in an interpretative exercise of deciding what the agreement between the parties means.[58]

Mitchell terms this the 'interpretative turn'.[59] In Mitchell's view s11 and the contracting out provisions would not be deemed regulatory but are rather aids to interpretation. Indeed some may say this accords with the policy objective underlying reform, which was to develop a 'principles-based approach' that would place more power in the hands of the courts to develop the law flexibly and organically. In 'reconceptualising the judicial

[57] George Leloudas, 'Contracting Out of the Insurance Act 2015 in Commercial Insurance Contracts' in Clarke and Soyer (eds), The Insurance Act 2015 *A New Regime for Commercial and Marine Insurance Law*, (Informa Law from Routledge 2017) 95.

[58] Catherine Mitchell, 'Obligations in Commercial Contracts: A Matter of Law or Interpretation?' (2012) 65 Current Legal Problems 455, 456.

[59] ibid.

role'[60] as one of interpreting the contract, Mitchell adds that 'the interpretative process itself has been re-evaluated to embrace a contextual rather than textual method'.[61]

When applied to the 2015 Act there may well be disagreement on whether s11 and the contracting out provisions are in fact regulatory or whether they are simply a guide to interpretation. From the above discussion it was shown that s11 is a fairly open-textured rule (at least for a period of time) while the contracting out provisions contain a requirement for differentiation when contracting out based on the parties and the transaction (ie 'the qualifying transparency requirements').[62] This implies a contextual, fact-driven approach in the interpretation and application of these provisions. Nevertheless, even if Mitchell's perspective is correct and the judicial role has been reconceptualised to one of using the statutory default rules to interpret the contract (as opposed to regulating it), it can be accepted that both are novel approaches to the design of a legal regime for marine insurance law and hence is therefore a new type of regulation. The issue then arises as to how courts should adopt a minimalistic approach to interpretation in relation to marine insurance contracts and why they should do so.

4.2.2 The Regulatory Objective of the Insurance Act 2015

As discussed in Chapter 2, regulation is never uniform but is rather designed in a manner to suit particular sectors and contracting parties. In the realm of consumer law there has been an emergence of consumer protection legislation, in other words, welfarist regulation, which is necessary to protect consumers.[63] As will be discussed below, Hugh Collins's idea of regulation would be more suitable to areas like consumer law.[64] In relation to commercial transactions it can be argued that in appropriate cases core commercial law values such as freedom of contract and legal certainty should be tempered

[60] Mitchell, 'Obligations in Commercial Contracts' (n 60) 459.

[61] ibid.

[62] The IA 2015, s17(4).

[63] For example, the Consumer (Insurance and Disclosure Representations) Act 2012 ('CIDRA 2012') and the CRA 2015.

[64] Steve Headley, 'Two Laws of Contract, or One?' (Contract Law and the Legislature Workshop, York, 11th & 12th January 2019).

to accommodate considerations of fairness. This is particularly understandable in relation to less sophisticated commercial parties.

However, there are other areas of law that are better suited to a minimalist form of regulation, and commercial marine insurance is one such area. The perspective proposed in this thesis neither endorses the view that the law should not pursue welfarist concerns at all, nor does it say that this should not be the case in relation to commercial parties. The perspective is more nuanced: rhetoric suggesting that the law should adopt a welfarist approach should be more limited and should be applied cautiously in relation to sophisticated marine and commercial insurance markets.

From the above discussion on the 2015 Act two trends can be identified: that statutory regulation is protectionist or paternalistic, and that party autonomy has been diluted. It has been stated that the 2015 Act is intended to bring insurance contract law in line with developments in general contract law. In addition, the public regulatory framework as seen through the FOS and ICOBS has as its guiding principles inter alia fairness (both procedural and substantive), and fair payment of claims. Indeed, the 2015 Act moved swiftly through Parliament as an uncontroversial bill because it was viewed as effectively codifying the position adopted by the FOS[65] and one can add, as bringing insurance law in line with general contract law. It is recognised in this thesis that the dominant rhetoric guiding legislation in the area of commercial insurance contract law is fairness or the protection of policyholders. The emergence of paternalistic concerns or consumer protection elements in marine insurance markets brings to the fore the regulatory objectives of commercial insurance contract law and the matter of how to manage the tension that arises between such public law concerns and freedom of contract. This section deals with what the default approach of the law should be for sophisticated commercial insurance markets, and leads to a discussion on how courts ought to respond to that default approach.

It is generally accepted that the regulatory threshold for intervention in consumer contracts is lower than commercial contracts.[66] Commercial and consumer are recognised

[65] SPBC, *Insurance Bill* (n 6).

[66] Rajiv Shah, Morgan's Minimalism: An Epistemic Approach to Contract Law' (2016) 28 (3-4) Critical Law Review 356, 370.

as distinct spheres although some degree of overlap between the regimes is unavoidable.[67] The reason for these distinct spheres is because the objectives and policy considerations underlying consumer protection legislation is different to that pertaining to the private law of contract (commercial parties). In the case of consumer protection legislation there is a need to cure information asymmetries and inequality of bargaining power that exists between parties. Consumer law also calls for more paternalistic measures in ensuring: that consumers are able to make informed choices; and that contracts are both procedurally and substantively fair – it is not just about the process in how contracts are made, but about its substance as well. In furthering these objectives certain types of clauses are prohibited in consumer contracts, such as unfair terms [68] or exclusion clauses[69], and this paternalistic approach allows for statutory intervention into contracts.[70]

From a public regulatory perspective, the FOS is primarily geared towards coming to the aid of consumers. As part of the regulatory structure governing insurance business, ICOBS limits the impact of the 2015 Act as insurers are not permitted to act unfairly towards consumers (and small businesses) by rejecting a claim unfairly.[71] This is an example of how regulatory principles may impinge on the parties' contractual relationship. The FOS decides cases based on what is 'fair and reasonable in all the circumstances having regard to principles of law, good practice, equitable conduct and good administration'.[72] The FOS decisions are a body of soft law that is independent of what happens in court.

On the other hand, the private law of contract holds values such as party autonomy and commercial certainty as core values.[73] Even though the default regime of the 2015 Act cannot entirely be explained by 'consumer protection', the resemblance indicates a new

[67] Chris Willett, *Fairness in Consumer Contracts* (Aldershot 2007). Cf Chris Willett, 'Re-Theorising Consumer Law' (2018) 77 Cambridge JL 179, 190.

[68] The CRA 2015; UCTA 1977.

[69] ibid.

[70] See Roger Brownsword, *Contract Law Themes for the Twenty-First Century'* (2nd edn, OUP 2006; Iain Ramsay, *Consumer Law and Policy* (2007).

[71] Arnould *Law of Marine Insurance and Average* (n 47)3-40.

[72] Consumer Ombudsman, *Terms of Reference* 9.9.

[73] Hugh Collins, *The Law of Contract* (4th edn, LexisNexis 2003) 7.

type of regulation in these markets.[74] As was discussed in Chapter 3, the case studies in the 2015 Act reflect values underpinning consumer-welfarism.[75] The objective behind the contracting out provision was to ensure that there was an element of informed consent and, indeed it would difficult to argue (or accept an argument) that there should not be informed consent. Such an argument is not made in this thesis even in relation to contracts between sophisticated commercial parties. Informed consent is not specific to consumer contracts as consumer-welfarism invariably overlaps to a degree with market-individualism, much in the same way as a clear demarcation between consumer/commercial is not always possible.[76] Indeed it may well be argued that the 2015 Act does not reflect consumer protection tendencies and is simply a fairer regime than the 1906 Act. That the 2015 Act is a fairer regime (or aims to be) is correct. Indeed, there is a fine line and an invariable overlap

This thesis does not argue that the 2015 Act is not a fairer regime or that fairness should not be pursued by the law – the argument is more nuanced. In pursuing these fairness objectives, the 2015 Act reflects a design that is similar to consumer protection in commercial insurance markets, particularly sophisticated commercial markets. Even though the 2015 Act is not a consumer protection statute, the rhetoric underlying consumer protection is reflected in the objectives and design of the 2015 Act. As consumer-welfarism and market-individualism exist on a spectrum, the 2015 Act has appreciably shifted the statute governing insurance law from a formalist approach to one which embraces objectives of consumer protection, including curing information

[74] As discussed in Chapter 3, s11 and the contracting out provisions bear resemblance to CIDRA 2012 and the CRA 2015.

[75] Discussed in Section 3.7 in Ch 3.

[76] YongQiang Han, 'The Relevance of Adams and Brownsword's Theory of Contract Law Ideologies to Insurance Contract Law Reform in Britain: An Interpretative and Evaluative Approach' (PhD thesis University of Aberdeen 2013) 19. Han gives the example that:

> [a]n absence of protection of the weak participants in the market, e.g. small and medium businesses, could inhibit the proper functioning of the market. Equally, asymmetrical bargaining positions can be seen as distorting markets and thus also need counterbalance as is the case in consumer-welfarism'.

asymmetries and the inequality of bargaining power,[77] informed choices,[78] and procedural and substantive fairness.[79]

These objectives also reflect the public regulatory objectives as seen through the FOS and ICOBS which reflects a 'co-opting of private law in the service of public purposes, and in particular, the development of a regulatory mindset that views the law of contract as a tool to be shaped and applied for such purposes'.[80] By bringing the 2015 Act more in line with the approach of the FOS which is consumer-orientated and intended to protect weaker parties in a contractual relationship, the reforms are indeed connected to these regulatory objectives.

The 2015 Act was meant to apply to a range of commercial insurance contracts even though s11 does not explicitly call for a differentiation in the way the contracting out provisions do. Section 11 is regulation that pursues instrumental concerns, such as fairness in relation to all commercial parties, whereas the 'qualifying transparency requirements' expressly provide for differentiation.[81] As will be discussed below, sophisticated parties should be held to a different set of rules grounded in freedom of contract. But why should sophisticated parties, such as parties to a marine insurance contract, be held to a different standard, or why should they have more party autonomy?

As discussed in Chapter 1, it can be presumed that sophisticated parties relative to each other have the experience, knowledge and resources to be aware of the terms of the contract and be able to negotiate those terms from a fairly even keel and order contract risks sensibly.[82] In these transactions, freedom of contract should prevail and parties should be held to their bargains unless there are strong public policy considerations weighing against them. Conversely, where a party is not so sophisticated a less formalist

[77] The contracting out provisions in the IA 2015, s17.

[78] ibid.

[79] ibid.

[80] Van Gestal, Micklitz and Rubin, 'Introduction' in Van Gestal, Micklitz and Rubin (eds), *Rethinking Legal Scholarship: A Transatlantic Dialogue* (CUP 2017) 1.

[81]The IA 2015, s17(4).

[82] Although parties are never on an exact equal footing.

approach may be more appropriate[83] This sentiment has been expressed by some members of the judiciary by being cautious about intervening in contracts between commercial parties.[84]

As stated above, consumer-welfarism and market-individualism exist on a spectrum and values such as fairness and party autonomy underlie both ideologies but with a differing level of emphasis. This can be seen with the contracting out provisions where the 2015 Act restricts party autonomy in all non-consumer contracts by placing restrictions on the ability of parties to contract out of the Act. Yet in acknowledging that some of these values require greater protection in some contexts than others, the Act allows for courts to take into account the type of parties and market when determining the weight to be given to the parties' contract (ie freedom of contract).

There has not been a revival of freedom of contract if one considers statutes like UCTA 1977 and the 2015 Act.[85] As Davey says:

> [i]nsurance law therefore needs to identify a new unifying principle. This might be a renewed enthusiasm for freedom of contract: for enforcing terms agreed by the parties.[86]

He continues:

> … consideration is made of the extent to which freedom to contract around statutory defaults remains at the heart of insurance contract law. This matters

[83] Meredith Miller,' Contract Law, Party Sophistication, and the New Formalism' (2010) 75(2) 493, 497-8.

[84] *Photo Production Ltd v Securicor* [1980] UKHL 2. This approach has been alluded to in a number of cases, including by the Court of Appeal in *Watford Electronics v Sanderson* 2001] 1 All ER (Comm) 696; *Granville Oil & Chemicals Ltd v Davis Turner & Co. Ltd* [2003] EWCA Civ. 570.

[85] For example, a recent article by John Lowry and Rod Edmunds, '*The Reform of Insurance Warranties: Looking Beyond the Past'* (The Contents of Commercial Contracts: Terms Affecting Freedoms, UCL, May 2019), which shows that it is not enough to dismiss freedom of contract arguments as 'old hat' but that its place in commercial contract has a renewed significance.

[86] James Davey, 'Utmost Good Faith, Freedom of Contract and the Insurance Act 2015' (2016) 27 ILJ 253.

> because a shift away from freedom of contract might mark a shift towards insurance law as a body of regulatory principles rather than contractual norms. If true, then the era of the libertarian Victorian codification is well and truly over.[87]

The evidence adopted to support the above discussion is drawn from comments made during the law reform process, particularly by the marine insurance sector.[88] It also draws on empirically based accounts in contract law[89] and recognises that the available evidence is incomplete as different markets need different things. However, by drawing on the evidence that is available coupled with a theorisation of commercial insurance contract law, this thesis submits that welfarist regulation has no place in relation to sophisticated marine insurance markets and that s11 and the contracting out provisions are not needed in these markets. Rather this area of law should be shaped by pragmatic concerns, such as producing workable rules that will promote certainty in market dealings[90] and in ensuring that there are clear and simple rules that allow the parties to make contracts with the comfort of knowing how they will be enforced.[91]

4.2.3 Regulatory Objectives and Statutory Design of the Insurance Act 2015

Having considered the objectives of the 2015 Act, I use default rules analysis to highlight the paternalistic approach in its design. As discussed in Chapter 2, there are default rules and there are immutable (or 'mandatory') rules. The former are less controversial as they

[87] ibid 3.

[88] SPBC *Insurance Bill* (n 6) 19-20

[89] Hugh Beale & Tony Dugdale, 'Contracts between Businessmen: Planning and the Use of Contractual Remedies' (1975) 2 British Journal of Law and Society 45; Robert C Ellickson, *Order Without Law: How Neighbors Settle Disputes* (Harvard University Press 1991); Lisa Bernstein, 'Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry' (1992) 21 Journal of Legal Studies 115; Lisa Bernstein, 'Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms' (1995-1996) 144 University of Pennsylvania LR 1765; Lisa Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms and Institutions' (2000-2001) 99 Michigan LR 1724.

[90] See for example Bernstein, 'Merchant Law' (n 92); Bernstein, 'Private Commercial Law' (n 75).

[91] See generally Morgan, *Contract Law Minimalism* (n 18).

can be altered by parties, which is less of an imposition on party autonomy.[92] Ian Ayres has also highlighted that it is not just how the default rule is chosen but also how parties can change a default rule by contracting out that matters.[93]

This thesis claims that the default rule in s10 is deemed to be a majoritarian default whereas s11 is a penalty default insofar as it applies to sophisticated commercial parties.[94] The former is a default rule that the majority of contractors would want, which reduces transaction (drafting) costs as more parties would be content with such a rule[95] and it satisfies 'reasonable expectations'.[96] Section 10 was viewed as necessary by the insurance industry given the criticism of the remedy for breach of warranty under the 1906 Act.[97] The marine insurance industry also welcomed the reform of the remedy of suspension of liability in s10,[98] hence s10 is a majoritarian default. The regulatory principle that claims are not to be rejected unfairly by insurers has now had an impact on the contractual relationship as the 2015 Act has created a new default remedy upon breach of warranty, thereby regulating the secondary obligations.

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[92] Jonathan Morgan, 'Immutable or Default Rules? Compulsion, Choice and Statutory Intervention in Contract Law' (Contract Law and the Legislature Workshop, York, 11th & 12th January 2019).

[93] Ian Ayres, 'Regulating Opt Out: An Economic Theory of Altering Rules' (2012) 121 Yale LJ 2032.

[94] This is what Ian Ayres and Robert Gertner have dubbed 'penalty defaults'. See Ayres and Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 Yale LJ 87. Some have suggested that there are in fact no penalty defaults, see Eric Posner, 'There Are No Penalty Default Rules in Contract Law' (2006) 33 Florida State Univ LR 563. But cf Ian Ayres, 'Ya-huh: There are and should be Penalty Defaults' (2006) 33 Florida State Univ LR 589.

[95] Morgan, *Contract Law Minimalism* (n 18) 92.

[96] ibid. But the debate regarding when default rules should be penal as opposed to majoritarian is irresolvable due to a lack of empirical data. See also Eric Posner, 'Economic Analysis of Contract Law After Three Decades' (2003) 112 Yale LJ 829.

[97] The Marine Insurance Act, 1906 ('The MIA 1906'), s33(3) provided that an insurer is automatically discharged of all prospective liability irrespective of whether there was a causal connection between the breach and loss.

[98] SPBC, *Insurance Bill* (n 20) 3.

A penalty default refers to a default rule which legislators deliberately make undesirable in order to encourage contracting out of that rule. In so doing, it forces parties to reveal information about their preferences which leads to a more transparent and fully-informed agreement.[99] It is argued that this is to incentivise the disclosure of welfare-enhancing information[100] thereby curing information asymmetries between parties.[101] It would be hard to classify s11 as a majoritarian default rule. The Law Commissions were aware that s11 was an unpalatable rule for some markets and that there were likely to be general problems with its interpretation and application, yet they adopted it on the basis that parties can still contract out of it.[102] Morgan's view is 'that penalty defaults may be a useful tool but one of very uncertain value in practice'.[103] Ayres and Gertner too accept that there are serious practical difficulties with applying the penalty approach.[104] The conclusion is not that majoritarian defaults must always be more efficient in practice – sometimes penalty rules would be optimal, but it is impossible to say when.[105] Ayres and Gertner admit that introducing real-world behaviour[106] makes the determination of efficient rules 'dramatically more difficult', so that there is little hope that lawmakers will be able to divine the efficient rule in practice.[107]

The Law Commissions attempted to bring insurance contract law in line with general contract law and s11 is meant to follow the approach of innominate terms by focusing on the seriousness of breach. However section 11 is of uncertain value in sophisticated commercial insurance markets and is an unnecessary intrusion in these markets due to the manner of contracting in marine insurance markets coupled with the fact that these

[99] Ayres and Gertner, 'Filling Gaps' (n 97).

[100] ibid.

[101] Morgan, *Contract Law Minimalism* (n 18) 92. See also Lisa Bernstein, 'Social Norms and Default Rules Analysis' (1993) 3 Southern California Interdisciplinary LJ 59.

[102] SPBC, *Insurance Bill* (n 6).

[103] Morgan, *Contract Law Minimalism* (n 18) 92.

[104] ibid 118. Ayres and Gertner, 'Filling Gaps' (n 97).

[105] Morgan, *Contract Law Minimalism* (n 18) 119.

[106] Are gaps in contracts due to strategic incompleteness or prohibitive drafting costs, in which case the majoritarian approach would seem more fruitful. If negotiations are induced will this reveal information valuable enough to offset the increased transaction cost? If information is withheld strategically parties will also react strategically to a regime of penalty defaults. ibid 118.

[107] ibid.

markets are fast-paced, involving sophisticated insureds and insurers.[108] As was stated in the Special Committee Report,[109] the marine insurance industry accepted that certain reforms were necessary, such as changing the remedy for breach of warranty from automatic discharge of all prospective liability[110] to suspension of liability in s10. However, the marine insurance industry pushed back against s11 and viewed it as unnecessary.[111] In this market the guiding principle should be freedom of contract rather than binding contracting parties to an unpalatable rule. The corollary is not, of course, that information should not be disclosed or that parties should enter into contracts with their eyes closed. As Morgan has said, penalty defaults may be of value in some instances but the fact that it is impossible to know when these instances arise means that s11 is a step too far.

'The form of default rules influences the ease of modification'.[112] Ayres has contended that given that default rules can be altered, any theory about default rules should have an associated theory of 'altering rules' to determine 'the extent to which the defaults are modifiable and how this can be done'.[113] The type of altering rule is influenced by the underlying purpose, for example, permissive altering rules would further the goal of minimising transaction costs for parties who wish to contract out of a particular default rule.[114] This concept of paternalism is relevant when examining the concept of altering rules as the type of paternalism influences the type of altering rules.[115]

At one end is hard paternalism, which justifies mandatory rules; at the other is a kind of 'soft' or 'libertarian' paternalism, whereby instead of prohibiting opt-out, lawmakers use altering rules to intentionally increase the difficulty of displacing defaults to respond to

[108] English and Scottish Law Commissions' Report, *Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment* (Law Com Report 352; SLC Report 238, 2014, 315.

[109] SPBC *Insurance Bill* (n 6) 19.

[110] The MIA 1906, s33(3).

[111] SPBC *Insurance Bill* (n 6) 19-21.

[112] Morgan, *Contract Law Minimalism* (n 18) 93.

[113] ibid. See also Ayres, 'Regulating Opt Out' (n 96) 2032.

[114] Morgan, *Contract Law Minimalism* (n 18) 93.

[115] Ayres, 'Regulating Opt-Out' (n 96) 2045.

problems of paternalism.[116] To the extent that contracting out is obstructed whether *de facto* or as a matter of law, the default becomes 'sticky' – or quasi-mandatory.[117] There will always be some stickiness since contracting out is never costless.[118] Reasons other than drafting costs may make the default rule 'stick' even when it is undesirable. Suspicion will be generated when one party wishes to 'opt out' from a default rule as the other party may fear that such deviation from the norm indicates some unknown problem or indicates a legalistic or even litigious attitude.[119] It is therefore a very real possibility that parties can also fail to successfully 'opt out' of rules.

An insurer is required in terms of ICOBS to ensure that any information is communicated in a manner that is clear, fair, and not misleading.[120] In this respect, the contracting out provisions also reflect regulatory principles that parties should be made aware of terms in their contracts and this has also impinged on the parties contractual relationship as insurer's are specifically required to draw an insured's attention to any term that puts the insured in a worse position than he/she would be under the 2015 Act and also to draw attention to the effect of the term in question.

Contracting out under the 2015 Act therefore adopts a more 'paternalistic' approach compared to the 1906 Act. James Davey says that, '[i]n regulatory parlance, this is a highly 'sticky' default',[121] going on to elaborate that '[t]his is not the removal of freedom of contract, but it places significant regulatory costs on attempts to move from the default regime'.[122] He critically adds that:

[116] ibid 2046.

[117] ibid 92. See Omri Ben-Shahar and John Pottow, 'On the Stickiness of Default Rules' (2006) 33 Florida State University LR 531.

[118] Morgan, *Contract Law Minimalism* (n 18) 92.

[119] ibid 94.

[120] Rob Merkin and Jenny Steele, *Insurance and the Law of Obligations* (OUP 2013) 82.

[121] On the nature of sticky defaults generally, see R Korobkin & T Ulen 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 Cal L Rev 1051 and for an insurance-specific discussion, see James Davey, 'Claims Notification Clauses and the Design of Default Rules in Insurance Contract Law' (2012) 23 Ins LJ 245.

[122] Davey, 'Utmost Good Faith' (n 89).

> this is the somewhat insidious limit on the freedom of contract that often goes unnoticed and is considered by many as the dead hand of regulation, where the State should leave well alone.[123]

This thesis claims that the contracting out provisions are a sticky default rule, particularly when compared to the manner of contracting out under the 1906 Act which simply required a contrary intention to be expressed. However, the counter-argument is that the contracting out provisions are in line with developments in general contract law which is simply to ensure that there is informed consent. As was discussed previously, informed consent does not solely lie within the domain of consumer contract or consumer-welfarism but is a necessary ingredient in any contractual relationship. In recognising this, it would be difficult to ignore the difference in the design of the contracting out provisions compared to s11. In relation to the contracting out provisions, the Law Commissions incorporated informed consent through the transparency and qualifying transparency provisions but also with the additional requirement of 'actual knowledge'. This provides sophisticated parties with two possible avenues to ensure that their attempts to contract out of the 2015 Act are given effect to.

It may be inferred from the above analysis that the design of s11 and the contracting out provisions could have been designed better and it is therefore useful to consider some alternatives. First, perhaps if s11 had a broadly discretionary application of a standard such as that of 'reasonableness' in UCTA 1977, then much of the above criticisms with s11 would dissipate, or perhaps if s11 had a 'sliding scale'[124] approach, similar to the contracting out provisions that would eradicate the problems with s11 being equally applicable to *all* commercial parties. The minimalist response to this would be that statutory regulation requires clarity and formality from the law.[125] Minimalism also means a minimally 'sticky' default regime, which means that parties prefer, and the law

[123] ibid.

[124] The 'sliding scale' refers to The IA 2015, s17(4) which provides for differential criteria to be applied based on 'the characteristics of insured persons…and the circumstances of the transaction' in determining if the contracting out provisions in s17 (2) and (3) have been satisfied.

[125] Morgan, *Contract Law Minimalism* (n 18) 88.

should adopt, default rules that are 'strict, formal and rule-based'[126] that are easier to displace by contracting out.

The above discussion centres on a much bigger debate regarding what the optimal default rule should be, and this is much harder to apply in practice. The bigger debate is beyond the scope of this thesis, except to say that there is no consensus on the matter. It is important to take away from the discussion on the design of (insurance) contract rules that it is within Parliament's right to be guided by public policy concerns when determining whether a rule should be mandatory or default, and if a default, how that rule may be displaced.[127] This is particularly welcome in relation to parties who are in need of protection, such as consumers or SMEs, or where the common law has not been able to effectively resolve issues. For example, legislative intervention was found to be more satisfactory through statutory control over exclusion clauses (UCTA 1977) than through the common law device of *contra proferentem* interpretation.[128]

As this chapter argues, statutory reform was necessary in commercial insurance contract law, but there are problems that arise with the application of the default rules to sophisticated insurance contracts. The Law Commissions' view was that it was important to maintain freedom of contract in commercial insurance law but that there was a justifiable limitation to that right in the interests of ensuring a more balanced regime between the insured and insurer.[129] The Law Commissions had in mind commercial parties that needed statutory protection; for more sophisticated parties the contracting out provisions were viewed as the 'saving grace'. In other words, if parties can contract out of the case studies then freedom of contract is preserved to an acceptable level.

This thesis claims that from a minimalist perspective, the addition of s11 to the 2015 Act should have been tempered by simple contracting out provisions that should have been easy to contract out off. However the contracting out provisions were designed and included to preserve the objectives of s11 in the 2015 Act, otherwise parties could simply

[126] Jonathan Morgan, 'In Defence of *Baird Textiles*: A Sceptical View of Relational Contract Law' in Campbell and others (eds) *Changing Concepts of Contract: Essays in Honour of Ian Macneil* (Palgrave Macmillan 2013) 178.

[127] Morgan, 'Immutable or Default Rules?' (n 95).

[128] ibid.

[129] SPBC *Insurance Bill* (n 6) 1.

contract out of s11 and render the reforms ineffective. The true success of the reforms lies in judicial regulation as the idea behind the reform was to create a neutral regime and leave it to the courts to develop the legislation and insurance contract doctrine. The true extent of 'stickiness' of the contracting out provisions therefore lies with how courts interpret these provisions. Should courts take a more lenient approach as was intended by the Law Commissions in relation to sophisticated parties, then the contracting out provisions will be less sticky. But if courts try to preserve the default rules and to defeat attempts to contract out including by not giving effect to the 'actual knowledge' route then the contracting out provisions will be more sticky in relation to sophisticated parties. Judges may well interpret in line with the what the Law Commissions intended but until there is case law, the judicial approach remains uncertain.

It is to the courts that we must now look to rein in the reach of the 2015 Act in sophisticated insurance markets. As will be elaborated on below, the emphasis ought to be on how judges should rein in the statutory thresholds in the 2015 Act to minimise interference with party autonomy in sophisticated commercial cases. This becomes more acute as judicial regulation can be both a protectionist and regulatory tool when courts try to instil fairness through interpretative approaches.[130]

4.3 Theoretical Perspectives for Reconceptualising the Judicial Role

4.3.1 An Overview

In the discussion above the regulatory objectives for marine insurance contract law were examined along with how the statutory design of the 2015 Act reflects a change in the regulatory objectives of marine insurance contract law from certainty and freedom of contract to fairness and protection of policyholders. Now that the 2015 Act is in place, this section turns to consider the judicial regulation aspect: how courts should approach the interpretation of the 2015 Act and thus develop modern marine insurance contract law. While interpretation is viewed as the primary concern for scholars analysing the 2015 Act, this section (and indeed this thesis) is not meant to focus on interpretation *per se* but

[130] Eg *Kler Knitwear Ltd v Lombard General Insurance Co Ltd* [2000] Lloyd's Rep IR 47.

on broader concerns arising from how courts approach interpretation. The importance of this is best expressed in the words of Mitchell:[131]

> [there] are three essentially different lines of enquiry that are best kept separate: how courts should interpret written contracts, the proper scope of freedom of contract and the potential reach of interpretation… How courts interpret contracts could be regarded as largely a practical matter, not involving any great issues of normative principle, but that really depends on how that process is undertaken and what the favoured method of interpretation is. This in turn will affect the reach of interpretation, or what can be achieved through contract interpretation, and that in turn will have implications for freedom of contract (which in essence concerns the balance of contract power between the parties and the law). [132]

The 2015 Act is a new type of regulation for insurance contract law that is intended to apply to all commercial insurance contracts.[133] It can therefore be said that the rationale behind the Act was to create a contextual framework, thereby allowing judges to interpret and apply the provisions of the 2015 Act to suit different commercial contracts and parties.[134] While the focus of this thesis is on marine insurance that should not be taken to mean that this thesis advocates for a different approach to interpretation in marine insurance cases as opposed to non-marine insurance cases. That would be an over-simplification and in principal it seems wrong to propose a differentiated approach to interpretation, depending solely on what type of insurance policy a court is faced with.

Rather, this thesis recognises 'that interpretation is value neutral in that interpretation is not meant to assess the fairness of contract terms'.[135] Interpretation is rather a process to ascribe meaning to the terms of the contract which the parties intended the wording to carry'.[136] Yet interpretation may also be seen as a protectionist or regulatory device

[131] Even though Mitchell is not referring to the IA 2015.

[132] Mitchell, 'Obligations in Commercial Contracts' (n 48) 460.

[133] The consumer part is excluded for this discussion.

[134] SPBC Insurance Bill (n 6) 1.

[135] Bennett, 'Reflections on Values' (n 26) 158. *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 at 387.

[136] ibid. *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1997] UKHL 28, [1998] 1 All ER 98, [1998] 1 WLR 896, [1998] AC 896 ('*ICS*').

depending on the manner in which the process of interpretation is undertaken.[137] I will return to this point later, but for now I turn to the two examples of differentiation in the 2015 Act: the contracting out provisions and s11.

In determining whether the requirements to contract out of the 2015 Act have been satisfied, the contracting out provisions specifically allow for differentiation based on the 'characteristics of insured persons… and the circumstances of the transaction' ('the qualifying transparency requirements'). [138] The issue is how courts will apply this differentiation criteria to determine what amounts to successful contracting out. On the one hand, the purpose of the contracting out provisions is to ensure that parties are made aware of any potentially disadvantageous terms and the effect of such terms. Courts may therefore take a protectionist approach when interpreting to ensure that there is informed consent between contracting parties:. On the other hand, the contracting out provisions introduce a measure of leniency in relation to certain types of parties and circumstances.

As the contracting out provisions specifically require differentiation in the application of the provisions, this chapter suggests that courts should differentiate based on the sophistication of the parties by looking at the 'characteristics of insured persons… and the circumstances of the transaction'. [139] This was clearly intended by the Law Commissions.[140] Where parties are found to be sophisticated, then a minimalist approach to interpretation should prevail and effect should be given the terms of the contract. Where parties are less sophisticated a more contextual approach may prevail. Notwithstanding the requirement for differentiation, and as was discussed in Chapter 3, an easier route may be for judges to consider whether the insured or its agent had actual knowledge of the term.[141] This is not necessarily a 'secondary route', particularly in markets such as marine insurance where brokers are frequently part of the contracting process. In that instance, actual knowledge will in fact be present in most cases.

Returning to an earlier point, the starting point is not whether it is a marine insurance contract, and hence a different approach to reasoning should apply. Rather, there is a

[137] Bennett, 'Reflections on Values' (n 122) 158.

[138] The IA 2015, s17(4).

[139] ibid.

[140] SPBC *Insurance Bill* (n 6) 3.

[141] The IA, s17 (5).

presumption that marine insurance is a sophisticated market and that it should generally be treated in a minimalistic way.[142] But this is a rebuttable presumption. The bottom line is that this thesis does not propose that the label of marine insurance should lead a court to a minimalist approach.[143] The minimalist line of reasoning should also apply to other commercial contracts and parties that are identified as sophisticated. On that note it is recognised that the approach to identifying what is meant by 'sophisticated' is by no means clear.[144] The best guide to doing so is based on factors that would lead a court to determine that a party is sophisticated.[145]

The second example of differentiation in the 2015 Act pertains to risk control terms in s11. This section differs from the above discussion on contracting out as s11 lacks specificity in that it applies to all commercial parties. There is no differentiation between less sophisticated and more sophisticated parties. Yet it has been stated that the reforms were intended to bring insurance contract law in line with developments in general contract law, and s11 is meant to resemble innominate terms by focusing on the seriousness of the breach rather than the classification of a term. Coupled with the fact specific nature of s11, this may well give rise to the potential for judges to adopt a differential approach when interpreting s11 in relation to the types of parties and contracts. This thesis has claimed that s11 is contextual, regulatory and dilutes party autonomy. It is not an appropriate type of statutory regulation for all commercial markets, particularly marine insurance. This thesis claims that a level of differentiation (similar to the contracting out provisions) should be applied when courts interpret s11 to minimise the level of intervention in sophisticated commercial insurance contracts, such as marine insurance. In other words courts should give effect to the warranty/risk control term which parties have chosen to insert in their contract. In referring to the approach adopted in the contracting out provisions, this does not imply that this thesis agrees with the design of

[142] See 1.3.2 in Ch 1.

[143] Miller, 'Contract Law, Party Sophistication, and the New Formalism' (n 86) 496.

[144] ibid 518, who confirms that in the US even leading scholars have not been able to define what types of parties would fall into the category. The UK has had little to no engagement on this concept specifically. Section 1.3.2 in Ch 1.

[145] For example, access to resources, the level of experience and knowledge, access to information relative to the other party. In relation to marine insurance an indication of these factors was set out in Chapter 1.3.2.

the contracting out provisions but simply means that, given that s11 is already in place, this approach of differentiation within s11 is the lesser of all evils.

The next section examines the practicalities of s11 and the contracting out provisions. How should courts approach a situation in which parties attempt to draft a term as a term defining the risk as a whole so that it falls into the exception in s11(1) and therefore falls outside the ambit of s11?[146] Should courts give effect to a contractual term that attempts to circumvent the reforms? The 'connection test' in s11 (3)[147] is a factual enquiry that creates a threshold question.[148] The issue centres on whether courts are likely to take the view that the threshold requires a broad or narrow connection between the breach of the term and the actual loss that occurs, and how that threshold should be determined. A broad connection is preferable for sophisticated markets. These types of questions pertain to whether the written contract should prevail or whether the court should go beyond the contract to the commercial relationship and transaction.

In connecting these issues to the theoretical visions of the judicial role, this thesis claims that differentiating between commercial parties when interpreting the 2015 Act should determine whether a formalist or contextual (realist) approach is appropriate.[149] In this way, sophisticated parties (such as those in the marine insurance market) can be held to a different set of standards grounded in legal certainty and freedom of contract, whereas in relation to other less sophisticated commercial parties a contextual (and, in some instances, a more protectionist) approach can be applied.[150] At first glance, it may sound counter-intuitive to say that a court should approach the 2015 Act from a contextual perspective (where needed) to determine whether to apply a formalist line of reasoning to

[146] The IA 2015, s11(1):

> This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole, if compliance with it would tend to reduce the risk of one or more of the following…'

[147] The insured satisfies this subsection if it shows that the non-compliance with the term could not have increased the risk of the loss that actually occurred in the circumstances in which it occurred.

[148] The question requires a determination of 'how contextual' should s11 (3) be, that is, does it entail a broad or narrow interpretation.

[149] Miller, 'Contract Law, Party Sophistication, and the New Formalism' (n 86) 517.

[150] ibid 500.

contracting out and risk control terms. This is not a fanciful notion: in contract law cases judges have already been applying such an approach, although not always consistently.[151] This was discussed in relation to interpretation where judges have grappled with the issue of the balance between textualism and contextualism between parties of relatively equal bargaining power.[152] This thesis claims that if judges are to take on a more regulatory role under the 2015 Act then they should be more explicit about the reasons for adopting a particular approach.

4.3.2 Reappraisal of the (Neo) Formalist-Contextualist Debate

4.3.2.1 Law v Scholarship

Understanding how the formalist-contextualist debate is framed will in turn help to understand how certain aspects of the debate may need to be re-framed in the context of commercial insurance contract law. This chapter shows that judicial regulation is about more than just text versus context; the formalist-contextualist debate is not an accurate depiction of the real fault lines concerning the legal regulation of commercial contracts and the role that courts have in developing the law by reducing it to a formalist or contextualist answer.[153]

The issue is not 'context or no context' since commentators on both sides of this debate agree that some level of context is inevitable. Equally, it does not follow that 'a textualist or contextualist interpretation results predominantly from a textualist or contextualist judicial philosophy'.[154] Where the different schools overlap is in a general recognition of

[151] *Photo Production* (n 70). This approach has been alluded to in a number of cases, including by the Court of Appeal in *Watford* Electronics (n 70); *Granville Oil* (n 70).

[152] See Chapter 2.6.1.

[153] This has been recognised by other scholars such as Catherine Mitchell, 'Commercial Contract Law and the Real Deal' in Christian Twigg-Flesner and Gonzalo Villalta-Puig (eds), *The Boundaries of Commercial and Trade Law* (Sellier European Law Publishers, Munich, 2011) 21, 38 where Mitchell says that 'responsive commercial contract law cannot be developed while we retain the belief that there are only two values – formalism or contextualism – that inform legal reasoning in this area'. P Vlaar, F Van Den Bosch and H Volberda, 'Towards a Dialectic Perspective on Formalization in Inter-organizational Relationships' (2007) 28 Organization Studies 437–466 at 440.

[154] Tan, 'Beyond the Real and the Paper Deal' (n 9) 624.

a sensitivity to both formalism and contextualism in legal reasoning in any given situation. In other words, neither calls for a single strategy nor believes that the different schools can be entirely divorced from each other when engaged in legal reasoning.[155]

However, as was made clear in Chapter 2, there is a distinction between scholarship and law.[156] The former takes a more contextual (and relational approach) whereas law remains largely formal,[157] apart from the move towards contextualism in interpretation. Despite the lively debate, working out what the judicial regulatory approach would look like is a difficult task, not least because there is no consensus about what it should look like. The 2015 Act imposes 'a more serious regulatory role on judges'[158] and within contract law scholarship there are growing calls for courts to take on a more regulatory role and for judges to be explicit about the role that they take on.[159] The practicalities of that regulatory role will be considered below, but it is first important to revisit the theoretical visions on the role of judges under the 2015 Act.

4.3.2.2 Theorising the Judicial Role in Modern Commercial Insurance Contract Law

Starting with what could be considered the more 'extreme' views, Gava and Collins sit at different ends of the formalist-contextualist divide. In relation to the 2015 Act both these views go too far: Gava calling for a strict formalist approach, and Collins calling for a far-reaching contextualist approach. Collins's view has proved influential in scholarship but the judiciary has not been as receptive to it. This may well be because Collins's argument is theoretically sound (even if one disagrees with his propositions) but it is

[155] Mitchell, 'Commercial Contract Law and the Real Deal' (n 157) 23.

[156] This distinction also explains the reasons for treating the theoretical side separately from the law side in how judges will interpret the IA 2015.

[157] See for example, *Yam Seng v International Trade Corp Ltd* [2013] EWHC 111 (QB), [2013] 1 All ER 1321. Others include: *Baird Textile Holdings Ltd v Marks & Spencer plc* [2001] EWCA Civ 274, [2002] 1 All ER 737 at [16]; *Total Gas Marketing Ltd v Arco British Ltd* [1998] UKHL 22, [1998] CLC 1275 at 1286; *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661 at [54], [61]; *BP Gas Marketing Ltd v La Societe Sonatrach* [2016] EWHC 2461 (Comm) at [242]; *Monde Petroleum SA v WesternZagros Ltd* [2016] EWHC 1472 (Comm) at [250], [254], [259]; *Ilkerler Otomotiv Sanayai ve Ticaret Anonim v Perkins Engines Co Ltd* [2017] EWCA Civ 183 at [28]; *Microsoft Mobile Oy (Ltd) v Sony Europe Ltd* [2017] EWHC 374 (Ch) at [67]–[69].

[158] Brownsword and Adams, 'The Unfair Contract Terms Act' (n 14) 113.

[159] For example, Hugh Collins, *Regulating Contracts* (OUP 1999); Headley (n 66).

difficult to translate the theoretical views into a practical application. Hence, Collins's view is valuable in providing 'a bird's eye view of contract'[160] but it has had little impact in law.

Certain areas may be better suited to a formalist approach – marine insurance being a key example. Gava is rightly critical of Collins but Gava's view is unflinching considering developments in both law and scholarship. Today, it is impossible to not take context into account. Gava's view is understandably reactionary as it pushes back against the increasing emphasis on contextualism (and relational theory) in scholarship and law (contextual interpretation). When applied to an insurance context, Gava's view is untenable – as seen in Chapter 3, courts in insurance cases have already moved towards a contextual approach.[161]

The relational approach also 'demands a preliminary contextual enquiry into wider aspects of the business relationship'.[162] Mitchell says that such an 'enquiry might yield a conclusion that the application of individualistic and formal norms is appropriate to resolve any dispute'.[163] That is all well and good, but the problem remains that the starting point demands too much of judges. The argument from formalists is that what commercial parties want from the law above all else is certainty not flexibility. A more formal law, rather than a contextual one, 'is better suited to these purposes, being less costly to use and enforce than the alternative'.[164] Morgan's rebuttal is that sensitivity to context may actually require the exclusion of broad, contextual interpretation' and that for most commercial contracts drafted by lawyers addressed to their professional colleagues, 'the relevant context is formalism!'[165]

[160] Headly (n 66).

[161] See Section 3.3 in Ch 3. Mitchell says that Gava's view, while possibly desirable as a theoretical position, is practically impossible. Mitchell, 'Commercial Contract Law and the Real Deal' (n 157) 35-6.

[162] Mitchell, 'Commercial Contract Law and the Real Deal' (n 157) 21.

[163] ibid.

[164] ibid 29 -30. This is the view of Macaulay, 'The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules' (2003) 66 MLR 44, 67.

[165] Morgan, *Contract Law Minimalism* (n 18) 233.

Mitchell has said that 'contextualism will not be cost free but that the costs of not following this path will be greater'.[166] In response, Gava questioned whether 'being an imperfect contextualist is worse than not being a contextualist at all.'[167] He adds that one would need to be 'a totally accurate contextualist to be an effective contextualist'[168] since an incomplete (or inaccurate) contextualism would not and could not reflect the practices, expectations and behaviours of the contracting parties.[169] Morgan is also willing to accept that legal reasoning in contract (and the common law more generally) is not neat and tidy but is messy, and 'life, and therefore living law, is just too complex to be reduced to classical simplicity'.[170]

Notwithstanding these competing views, minimalism offers a more tempered formalism as it is critical of doctrinal scholars[171] for their excessive purity about rules. Minimalism is not insensitive to contextualism.[172] But Morgan's thesis needs to be reappraised in light of what is required of judges by the 2015 Act. As the authors of Arnould say, prior to the 2015 Act in insurance cases the courts have followed the general principles of contractual interpretation.[173] In reframing the issues in relation to the 2015 Act, a legal reasoning method is required that would entail an approach of least interference with party autonomy and maximise giving effect to the terms of the contract. Minimalism offers the better approach to achieving this. I agree with Morgan's starting point that courts should give effect to what parties want in their contract – whether that be formalist, contextual or relational standards. I also agree that a textual approach to interpretation is preferable to contextual.

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[166] John Gava, 'What we know about Contract Law and Transacting in the Marketplace – A Review Essay of Catherine Mitchell, *Contract Law and Contract Law Practice: Bridging the Gap between Legal Reasoning and Commercial Expectation* and Jonathan Morgan, *Contract Law Minimalism: A Formalist Restatement of Commercial Contract Law*' (2014) 2 Adelaide Law Review 409, 417.

[167] ibid.

[168] ibid.

[169] ibid.

[170] ibid 420.

[171] Headley (n 66).

[172] Miller,' Contract Law, Party Sophistication, and the New Formalism' (n 86) 500.

[173] *Arnould Law of Marine Insurance and Average* (n 47) 19-10.

A minimalist restatement of commercial contract law was necessary due to the growing trend towards contextualism and relational contract law. Section 11 and the contracting out provisions are open-textured rules that create an uncertain threshold regarding how judges should interpret and apply such provisions. In the context of commercial insurance contract law, this thesis claims that there is now a need for a formalist restatement along the lines proposed by Morgan. The significance of translating theory into practice is because, as explained in Chapters 1 and 2, a legal doctrinal approach only goes so far and is therefore limited in its value given that there are no judicial decisions yet on the interpretation of warranties and contracting out under the 2015 Act. But what exactly that regulatory role entails and what a regulatory role for judges would look like under the new 2015 Act is unclear and speculative at best. Given the early stages of the 2015 Act, the following analysis will have to be speculative in its approach by drawing on existing case law and the Law Commissions' reports.

4.3.2.3 Differentiation and the Litigation-Centric Features of (Insurance) Contract Law

One of the central themes in relation to s11 and the contracting out provisions under the 2015 Act is the notion of differentiation, as discussed above. The contracting out provisions specially require a court to apply differential criteria when determining whether parties have successfully contracted out. In contrast, s11 applies to all parties with no statutory requirement for differentiation. The theme of differentiation ties in with the litigation-centric feature of (insurance) contract law.

Bernstein's work has highlighted the existence of Relationship Preserving Norms (RPN) and End Game Norms (EGN) which exist in a contractual relationship. This thesis acknowledged that Bernstein's findings related to contracts of a different nature to insurance contracts. Bernstein's research was concerned with contracts drafted by industry associations and in the event of a dispute, her research showed a preference for formalist private dispute resolution. Bernstein's research was concerned with industries where the parties participate as both buyers and sellers, whereas that is not the case with insurance contracts. Even though that difference is explicitly acknowledged in this thesis, Bernstein's work is still valuable in highlighting the different norms which, in her view, exist at different stages of a contractual relationship. The minimalist hypothesis draws on Bernstein's recognition of the existence of different norms to advance one of the main

features of minimalism which is that commercial contract law is for dispute resolution rather than contract governance (ie that it is concerned with EGN)[174]

Mitchell is critical of the litigation-centric feature of contract law. She says:

> It [contract law] is not a product with a limited market comprising of a certain species of commercial contractor – those with good resources, access to legal advice, involved in arms-length transacting in an industry where litigation is regarded as the local sport and where everyone who plays knows the rules. Litigating parties may have these features, but the law that results from the litigation process supposedly facilitates contractual dealings for the general commercial contracting community. This community is not a homogeneous group sharing a complete identity of interest over the design of the rules of commercial contract law. Empirical studies show this quite clearly, as do examples of cases coming before courts.[175]

Mitchell adds that:

> Law must therefore be capable of regulating and facilitating all manner of commercial agreements, not limited to any specific type nor limited to the range of problems presented by litigation repeat-players. [176]

Mitchell uses the non-homogenous nature of commercial parties and the general applicability of contract law to all commercial contracts to bolster her theory that relational theory is all–embracing and therefore judges can use it to accommodate all differences that may arise in commercial disputes. According to Mitchell's view, the minimalist approach may result in an array of decisions suited to specific circumstances and litigants that are not of general application to all commercial agreements. But this

[174] Morgan, *Contract Law Minimalism* (n 18) 88. This will be discussed further below.

[175] For a review of these studies, and more recent empirical work on commercial contracting practice, see Mitchell, 'Contracts and Contract Law: Challenging the Distinction between the 'Real' and 'Paper' Deal' (2009) 29 OJLS 675.

[176] Mitchell, 'Commercial Contract Law and the Real Deal' (n 157) 34-5. My emphasis.

fails to recognise that minimalism is a contextual argument and one that is not contrary to the non-homogenous nature of commercial parties.[177]

Mitchell's and Morgan's approaches can be reduced to two core issues: party autonomy; and that different markets should be treated differently. Both agree that these are important factors but disagree about how these factors should be effected. The starting point for minimalism is different as it states that the law should start at a minimum (i.e. with a clear simple rule) and let parties contract to what they want to suit their specific circumstances, and judges should give effect to parties' agreement. In doing so, like Mitchell's argument, the law is still able to facilitate a variety of commercial transactions. Mitchell's view asks for more context, whereas Morgan's view asks for less context and more effect to be given to the agreement of the parties, thereby maximising party autonomy.

Mitchell's view that law needs to be responsive to all commercial transactions is not lessened with the minimalist hypothesis as law's responsiveness is still achieved by courts giving effect to parties' agreement where parties have contracted to something different from the default position. The biggest hurdle with Mitchell's view is the practicalities of implementation. While Mitchell's account may be theoretically sound and cogently argued, she too accepts that there are inherent problems with developing a relational contract theory. While we can say that relationalism subsumes both contextualism and formalism,[178] developing such a law is the most challenging aspect of the relational enterprise.[179] This difficulty persists in contract law and is unlikely to be resolved or be made clearer in an insurance context. There is even greater resistance in English insurance contract law to embrace contract theory.

[177] Mitchell has acknowledged that minimalism is a contextual argument, but she makes that claim as a criticism of minimalism, whereas here, that 'contextual' statement is used to bolster the minimalist argument.

[178] Hugh Collins, 'Objectivity and Committed Contextualism in Interpretation', in S Worthington (ed) *Commercial Law and Commercial Practice* (Oxford: Hart 2003). Collins argues here that contextualism in interpretation subsumes formalism and literalism.

[179] Mitchell, 'Commercial Contract Law and the Real Deal' (n 157) 42.

4.4 Normative Perspectives for Judicial Regulation under the 2015 Act

4.4.1 Theory and Practice

This chapter did not aim to set out a normative basis for the judicial regulation of insurance policies but rather to extrapolate normative perspectives from the above theoretical discussion of what is required of judges in developing the law following the 2015 Act. Judges, particularly in insurance contract law, view policy considerations as contractual issues that are not influenced by broader social or legal norms. This chapter considers the type of judicial intervention that is required in commercial insurance contracts and to identify the guiding principle for judicial regulation. One must bear in mind the objectives of the Law Commissions in designing a 'principles-based' legislation that would allow courts to develop the law organically.[180] Leggatt LJ in *First Tower Trustees Ltd v CDS (Superstores International) Ltd*[181] explained the role of courts in giving effect to the will of the legislature, stating:

> The importance which English law attaches to the freedom of parties to contract on whatever terms they choose depends crucially on the assumption that their consent to the terms of the contract has been obtained fairly… But in so far as a contract term is said to have removed that right, a control mechanism is needed to ensure that this term was a fair and reasonable one to include. *That, at all events, is the policy which Parliament has thought it right to adopt. It is the duty of the courts to uphold and not to subvert that policy choice*.[182]

I therefore argue that this statement is an apt depiction of the real fault-lines of judicial regulation in relation to sophisticated commercial insurance markets. Section 11 and the contracting out provisions are not simply a judicial fact-finding mission reverberating between textualism and contextualism, rather they raise deeper questions about how judges should moderate competing objectives between party autonomy and welfarist concerns in the 2015 Act. In other words, how can judges take a minimalist approach to the interpretation of the 2015 Act when, as has been discussed above, the 2015 Act is not designed in a minimalistic way? This is particularly relevant when parties seek to restore the former statutory position under the 1906 Act or where they contract to a more onerous

[180] SPBC *Insurance Bill* (n 6) 1.

[181] [2018] EWCA Civ 1396.

[182] [2018] EWCA Civ 1396 [104].

position in contrast to the objectives underlying reform. *Why* s11 should have been drafted in minimalistic terms has already been discussed, and it was also claimed that judges should approach s11 from a minimalistic approach.[183] The rest of the chapter examines *how* a minimalist approach should be applied by courts.

4.4.2 Section 10

To reiterate what was discussed in Chapter 3, the way in which s10 and s11 work together is that if an assured is in breach of a warranty during the time that loss occurs, the assured cannot rely on the remedy of suspension of liability in s10 as the breach has not been remedied. Section 10(2) is a new default rule and can be viewed as the first level of protection for an assured in the event of breach of warranty. Where the first level of protection fails, s11 kicks in as the second level of protection. Here the assured must show that the term is not excluded as a term that defines the risk as whole.[184] If that is the case, the assured must then show that the term tends to reduce the risk of particular type, location or time[185] ('the category of loss test') and that the breach could not have increased the risk of loss that actually occurred ('the connection test').[186] If the assured is able to show this, then the insurer cannot rely on the breach of that term. The second level of protection therefore limits the availability of an insurer relying on a contractual defence. The focus of these sections are not to control substantive terms but rather to control the consequences on breach of a term.

Section 10 has been generally welcomed by the insurance industry and the marine insurance industry also did not object to s10 and the remedy of suspension of liability.[187] The marine insurance industry did however object to s11 and the contracting out provisions given that it was viewed as an unnecessary intervention in sophisticated markets.[188] For that reason, this thesis does not take issue with s10 and regards this reform as necessary and welcome. There will of course be uncertainty and interpretative

[183] Discussed in Section 2.4.2.5 in Ch 2 pertaining to the limits of contextualism/relational theory.

[184] The IA 2015, s11(1).

[185] ibid.

[186] ibid, s11(3).

[187] SPBC *Insurance Bill* (n 6) 19.

[188] Ibid 19-21.

difficulties with s10, but it is submitted that those are acceptable uncertainties that naturally follow a period of reform.

However, s11 and the contracting out provisions are not cut with the same blade as even though these provisions will also have interpretative difficulties, the concern with these provisions extends beyond that. MacGillivray confirms this view by saying that, 'the reform introduced by s11 is potentially more significant [than that in s10] but its construction and application may cause more difficulties'.[189] This thesis has claimed that these provisions are regulatory and the interpretative approach to s11 and the contracting out provisions will have implications for party autonomy in sophisticated markets like marine insurance. The focus for the remainder of the chapter will therefore be primarily on s11 and contracting out.

4.4.3 Section 11 and the Threshold Question

The Law Commissions intended for there to be a connection between breach and loss, yet the design of s11 (3) does not explain what type and the degree of connection that is required. This is the threshold question that judges must answer. Judges therefore have a choice between a broad or narrow interpretation in setting the threshold in s11, yet there are several inconsistencies/uncertainties with interpreting the 'connection test' which were discussed in Chapter 3.[190]

As was shown the operation of s 11(3) is fairly technical and at this early stage, there is much uncertainty as to how it should be interpreted and applied. The uncertainty surrounding the substantive law aspects of s11 pertained to determining the purpose of the term/warranty and the connection to the type of losses that could result from breach of that term/warranty. It has already been determined that given the absence of case law on this section, any discussion can only be speculative and act as a guide as to how these sections ought to be approached. Rather than focusing on these aspects, this section therefore casts a wider net and takes a more discursive approach. In so doing, it applies Bernstein's distinction between Relationship Preserving Norms (RPN) and End Game Norms (EGN) to the nature of insurance contracts. This approach furthers an

[189] Birds and others, *MacGillivray on Insurance Law* (14th edn, Sweet & Maxwell 2018).

[190] See 3.6.3 in Ch 3.

understanding of the place of s11 in the contracting process to further understand the operation and application of s11.

One of the main elements of the minimalist hypothesis is that contract law is for dispute resolution than contract governance and hence should be focused on the end game where EGN apply.[191] It is true that some rules are needed in insurance law, such as, to regulate the formation of insurance policies and to protect vulnerable parties, such as consumers when purchasing a variety of insurance products. Often such parties have little understanding of how insurance works, do not read the 'fine print' or often do not understand the implications of many of the terms included in the fine print.[192] It would be a stretch to therefore say that insurance contract law is only for dispute resolution and not for contract governance.

Notwithstanding that, in relation to insurance contracts the hypothesis that contract law is for dispute resolution rings particularly true. This thesis claims that there is a strong litigation-centric feature to insurance contract law which encompasses two aspects of the insurance relationship: contract and claim.[193] In the UK, insurance is dealt with as a contractual issue but as this thesis shows, the focus on the claim highlights that every 'doctrinal issue involves a conception of the insurance contract and arises because of a disputed claim'.[194] Claims is a distinguishing feature of insurance contracts from other types of contracts.[195] Every insurance contract is fundamentally about 'paying or not paying claims'.[196]

How judges approach s11 depends on the conceptualisation of whether a warranty is viewed as being about remedying harm (to prevent insurers relying on irrelevant warranties to avoid paying a claim) or whether it is viewed as a defence that arises at the

[191] Morgan, *Contract Law Minimalism* (n 18) 88.

[192] E.g. basis of contract clauses.

[193] Jay Feinman, 'Contract and Claim in Insurance Law' (2018) 25 (1) Connecticut Insurance Law Journal 159.

[194] ibid 160.

[195] It is beyond the scope of this thesis to deal with the claims process in insurance law. See ibid 196 -172, bearing in mind that the US position differs from that of the UK. See also Malcolm Clarke, *Policies and Perceptions of Insurance Law in the Twenty-First Century* (OUP 2002) 357 where he says at 182.

[196] Feinman, 'Contract and Claim in Insurance Law' (n 198).

dispute stage. Warranties reflect a conflict between tradition, contract and the claim.[197] First and foremost warranties are a contractual term. However its purpose is rooted in tradition due to the nature of shipping and the need to provide a defence to insurers in circumstances where the insurer was the party in need of protection.[198] In modern times, the evolution in the use of the warranty defence and the manner in which courts have approached them[199] implies 'an unease with the insurers conception of the policy at formation'.[200] This view does invite caution depending on the nature of the insurance contract and the parties.

In focusing on this claims aspect of insurance, Bernstein's distinction between RPN and EGN, and Collins's normative framework (the economic deal, the business relationship and the contract) becomes relevant.[201] As discussed, it is recognised that Bernstein's empirical work focused on a different type of contract to marine insurance, Despite that, Bernstein's work remains relevant to marine insurance as it highlights that different norms govern commercial relationships. There are two stages according to the minimalist hypothesis: the contract before any disputes arise (ie the contract stage) and the point when disputes arise (ie the dispute stage). The former accords with Bernstein's RPN, and Collins's business and economic models. The latter accords with Bernstein's EGN, and Collins's contract stage. The contract stage is prospective, whereas the dispute stage is retrospective.

The reforms that resulted in s11 were undoubtedly to remedy (or prevent) harm, being a measure to remedy the problem of insurers relying on irrelevant warranties and denying valid claims to insureds. The focus of the reforms was on the secondary obligation which follows breach of a primary obligation (ie to regulate the consequences on breach of a warranty/term). Despite the reforms, one must not lose sight of the functional purpose of warranties (or risk control terms), which is to allow insurers to rate and circumscribe the

[197] ibid 175.

[198] See Section 3.2.1 in Ch 3.

[199] See Section 3.3 in Ch 3.

[200] Feinman, Contract and claim' (n 198) 179.

[201]The 'deal' aspect of a transaction is concerned with the benefits associated with a transaction. The aspect concerns how any particular deal fits into the longer-term relationship between the parties, and the contract refers to the rights and obligations contained in the formal contract.

risk. The function of 'insurance in society is to spread the risk and, if the risk materialises, to spread the resulting loss'.[202]

The RPN stage is an example of the prospective stage as it is forward-looking. On that basis, warranties can be said to be applicable in the contract stage, that is, they preserve the relationship by allowing both parties to know the limits of the insurance policy so that the assured is adequately protected from risk but is also aware of what type of behaviour is expected of the assured to keep the risk within the bounds of the policy. When applied to marine insurance for risks placed in the London market, subscriptions are confirmed by signing the Market Reform Contract.[203] This can be viewed as indication of RPN as both the insured and insurer 'are represented in negotiations for recommended wordings, and the outcome is generally regarded as a fair compromise between the parties'.[204]

The EGN stage is retrospective; the relationship has broken down and the concern is with proving and defending a claim. Warranties are a notorious defence to a claim as they are a shield to liability, not a sword.[205] This means that warranties become even more relevant in the dispute stage and s11 is relevant at the stage of a dispute. Even though the Law Commissions focused on remedying/preventing harm by reforming the law of warranties that very aspect becomes more acute in the dispute stage as that is precisely when warranties are relied upon.

The approach in both these stages varies. In the RPN stage, using the example of a warranty prohibiting a vessel from entering certain ice areas, insurers may require a such a locality warranty to be included in a policy that insures the vessel in question. The assureds are likely to agree to that warranty (term) to not enter certain areas. Between both parties it may well be assumed that such warranty is meant to guard against the possibility of losses arising from entering ice-prone areas. However, the precise details of what type of losses are covered by such a warranty are unlikely to be discussed in detail

[202] Clarke, *Policies and Perceptions* (n 200) 251.

[203] Explained in S 1.2.2.2 Ch 1.

[204] ibid 47. For example, this equality of bargaining is seen from the International Hull Clauses 2003, which were not well received by the market as they were regarded as favouring the interests of the insurers. These Clauses have hardly been used, with the market reverting to the earlier versions of the Hull Clauses 1982 and 1996.

[205] Soyer, *Warranties in Marine Insurance* (n 44) 3.

(or at all), which is likely to be unproblematic. The focus for the insured is that they are adequately protected by insurance for whatever losses they seek to insure against. Insurers will focus on ensuring that the premium meets their risk assessment for that policy.

In contrast, at the EGN stage both parties will want to interpret the factual circumstances in a manner that furthers the outcome they want, ie to decline a claim (insurers) or to receive an insurance pay out (assureds). Using the above example, the insurer would want to show that the term to not enter a prohibited area was to guard against all losses whatsoever associated with the vessel being in that area,. The insureds will want to apply the provisions strictly to say that the term was meant to cover a narrow set of circumstances i.e. only loss or damage to the vessel[206] arising from ice conditions . The authors of MacGillivray have said that 'the connection test' has both prospective – 'could not have increased the risk' – and retrospective – 'loss which actually occurred in the circumstances in which it occurred' – elements.[207] The former is set at the time of agreement whereas the latter is found in the statement: 'which actually occurred in the circumstances in which it did',[208] and this will only arise at time of loss/claim.

The Explanatory Notes to the Insurance Bill states that it is necessary to look at the issue broadly and not to consider 'the way' in which the loss occurred.[209] The focus is on looking forward from when the risk was underwritten (the breach could not have increased the risk of the loss), as opposed to looking backwards from the actual circumstances of the claim (whether the breach contributed to the actual loss).[210] The Law Commissions' view implies that the RPN approach is the correct approach. Yet as was made clear in Chapter 3, the design of s11 (3) does not accord with this intention of the Law Commissions.[211] The authors of MacGillivray may be right in saying that there is a prospective element that will be relevant in determining what the parties' initial intentions were. However, that is not correct when applied to s11 (3) as there is a temporal element here that means the application of s11 (3) can only be retrospective.

[206] Not the cargo as that is not the subject of the insurance.

[207] MacGillivray (n 194) 10-131.

[208] The IA 2015, s11(3).

[209] *Explanatory Notes to the Insurance Bill* (n 55) para.1.17.

[210] *i*bid para.1.16.

[211] Section 3.6.3 in Ch 3.

This thesis disagrees with the above approaches as the legal context of litigation is backward-looking and that is precisely when s11 (3) becomes relevant – when a claim is made. This is bolstered by the fact that a warranty is a defence and the correct test here is reliance not incorporation. The Law Commissions recognised that there may be hard cases that will turn on particular facts but s11, they say, is meant to focus on the real issue: what the term was designed to do in relation to the risk. Therefore, the design of s11(3) is not compatible with the Law Commissions' explanation as the focus is less on the category of loss and more on the factual circumstances of how the loss occurred. This discrepancy is likely to give rise to uncertainty as to how judges should interpret s11.

The approach is complicated through 'hindsight bias' (or the 'knew it all along' bias) which is a term used in psychology 'to describe the tendency of people to overestimate the probability of an event once they are aware of the fact that the event has occurred'.[212] This has implications in law through judicial decision-making. This may cause parties at the stage of a dispute or claim to believe that they could have predicted the outcome of the event which actually occurred by basing it on a 'hindsight' view rather than on the perceptions and facts which existed at the time the contract was entered into.

This ties in with the point discussed previously that at the EGN stage both parties will interpret the factual circumstances in a manner that furthers the outcome each wants. The insurer would want to show that a broad connection was envisaged, whereas the insured would likely show that the term was meant to only cover a narrow set of circumstances. This is affirmed by Lord Neuberger who in *Arnold v Britton*[213] pointed out the danger of applying a contemporary idea of commercial sense influenced by what had gone wrong after the contract had been made. Lord Neuberger was, of course, not referring explicitly to hindsight bias, but his reasoning recognises the risk of the central tenet of hindsight bias.[214] Even though commercial common sense should be applied at the time when the contract was made, s 11(3) renders that difficult to do. Ostensibly an application of a commercial sense approach to the insurance contact will focus on what was agreed at the

[212] 'Doron Teichman, 'The Hindsight Bias and The Law in Hindsight' in Eyol Zamir and Doron Teichman (eds), *The Oxford Handbook of Behavioral Economics and the Law* (OUP 2014) 355.

[213] [2015] UKSC 36.

[214] Hindsight bias therefore conflicts with the fundamental principle in contractual interpretation that commercial sense is to be assessed at the time of formation not retrospective. Hindsight bias is beyond the scope of my thesis but will feature in my future research.

RPN stage (when the contract was made) but this will invariably be influenced by factors at the EGN stage (when a claim is made or a dispute arises).

As has been argued in this thesis, litigation (i.e the end game) creates a different context which changes the dynamics of the relationship between the parties. A comparison can be drawn with the Civil Procedure Rules 1998 and with terms that imply co-operation, such as a 'best endeavours' clause. Campbell and Harris argue that these co-operative mechanisms are inadequate if they are not first preceded by a change in attitude.[215] For any 'formal provision for flexibility is fruitless, for one cannot create a co-operative attitude by writing down that such an attitude will be taken to contingencies as they arise'.[216]

Looking again at the contract and claim paradigms in insurance law, some concluding reflections are useful in assembling the above threads into a coherent, overall picture of s11. Feinman has said that the purpose of insurance is a 'relationship of security' in that the insured knows that s/he is covered against particular types of risks and can act accordingly.[217] This relationship creates different understandings for both the insured and insurer at two distinct phases in the relationship: at formation (ie the contract stage) and at the dispute stage.[218] In applying Feinman's observations to that of Bernstein distinction, Feinman's argument is that because the expectations of the parties differ at the RPN stage, it would be unfair to rely on the terms of the written contract only. The dispute (at the EGN stage) is because of the relational expectations of the insured which was created at the RPN stage.[219] As was discussed previously, this relational approach sees the contract as more than the written terms and calls on courts to recognise these different expectations which are in fact part of the contract. However, as this thesis argues '[l]itigation is…an artificial point of view from which to assess the social context of the

[215] Mitchell, *Interpretation of Contracts* (n 36)118. Campbell D and Harris D, 'Flexibility in Long Term Contractual Relationships: The Role of Cooperation (1993) 20 J.Law and Soc 166, 173.

[216] ibid.

[217] See *Baxendale v Harvey* (1849) 4 H& N 455 where it said that 'a person who insures may light as many candles as he pleases in his house, though each additional candle increase the danger of setting the house on fire…'

[218] Feinman, 'Contract and Claim in Insurance Law' (n 198) 166.

[219] ibid 167.

parties agreement'. [220] The minimalist hypothesis expresses scepticism as to whether 'courts can be the arbiters of the relational aspects of the parties' agreement'. [221]

Warranties have been said to reflect a conflict between tradition, contract and the claim approach.[222] This thesis was not intended to present a view that is the polar opposite to the contextualist school of thought. Rather it offered a perspective to show why the contextualist school of thought is not ideal in relation to sophisticated commercial insurance law and why minimalism offers a more reasoned and pragmatic approach. Similarly this thesis does not say that Feinman, the Law Commissions and the authors of MacGillivray are wrong in their analysis. Instead, the above discussion has sought to demonstrate that the contract conception of insurance cannot be viewed in isolation from the 'claim' conception of insurance. As this thesis has shown, in relation to sophisticated commercial parties it is assumed that 'they are symmetrically informed *at the time of contracting'*[223] and consequently the written contract reflects agreement between the parties which should be enforced at the claims stage.

This chapter has attempted to explain why the approach to the 'connection test' matters, since courts may interpret this test in a regulatory manner or in a way that gives weight to freedom of contract considerations. In other words, 'the connection test' can be interpreted in a more interventionist or a less interventionist manner. But why does this choice of judicial approach matter, why is the level of intervention a relevant consideration? The answer relates to s11 being a 'one size fits all' rule:[224] it applies to all commercial parties and hence assumes that all parties that fall within the ambit of s11 are vulnerable and require such protection. At the outset, this thesis has claimed that the issues centre on the type and level of regulation that is appropriate for sophisticated commercial marine insurance parties. This thesis has also claimed that s11 is a too regulatory type of intervention in such sophisticated markets. Section 11 is a contextual, fact-driven enquiry that awaits clarification through case law – it is important that judges recognise this fact and rein in the application of that regulatory threshold in sophisticated

[220] [1982] QB 84, 101.

[221] Mitchell, *Interpretation of Contracts* (n 36) 121..

[222] ibid 175.

[223] Miller,' Contract Law, Party Sophistication, and the New Formalism' (n 86) 493.

[224] SPBC *Insurance Bill* (n 6) 95.

markets. The way they should do that is through a minimalist approach to interpretation, which I return to below.

4.4.4 Contracting Out

The marine insurance industry voiced its opposition to s11[225] and is expected to contract out of s11. Judicial regulation of the contracting out provisions is likely to be even more important where parties contract to more onerous terms that those in the 2015 Act. As mentioned previously, the consequences of not getting this right are that it will not simply be a case of *contra proferentem* but rather will render the entire attempt to contract out ineffective, meaning that the default regime in s11 will apply to that contract.

The contracting out provisions clearly make room for differential treatment. Even though the basis of this differential treatment was protectionist in that it was important to the Law Commissions that parties knew not only that insurers were contracting out of the 2015 Act but that they were contracting in to more onerous terms. This knowledge meant that insureds were informed and aware of potentially unfair terms. But if this provision specifically allows for differential treatment through the 'qualifying transparency provisions',[226] then the converse must also apply. For sophisticated insureds, like marine insurance, less should be needed to satisfy these provisions, for as the Law Commissions said: 'there may be situations in which very little must be done to satisfy the requirement'.[227]

It may not in fact be necessary for courts to engage the differentiation criteria, as a simpler route would be to determine if the insured or its agent had actual knowledge of the disadvantageous term at the time of agreement.[228] This additional mechanism to introduce flexibility signals that the Law Commissions had in mind that a higher threshold to contract out of the 2015 Act should be applied to less sophisticated parties and a lower threshold when sophisticated parties are involved (usually where a broker is involved). The 'one size fits all' approach in s11 is not found in the contracting out provisions as

[225] (n 97).

[226] The IA 2015, s17 (4).

[227] *Arnould Law of Marine Insurance and Average* (n 47) 20A-12.

[228] The Ia 2015,s 17(5).

courts are called upon to distinguish between less sophisticated parties, such SMEs and sophisticated parties, such as in commercial marine insurance where brokers and lawyers have a more active involvement.

The contracting out provisions were intended to regulate not just awareness of the primary obligation but the secondary obligation, that is, the effect of breach of the primary obligation. That is to ensure that there is informed consent between contracting parties. As was discussed previously, consumer-welfarism and market-individualism exist on a spectrum, and informed consent is therefore not a value that is wholly confined to the consumer-welfarism sphere. In much the same way that it cannot be argued that informed consent should only be present in consumer contracts and not commercial contracts. In recognising this spectrum, informed consent can also be thought of as existing on a spectrum when applying the differential criteria. In some instances, a greater degree of informed consent would be required as between less sophisticated parties, whereas in relation to more sophisticated parties the threshold for satisfying the requirement of informed consent should be lower. Even though judges disagree on the appropriate interpretative approach, these has been some judicial guidance in recognising that contracts between sophisticated parties may justify a less interventionist approach.[229]

The sentiment is that contracting out should be as clear as possible until there is judicial determination on this matter, and that it is preferable for parties to use the Lloyd's Market Association terms ('LMA terms') even though there is no certainty on how judges will interpret these terms.[230] Even though statutory requirements must be met, there should be no justification for courts to regulate the contracting out provisions in sophisticated markets with policy objectives in mind that extend beyond giving effect to the parties' agreement. This kind of protectionist judicial approach is not justifiable considering the statutory form encouraging such differentiation. Parliament has legislated to place limits on contracting out, in which case *contra proferentem* construction seems unnecessary. Courts might be tempted to release parties from hard bargains, but where agreements have been freely made such a temptation must be resisted – even well-meaning paternalism

[229] See S 2.6.1 Ch 2.

[230] ibid 20A-13.

betrays a lack of respect for a person's autonomy.[231] Any superiority in bargaining position is itself a matter for the market.[232]

The use of brokers makes a significant difference as '[i]n sophisticated insurance markets the burden is on the broker to protect the insured from such manipulative application of the 2015 Act'.[233] Yet in relation to 'SMEs insurance markets, where brokers are frequently not retained, it is unlikely that the insured would be forewarned'.[234] This is in line with the duty of brokers to their clients in ensuring that they are properly informed about the scope and limitations of their cover.

It is useful to refer to some examples used by the Law Commissions to explain how differentiation should work. In sophisticated transactions, such as a sophisticated insurance buyer purchasing cargo insurance cover through Lloyd's, the Law Commissions have said that less should be needed to satisfy the contracting out provisions. The example given is where standard cargo insurance wording, developed in the Lloyd's market, dis-applies provisions of the 2015 Act on warranties and these are given codes like LC1 or LC2. Where cargo insurance is negotiated through a broker, and the underwriter insists on this wording (ie LC1 or LC2) being applied as representative of the contracting out wording, the Law Commissions are clear that the transparency requirements are satisfied as this is a fast-paced market and they do not want to interfere with its operation unnecessarily.[235]

A further example is where the underwriter does not mention the desire to exclude specific sections of the 2015 Act, nor does s/he refer to the contracting out wording such as LC1 of LC2. Instead it refers to standard voyage conditions that have recently been updated to include wording substantively the same as LC1 and LC2. A reference to those standard conditions is included in the slip but there is no further discussion. The Law Commissions' tentative view was that these exclusions could be held to be ineffective if the matter was to come before a court, and that the conclusion would depend on the

[231] Roger Brownsword, *Contract Law Themes* (n 72) 51.

[232] ibid 72.

[233] Leloudas (n 59) 98.

[234] Ibid.

[235] *Arnould Law of Marine Insurance and Average* (n 47) 20A-12 Identified as LC1 and LC2 codings on the slip drawn up by the broker.

circumstances of the case, such as whether the underwriter's standard wording as modified was known by brokers generally and was available for inspection.[236]

This seems to imply that brokers in sophisticated markets, like marine insurance, bear a greater burden that brokers involved in insurance transactions with SMEs.[237] These provisions place a significant burden on brokers as insurers do not have to draw matters to the attention of brokers that they ought to know. At least in the early stages, the contracting out provisions are ripe with uncertainty.[238] Underwriters are advised to use the LMA terms as even though there is no guarantee that these will be effective there is some safety in making use of terms developed by the market.[239]

It may be argued that the contracting out provisions provide an opportunity for courts to engage with the relational dimensions of the parties as these sections specifically consider the relationship and economics of the transactions. But whether judges will consider the 'real deal' as having a more serious role to play when qualifying the transparency requirements based on the characteristics of the parties and the circumstances of the transaction is uncertain. Will legal reasoning in insurance contexts seek to classify these business relations within traditional categories (such as freedom of contract), or will there have to be novel arrangements to adapt to the new commercial objectives of the 2015 Act and be guided by the (implicit) objective of the Act 2015, which is fairness?

Contract scholars[240] have said that judges should act more as regulators, but what would this entail? What should be the overriding judicial approach where parties attempt to contract out of the 2015 Act and restore the former statutory provision or where through drafting techniques a term under s11(1) is drafted as a risk defining term so that it falls outside the ambit of s11?[241] Should judges respect the parties bargain or give effect to the spirit underlying the 2015 Act and strike down drafting attempts that undermine the spirit

[236] ibid 20A-12.

[237] Leloudas (n 59) 100.

[238] ibid 20A-13.

[239] *Arnould Law of Marine Insurance and Average* (n 47) 20A-13.

[240] Views expressed at the Contract Law and the Legislature Workshop, York, 11th & 12th January 2019.

[241] Merkin & Gurses, 'The Insurance Act 2015' (n 2) 1021.

of the reforms?[242] The view expounded in this chapter is that courts insofar as sophisticated parties are involved should be slow to circumvent the express wording of the contract. Where a term is drafted as a risk-definition term, courts should read that as a valid contract term rather than as an attempt to circumvent s11.

4.5 A Contract Law Minimalist Approach to the Insurance Act 2015

4.5.1 Case Examples: Sections 10 and 11

Two important questions to the contract law minimalism claim have been advanced in this thesis. The first was *why* the 2015 Act should have been designed along minimalist lines and *why* should judges takes a minimalist approach to the 2015 Act. The second question was *how* judges should take a minimalist approach to the 2015 Act. The former question has been answered by drawing on the contextualist-formalist debate to evaluate the strengths and weaknesses of the minimalist judicial approach. This section now considers case examples of how judges can take a minimalist approach, or what a minimalist approach to the 2015 Act would look like.

The first case considered is *Amlin Corporate member Ltd v Oriental Assurance Corporation ('The Princess of the Stars')*,[243] which was a reinsurance policy between sophisticated parties. This case is useful in highlighting that in some cases the context may in fact reinforce a textual interpretation, but this does not mean that the court is endorsing a 'strict formalism' as a matter of judicial philosophy.[244] The facts were that the reinsurers sought to rely on a typhoon warranty, which was incorporated into the reinsurance policy and stipulated that 'the vessel shall not sail or put out of Sheltered Port when there is a typhoon or storm warning at that port'. The reinsurers provided cover for a Philippine insurance company that insured a shipping company in respect of its loss of or damage to cargo. One of the insured vessels sank on 21 June 2008 after sailing into the eye of typhoon Frank.[245]

[242] Davey, 'Utmost Good Faith' (n 89) 47.

[243] *Amlin Corporate member Ltd v Oriental Assurance Corporation ('The Princess of the Stars')* [2013] EWHC 2380 (comm); [2013] 2 Lloyd's Rep 523; [2014] EWCA Civ 1135; [2014] 2 Lloyd's Rep 561 (CA) (*The Princess of the Stars'*).

[244] Tan, 'Beyond the Real and the Paper Deal' (n 9) 632.

[245] Soyer, *Warranties in Marine Insurance* (n 34) 21.

The reinsured contended that the warranty should have been read within the wider factual matrix, which included the Revised Guidelines on Movement of Vessels during Heavy Weather issued by the Headquarters of the Philippine Coast Guard contained in a circular dated 27 June 2007. This would have included details of the severity of the storm precluding the vessel's setting sail and how that warning would have been understood by an experienced assured. The reinsured said that having regard to the background knowledge available, the warranty was not breached as an experienced insured would not have read the storm warnings as prohibiting departure from Manila.

The warranty was to be construed having regard to the language actually chosen by the parties, giving those words their natural and ordinary meaning unless the background indicates that this was not the intended meaning. Background knowledge available to the parties included: the prevalence of typhoons in the Philippines around that time; the danger that typhoons posed to shipping; routine issuance of Public Storm Warning Signals and Severe Weather Bulletins; and guidelines issued by the Headquarters of the Philippines Coast Guard from time to time. The commercial purpose of the warranty was identified as 'preventing insured vessels from sailing when there was the possibility of encountering with a typhoon or storm'. Field J identified the underlying policy of the warranty to be 'safety first' and on that basis was prepared to accept the reinsurers' contention that the warranty was breached as soon as the vessel sailed from Manila, despite the typhoon and storm warnings. Few would now argue that text and context are polar opposites. The above example is a good indication of how context can be utilised to give effect to parties' agreement. This is an argument that is advanced in support of the minimalist hypothesis when interpreting the 2015 Act.

The second case is the crewing case of *The Resolute*,[246] which was discussed in Chapter 3,[247] whereby a crewing warranty read: 'Warranted Owner and/or Owner's experienced Skipper on board and in charge at all times and one experienced crew member'. A fire occurred on the insured vessel (a fishing trawler) while she was safely berthed but without the crew members, who were at a local pub. The insurer denied liability for breach of the warranty. The Court of Appeal held that the warranty was ambiguous therefore they applied the *contra proferentem* principle to hold that the phrase 'Warranted Owner and/or

[246] *Pratt v Aigaion Insurance Co SA (The Resolute)* [2008] EWCA Civ 1314; [2006] 1 All E.R. (Comm) 665.

[247] Section 3.3 in Ch 3.

Owner's skipper on board and in charge at all times' was to be construed in favour of the assured.[248] The crewing warranty was found to apply only when the vessel was sailing or preparing to sail.

How would *The Resolute* be decided under the 2015 Act? Any application of the facts of the case to the previous discussion on judicial regulation and the application of s11 will at best be speculative. But the aim is not to provide concrete answers but to rather engage with concerns that may arise with s11. The starting point is the relationship between s10 and s11 as applied to the facts of *The Resolute*. The authors of Arnould have said that where the words 'at all times' were interpreted as being subject to qualifications[249] any breach would seemingly be 'remedied' when the full complement of crew required to be on board at those times returned to the ship.[147] But the breach was not remedied before loss occurred. The assured will therefore not be able to avail themselves of the first layer of protection in s10.

However, the insured can to turn to s11 and first show that the term falls within the ambit of s11 in that it is not a term describing the risk.[250] Once that has been established, the insured will have to show that the term, if complied with, would tend to reduce the risk of loss of a particular kind, at a particular location, and/or at a particular time.[251] The warranty 'Warranted Owner and/or Owner's experienced Skipper on board and in charge at all times and one experienced crew member' could be a loss of a particular kind in that it is meant to guard against loss or damage to the trawler, and/or it could apply to loss at any location given the words 'at all times' (ie whether located at sea or in port).[252]

Given that s11 focuses on the type of loss, the loss suffered here was due to fire, of which the precise cause was unknown. Section 11(3) does not ask whether non-compliance with

[248] As seen above, contra proferentem is not commonly used in marine insurance contexts due to the manner in which such contracts are drafted.

[249] The exceptions in *The Resolute* were in cases of emergencies requiring the evacuation of the vessel of the area; or the temporary departure for the purpose of performing crewing duties.

[250] The IA 2015, s11(1):

'This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole...'

[251] ibid.

[252] *Arnould Law of Marine Insurance and Average* (n 37) 19-46.

the term *did not* increase the risk of loss but rather whether non-compliance with the term *could not* have increased the risk of the loss that actually occurred in the circumstances in which it occurred. The latter is therefore able to catch a broader range of non-compliance. Applying this to the facts of *The Resolute*, the failure to have any crew on board could indeed have increased the risk of loss (ie through fire) that actually occurred in the circumstances in which it occurred. In that instance, the warranty would be upheld, and insurers should not have to pay the claim. Anthony Clarke MR approved the following passages in the 10th edition of MacGillivray on *Insurance Law*:[253]

> The first relevant rule of construction is that the apparently literal meaning of the words in a warranty must be restricted if they produce a result inconsistent with a reasonable and businesslike interpretation of such a warranty. A warranty in a contract must, like a clause in any other commercial contract, receive a reasonable interpretation and must, if necessary, be read with such limitations and qualifications as will render it reasonable. The words used ought to be given the interpretation which, having regard to the context and circumstances, would be placed upon them by ordinary men of normal intelligence conversant with the subject matter of the insurance.

Given that the warranty may be ambiguous, courts may turn to the contract and the parties' expectations. Context that may be relevant includes the assured being a fisherman, occupying a weaker bargaining position, and the fact that the insured was assisted by professional brokers, which presumably shifted some of the responsibility to them.[254] Industry practice may also be useful, as the practice for fishing trawlers is different to that of large merchant vessels since the latter are required to be crewed at all times whether at sea or while berthed. This is unlikely to be the case for fishing trawlers as the emphasis in these cases is on the days when the trawler is supposed to be at sea. The circumstances of *The Resolute* are unlikely to qualify as 'sophisticated parties' and after such a determination the court may find (as happened in the original case) that the warranty was only applicable when the trawler was sailing and hence there was no breach of warranty in the first place.

[253] ibid 19-54.

[254] Soyer, *Warranties in Marine Insurance* (n 34) 28-9.

In the example of *The Resolute*, the warranty itself is likely to be interpreted as too broad to be caught by s11(1). As the authors of Arnould have said, s11 can apply to more than one type of loss but:

> there will obviously come a point where a policy term cannot sensibly be regarded as one tending to reduce the risk of a particular kind of loss, because compliance would tend to reduce the risk of such a large number of kinds of losses that the term in question can no longer be looked at in that way. [255]

Considering s11, courts are more likely to take a narrow approach to warranties when worded in this manner, rather than seeing them as a defence mechanism for a potential broad range of claims. Taking this approach, courts are likely to confirm that the warranty applies to a particular (narrower) type of loss before applying s 11(3).

Consider a situation where *The Resolute* was a high value marine insurance policy between sophisticated parties (such as a reinsurer and reinsured). [256] A minimalist approach would proceed along the same steps as above. If there was again ambiguity with the warranty and if a court considered the context, different considerations should apply. The comment by Lord Reid in *Wickman Machine Tools Sales Ltd v Schuler AG* is relevant:[257]

> The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable the result, the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention abundantly clear.

Similarly, in *Hussain v Brown*[227] Saville LJ observed: 'if underwriters want such draconian protection, it is up to them to stipulate for it in clear terms'.[228] These decisions say something important in relation to the minimalist hypothesis: when parties do in fact make their intentions clear and stipulate a term in the contract then courts should give effect to these terms. Courts should be less enthusiastic about resorting to context unless

[255] *Arnould Law of Marine Insurance and Average* (n 37) 19-43.

[256] *The Resolute* [1996] 1 Lloyd's Rep 627, 812.

[257] Eg *The Princess of the Stars* (n 214) or *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1992] 1 A.C 233.

considered necessary.[258] Sophisticated parties should be free to make and enforce their bargains – even if it is a bad one.

To return to the formalist-contextualist debate once more. A (neo) formalist view of *The Resolute* would focus on the terms of the contract and give effect to the warranty. Hence, the absence of the crew should be viewed as a breach that could have increased the risk of loss that actually occurred. This is particularly so when both parties are sophisticated as both would have been able to better protect their interests and the court should adopt a less interventionist approach. Freedom of contract should be upheld and preference given to a textual interpretation. A contextualist approach would require a consideration that extends beyond the contract to the commercial relationship and the transaction itself. This may well result in the same conclusion that there has been a breach. But the starting point is different as contextualism would require courts to engage with the transaction as a whole and to determine parties' expectations from that, rather than the legal terms.

The debate between formalism-contextualism is not simply a binary distinction between text versus context or the underlying judicial philosophies of judges – it is a contextual determination. This approach is mirrored in judicial approaches to contractual interpretation. In *Wood v Capita Insurance Services Ltd*,[259] the Supreme Court sought to explain both *Rainy Sky*[260] and *Arnold v Britton*[261] as consistent with one another. Lord Hodge, giving the judgment of the court, noted that:

> *Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation.* Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements.[262]

[258] Confirmed in *Arnold v Britton* (n 193).

[259] [2017] UKSC 24 [2017] UKSC 24.

[260] [2010] EWCA Civ 582; [2011] UKSC 50.

[261] *Arnold v Britton* (n 193).

[262] ibid [13].

There is no clear line between how courts should approach the case studies, but what this thesis has attempted to elucidate is that interpretation is a fine balance between formalism and contextualism. Indeed, judges have sought to re-adjust the scales between these two paradigms, but there is unlikely to be consensus on what is the 'correct' approach – both at a scholarship and law level. A contextual determination does not imply a preference for contextualism or relational norms, but rather recognises that even a minimalist approach as applied to marine insurance markets is a contextual determination. That said, the real issue is 'what context and how contextual?'[263] In answering these questions, it is submitted that a minimalist approach to judicial regulation would represent an approach of least interference with the terms of parties' contracts in sophisticated commercial marine insurance markets.

4.5.2 Interpretation as a Default Rule?

A related issue to contracting out that may have arisen in other commercial context is the use of 'interpretation clauses'. This issue will not be considered in detail as there is no certainty yet regarding what such interpretation clauses should say, and these clauses have not yet been considered in relation to insurance contracts. It is, however, worth discussing the objectives of this term as a means to control judicial regulation of commercial contracts. Interpretation clauses are not unknown in contracts and have usually been limited to definitional elements (or that masculine include the feminine, singular includes the plural, etc.), or that the agreement represents the entire agreement between the parties.[264]

There is a growing need for interpretation clauses to go beyond these trite matters. For instance, can an interpretation clause control the type and amount of background information that a court can take into account in interpretation? Can such clauses suggest a preference for the express words of the contract over a contextual interpretation, or perhaps conversely, can these clauses express a preference for a common-sense approach to override the express terms of a contract beyond the canons of construction that are

[263] Morgan, *Contract Law Minimalism* (18) 233.

[264] Entire agreement clauses raise issues pertaining to the 'real versus paper deal' as arguably these clauses emphasise the paper deal (the contract) over what may have the reality of the parties' agreement (the real deal). Stewart Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 (1) American Sociological Review 55.

usually used? Whether such clauses are legally permissible is beyond the scope of this thesis, but given that interpretation under the 2015 Act is at best a speculative endeavour, there is no harm in applying a speculative approach to such interpretation clauses and their value in insurance policies.[265]

The most important aspect about the rules of interpretation is that they should be recognised as defaults.[266] As has been discussed, contexualism is the prevailing approach in contractual interpretation in England and hence can be viewed as the default approach to interpretation. As was seen in relation to sophisticated parties in an insurance context, this contextual approach may not be suitable for all types of contracts and the issue then arises as to whether, commercial contracts may include 'interpretation clauses' directing the courts to interpret them textually. These do not yet appear common in practice, but 'there must be a clear rule giving effect to such interpretive choice given the advantage of formal interpretation'.[267] Mitchell and Morgan have both dealt with the issue of contracting out of contextualism or contracting into formalism.[268]

Morgan says that 'judicial relaxation of formality followed by party re-imposition of formality has been seen before in this area' and provides the example of the parol evidence rule which was diminished by 1986 that the 'Law Commissions concluded that there was nothing left to reform.[269] There have been increasing discourse on the possibilities of entire agreement clauses which reaffirms the written contract as the start and end point for interpretation. Morgan adds that these type of clauses 'reaffirm the parol evidence rule: [t]his is party-mandated formalism'.[270] In line with the premise of minimalism, where such clauses are inserted into commercial contracts between sophisticated parties, then courts should uphold those terms and reinforce a textual

[265] *Enterprise Oil Ltd v Strand Insurance Co Ltd* [2007] Lloyd's Rep. I.R. 186.

[266] Morgan, *Contract Law Minimalism* (n 18) 236. See Catherine Mitchell, *Interpretation of Contracts* (London: Routledge-Cavendish 2007); Cf Alan Schwartz & Robert Scott, 'Contract Theory and the Limits of Contract Law', (2003) 113 Yale LJ 541.

[267] Morgan, *Contract Law Minimalism* (n 18) 236.

[268] Catherine Mitchell 'Entire Agreement Clauses: Contracting Out of Contextualism' (2006) 22 Journal of Contract Law 22; Jonathan Morgan, 'Contracting for Self-Denial: On Enforcing No Oral Modification Clauses' (2017) 76 (3) Cambridge Law Journal 589.

[269] Morgan, *Contract Law Minimalism* (n 18) 237.

[270] ibid. Cf Mitchell, 'Entire Agreement Clauses' (n 239).

approach to the contract.[271] 'While the imposition of formality requirements by law is always controversial, the controversy subsides when contracting parties decide to tie their own hands'.[272]

Once there is some case law on this point, and to ensure that there is certainty as soon as possible following the 2015 Act, courts should make it clear how parties can alter the common law default.[273] Ayres further recommends that courts should always indicate how future parties could achieve the result desired by the losing party. By showing how to contract out of the court's decision, this would resist 'the tendency… to restrict contractual autonomy by transforming nominal default rules into de facto mandatory rules'.[274] While it may be too early to discuss interpretation clauses in insurance contracts, this is worth exploring if judicial regulation does not proceed in the manner suited to sophisticated commercial insurance markets.

Ayres believes that the law of interpretation could represent a kind of altering rule, because the court would have to determine whether the contractual provisions are effective at displacing the statutory default.[275] He argues that there is value in thinking about altering rules as a separate (or potentially sub-) category of interpretation. Developing a distinct theory of optimal altering rules is likely to lead to a different normative analysis than an interpretation theory, which simply seeks to maximise contractor autonomy.[276]

If the parties are deemed sophisticated, the interpretation clause should control the approach to the contract. Where parties to a contract are sophisticated, courts should take a formalist approach in according weight to the interpretation clause and, with that, a formalist approach in determining the meaning of the contract's terms. For sophisticated parties, literalism outweighs any consideration of the context of the deal or its fairness.[277]

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[271] Morgan, *Contract Law Minimalism* (n 18) 237.

[272] Morgan, 'Contracting for Self-Denial' (n 239) 590.

[273] Morgan, 'Immutable or Default Rules?' (n 78)

[274] ibid.

[275] ibid 2047.

[276] ibid 2043.

[277] Miller,' Contract Law, Party Sophistication, and the New Formalism' (n 86) 502-3.

4.6 Reflections on the Regulatory Role of Judges in Modern Insurance Contract Law

The provisions on risk control terms and contracting out are regulatory in that they take a more protectionist approach and amount to a dilution of freedom of contract. This is the case across all insurance contracts and parties subject to these provisions but is particularly acute in relation to sophisticated commercial parties. As Collins said:

> Once it is admitted that one strand in the normative discourses of private law concerns instrumental policy objectives, then it becomes fair to assess private law as an instrument or regulatory technique. [278]

Feinman reiterates this point by saying that 'courts should further the regulatory role of the law in improving the contracting process… in the sense of realizing the parties' legitimate expectations'.[279] Given the substantial statutory reform of insurance law, a logical next step should be to consider the role of judges in giving effect to the reforms. This raises interesting questions for law reform along with the many permeating discourses on that subject.[280] The issue of law reform overlaps with the normative perspective as to how judges are likely to approach the 2015 Act, and in this thesis, the regulatory role of judges is looked at from the perspective of the contextualist-(neo) formalism debate as it recognises that there are other perspectives from which to view the regulatory role.[281]

Minimalism has argued that courts should start and end with the contract between sophisticated insurance parties. But given the design of s11 and the contracting out

[278] Headley (n 66).

[279] I am cautious about extending the US position to a UK situation given that insurance is treated differently and a doctrine of reasonable expectations exists in the US but not the UK. It is relevant for highlighting the relational aspect though.

[280] For example, there was a recent conference on 'Impact and Law Reform' co-organised by the SLS and SLSA at the Institute of Advanced Legal Studies in June 2019 discussing such topics. However any examination of that subject has had to remain fairly limited in line with the objectives of this thesis. This is an aspect that I will consider post-Phd.

[281] Rob Merkin and Jenny Steele, *Insurance and the Law of Obligations* (OUP 2013) 48. Where they say that regulation by commercial expectation and regulation in line with public purpose are both captured by contextualism.

provisions, there is a much larger role statutorily conferred on judges. For instance, judges are required to apply differentiation criteria when determining what amounts to successful contracting out ('the qualifying transparency provisions').[282] This thesis has also called for courts to differentiate in relation to s11 given that it is regulatory as regards all commercial parties from SMEs to sophisticated marine insurance contracts. It is difficult to dispute that the 2015 Act through the case studies imposes a regulatory role on judges. Section 11 of the 2015 Act is a clear example of purpose contradicting the text. The issue that s11 raises is whether the role of purpose should win out even when the specific statutory provision points in a contrary direction. 'It is difficult to escape from the conclusion that this is the very outcome to which the market objected'.[283] The thesis echoes the sentiments of Morgan:

> Once the courts decide what the purpose of terms should be as a matter of legal policy [e.g. warranties], it is difficult to draft a form of words emphatic enough to compel a determined judge to a construction against that 'purpose'.[284]

He adds that:

> This can only result in an arms race of drafting complexity. Courts must respect parties' decisions to deviate from default rules.[285]

Collins has called for a greater differentiation in private law reasoning by regarding contracting parties as representative members of a group (for example, consumers) rather than just recognising the transaction between the parties.[286] For example, in a consumer transaction, by recognising not just the transaction between the parties but also the collective harm that results from that single transaction.[287] But Collins seems to have had

[282] The IA 2015, s17(4).

[283] Merkin & Gurses, 'The Insurance Act' (n 2) 1022.

[284] Morgan, *Contract Law Minimalism* (n 18) 235.

[285] ibid.

[286] Hugh Collins, *Regulating Contracts* (OUP 1999) 72, 77 where he says that 'the option of specialised regulation for certain contracts and markets were found to be too complicated'. Over time, legal doctrine has developed specialised regulation for certain types of recurrent and familiar contracts such as the sale of goods.

[287] Hugh Collins, *Regulating Contracts* (OUP 1999) 72, 72.

in mind a protectionist conception as this notion is derived from public law regulation.[288] His model is therefore geared towards consumers rather than specific commercial markets.

In supporting his view, Collins draws on the substantive aspects of private law, where he claims that 'the tendency towards generality in rules presents problems for the efficacy of regulation'.[289] He highlights the problem with generality using exclusion clauses in standard form contracts. In commercial contexts, exclusion clauses often represent an efficient exercise in self-regulation for the allocation of risk, but in consumer standard form contracts the practice of inserting exclusion clauses in the small print was interpreted rather as a sign of market failure.[290] He explains that private law reasoning was unable to produce legal reasoning that differentiated between these classes of contracts for the purpose of regulatory intervention.[291] The general rule that favoured freedom of contract was applied to commercial transactions and standard form consumer contracts alike.[292]

This thesis does not take issue with differentiation between commercial parties although it does recognise that differentiation can lead to more problems of legitimacy. The greater the differentiation, means that it is less likely to articulate a coherent body of law. If the rules differ according to the category of contract, the private law requires principles that can provide a rational explanation of the categorisation and the reasons for differential regulation.[293] This is similar to Mitchell's criticism of Morgan's minimalism, discussed above, where she observes that to justify a relational approach, litigation should focus on the general nature of the parties as opposed to specific classes of contracting parties as the outcome of litigation is the same for all. Hence taking a relational approach allows courts to make a contextual determination to suit particular circumstances.

This chapter has provided a new normative perspective as to how judges should approach s11 and the contracting out provisions. It is by no means intended as a complete solution

[288] ibid 71. As public law regulation characteristically sets the boundaries of its regulatory standards by reference to classes of participants.

[289] ibid.

[290] ibid.

[291] ibid.

[292] ibid 78.

[293] ibid 79.

to the uncertainties accompanying these case studies in the early stages of its interpretation and development by the judiciary. Rather it provides an important new perspective in recognising the regulatory role of judges under the 2015 Act. This approach finds some support by the authors of Arnould:

> Under the approach suggested by the Law Commissions, which the present editors support, s.11 should not be applied so as to frustrate the insurer's risk assessment process; the insurer needs to be able to charge higher premiums for "riskier" risks and to insert terms reflecting the scope of the risk he is prepared to take. These are all valid considerations, but how far they will affect the courts' approach to s.11 is uncertain.[294]

One of the concerns raised by this thesis is that s11 and contracting out are not straightforward, and these raise important questions about how judges are likely to regulate and on what basis they will regulate such contracts in marine insurance contexts. This seems to be a reversal of Collins's argument. Whereas Collins was wary of freedom of contract being the guiding principle across all contracts, both consumer and commercial, which was not ideal for consumers, this thesis expresses concern about the guiding principle now being protectionist, which is not ideal for sophisticated commercial markets. Thus, this thesis expresses caution to the judiciary: s11 and contracting out are not simply mechanisms that make the law fairer, but there are wider implications arising from judicial regulation.

4.7 Conclusion

This chapter had two layers: it first analysed the type of regulation that is the 2015 Act; and secondly the implications for judicial regulation. This was achieved by blending a substantive law analysis with that of the theoretical contextualist-(neo) formalist debate. At a statutory level it drew on insights from default rules analysis to determine the nature of regulation under the case studies.

It was found that the provision on warranties is a majoritarian default as it is a generally accepted term. Apart from interpretative difficulties that follow a new statute, s10 is not

[294] Arnould, *Law of Marine Insurance and Average* (n 47) 19-40.

problematic. Section 11 and the contracting out provisions were deemed to be a penalty default and a sticky default respectively in relation to sophisticated commercial parties. They were also found to be regulatory in that s11 prevents reliance on a contractual defence by an insurer and the contracting out provisions have increased the threshold to contract out. Both these provisions dilute party autonomy in sophisticated commercial markets. It is an unjustifiable intervention between sophisticated multi-national parties with equal bargaining power, and with contracts concluded with access to resources like brokers and lawyers.

This chapter did not dispute that the law on warranties needed to be reformed in that it created an unbalanced regime as between insurer and insured. It was also recognised that the case studies, particularly s11 and the contracting out provisions were intended as a 'half-way stop'.[295] In other words, given the large scope of commercial parties that the 2015 Act was intended to cover, the final result was meant to provide the most workable solution for all parties and not necessarily the best solution for all parties. Notwithstanding that, this chapter was relevant as it probed further and analysed the implications of the new statutory rules for sophisticated commercial parties. This category of commercial parties represent a significant and important part of the insurance market.

Having analysed and evaluated the statutory design of the case studies, the second part of the thesis provided a normative perspective on the judicial role in interpreting and applying the case studies. In relation to the 2015 Act, differentiation is more easily achieved in relation to the contracting out provisions, but how courts will enforce that is another issue. The rationale behind the 2015 Act was to target the mainstream commercial insurance markets and where markets fall outside the mainstream market, they would be able to vary the default regime of the 2015 Act. The Law Commissions specifically declined to have different statutory regimes for different markets and rather set out a neutral default regime and left it to the courts to regulate and develop the law in these various markets. One of the policy objectives of the 2015 Act was to recognise the differentiation between different markets, and this is reflected in the contracting out provisions that specifically call for judges to adopt differential treatment based on the type of assured and their transaction. There is also the additional avenue where insurers can rely on the insured or its agent having actual knowledge of the disadvantageous term.

[295] Lord Mance's comment, SPBC *Insurance Bill* (n 6) 58.

This will be of benefit to sophisticated markets, such as marine insurance, where brokers are frequently used.

Given the large scope of commercial parties that the 2015 Act is applicable to, it raised issues pertaining to whether courts should also differentiate when applying s11? If they do differentiate in relation to s11 and the contracting out provisions, how would they do so? Morgan's minimalist thesis also recognises this differentiation by calling for a minimalist approach in relation to *commercial* contracts only. But how judges give effect to differentiation is where this thesis parts company from the contextualists. Contextualists like Collins and Mitchell[296] call for judges to look beyond the contract to take into account the business relationship and the economic deal, and in Mitchell's case to give effect to relational norms. Minimalism does not deny the existence of context or that judges should factor in context. Rather minimalism places the emphasis on giving effect to the parties' contract and upholding freedom of contract. Sophisticated markets like marine insurance have already taken steps to contract out the 2015 Act (for example the LMA terms discussed in Chapter 3) and by giving effect to the parties' agreement, courts are actually giving effect to differentiation in these markets. This thesis did not call for a similar term to be applied differently in different contexts. Rather it called for a minimalist approach to interpretation to be the starting point when parties are recognised as sophisticated.

However, even if courts fail to adopt a minimalist approach in relation to sophisticated commercial insurance contracts, they still need to be clear that they are acting as regulators and state clearly the policy objectives that they are pursuing. They should also be clear about how parties may contract out of their decisions, as that will at least provide parties with autonomy to design their contracts in a manner that will fall outside this protectionist-type of judicial regulation. This would include giving effect to industry attempts to self-regulate certain markets such as the LMA terms. It is submitted that the core value of commercial contracting – freedom of contract – offers a commercial utility and convenience that furthers legal certainty rather than pursuing policy objectives.

According to Collins's thesis, private law can learn from public law by 'forgo[ing] the flexibility of abstract principle in favour of a more explicit rationalisation of the policy

[296] Mitchell would refer to herself as a relational theorist than a contextualist.

behind the law'.[297] The normative claims of this thesis are that courts should adopt a minimalistic approach when interpreting and enforcing a commercial marine insurance contract between sophisticated parties. In other words, freedom of contract should be upheld and preference given to a textual interpretation (after a consideration of relevant context). The theme is a consistent one: when such protection is stipulated in policies courts should give effect to those terms even though the result may seem unfair.

Considering the nature of the transaction, if the party has sufficient knowledge, experience and access to resources such that they know or should know what to bargain for, what the written terms mean and how to order contract risks, then a formalist approach to contract questions should prevail. Marine insurance is used in this thesis as a proxy for sophisticated markets. The sections of the 2015 Act are fact driven[298] and courts should engage with them to determine that parties to the contract are sophisticated and therefore effect should be given to the contract. The fact that the court is faced with interpreting a commercial marine insurance contract should lead to a presumption that these are sophisticated parties.

[297] Collins, *Regulating Contracts* (n 257) 82.

[298] The IA 2015, s11 (1), (3) and ss 16 and 17.

Chapter 5: Conclusion: A Formalist Restatement of Marine Insurance Contract Law

5.1 The Research Problem: Aims, Purpose and Methodology

It is an interesting time for insurance contract law given that for the first time since 1906 insurance contract law has been statutorily reformed. As with any period of major reform, a process of evaluation and analysis follows to understand the new regime and its benefits and limitations. This is invariably what ensued following the finalisation of the English and Scottish Law Commissions Reform Project on insurance contract law, which culminated in the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015 ('the 2015 Act'). This thesis focused on commercial marine insurance contract law, and hence the 2015 Act.[1] The 2015 Act has reformed various aspects of the law, but the scope of this thesis focused on the reforms pertaining to warranties, risk control terms, and contracting out.[2]

Much scholarly attention has been focused on the substantive changes to the law – and understandably so.[3] This thesis has re-focused and extended that substantive law enquiry. It has done so by showing that the substantive changes were indicative of something broader, as the 2015 Act is a different creature from the 1906 Act. The changes introduced by the 2015 Act did not just alter the substantive law but rather spoke to concerns regarding how marine insurance contracts are regulated under the 2015 Act, and why they

[1] Discussed in Section 1.3.1 in Ch 1. The Consumer Insurance (Disclosure and Representations) Act 2012 ('CIDRA 2012') only applies to consumer insurance contracts.

[2] The Insurance Act 2015 ('The IA 2015'), s10 (warranties), s11 (risk control terms), ss16-17 (contracting out).

[3] Including: Wenhao Han, 'Warranties in Marine Insurance: A Survey of English Law and Other Jurisdictions with a view to Remodeling the Chinese Law' (PhD thesis University of Southampton (2006); Baris Soyer (ed), *Reforming Marine and Commercial Insurance Law* (Informa London 2008); Robert Merkin and Ozlem Gurses, 'The Insurance Act 2015: Rebalancing the Interests of the Insurer and Insured' (2015) 78 (6) MLR 1004; Robert Merkin and Ozlem Gurses, 'Insurance Contracts after the Insurance Act 2015' (2016) 132 (3) Law Quarterly Review 445; Baris Soyer, 'Risk Control Clauses in Insurance Law: Law Reform and the Future' (2016) 75 (1) 109; Malcolm Clarke and Baris Soyer (eds), *The Insurance Act 2015: A New Regime for Commercial and Marine Insurance Law* (Informa 2017); Baris Soyer, *Warranties in Marine Insurance'* (3rd edn, Routledge 2017).

are regulated in this manner. These broader concerns were the focus of this thesis. In that respect, the aim of this thesis was to analyse 'regulation' from two different yet interlinked perspectives: first, statutory regulation through the design of the 2015 Act; and second, judicial regulation, which refers to the development of case law through the interpretative approach that courts adopt in relation to statutes. The research questions were:

(i) As seen through the case studies of warranties, risk control terms, and contracting out does the Insurance Act 2015 reflect a new type of legal regulation for marine insurance contract law and if so, what type of regulation?
(ii) What are the implications of this type of legal regulation for the judicial regulation of marine insurance cases?

As stated in Chapter 1, the issue is not whether to regulate marine insurance contracts or not, but rather, how much legal regulation there should be and the design of such legal regulation. It may well be argued that these issues are actually 'non-issues' in that the 2015 Act has reformed the law and done a good job of making the law fairer and more balanced or has effected a relatively benign change. It may also be argued that these issues are too theoretical and therefore do not contribute anything meaningful to understanding the 2015 Act and its application in practice. Others may agree that there is merit in considering these issues but disagree with the findings of this thesis.

To the former two criticisms, I would respond that the failure to recognise these issues in the first place highlights that the approach to the 2015 Act is too doctrinal – it boils down to comparing the 'old' law (the 1906 Act) with the 'new' law (the 2015 Act). However, this thesis is not critical of a legal doctrinal approach *per se* and, as mentioned in Chapter 1, it recognises that a legal doctrinal analysis provides an important preliminary step in understanding the substantive law changes introduced by the 2015 Act and continues to find an audience amongst judges and practitioners.[4] But the choice of methodology is determined by the research questions asked and, to that end, the research questions posed in this thesis mean that a legal doctrinal approach would only go so far in answering the questions. Consequently, the methodology adopted in this thesis blends a legal doctrinal analysis and applied contract theory.

[4] Van Gestal, Micklitz and Rubin, 'Introduction' in Van Gestal, Micklitz and Rubin (eds), *Rethinking Legal Scholarship: A Transatlantic Dialogue* (CUP 2017) 9.

This ties in to the latter criticism mentioned above: that the issues raised in this thesis are relevant but there may be disagreement with the findings. Such criticism is accepted as valid as there is no case law yet on the 2015 Act and any projections regarding interpretation and application will have to be speculative. It is generally acknowledged that insurance contract law is (and should be) aligned with general contract law and that insurance contract law operates within a social and economic context.[5] Yet broader socio-legal discussions have not featured in insurance contract law to the extent that it has in general contract law.[6] Rather, insurance contract law has remained largely doctrinal – both at a law and scholarship level. The application of contract theory sought to re-focus and frame the research questions in a manner that would unpack what was significant about legal regulation under the 2015 Act for marine insurance contracts.

The socio-legal debate between the (neo) formalists and the contextualists on 'the rules of contract law as applied by judges in resolving contract disputes in courts'[7] was used to explain the change in regulation following the 2015 Act. Applying the (neo) formalist/contextualist debate to the 2015 Act has explained how the Act was designed, and this in turn required a reconceptualization of the judicial role in sophisticated markets, such as marine insurance. The contextualist theories were used to show the shift towards contextualism in the 2015 Act, and Morgan's neo-formalist hypothesis of contract law minimalism articulated an alternative theory for the regulation of sophisticated markets.[8] The contract law minimalism perspective advanced in this thesis is just that: a perspective. There are undoubtedly limitations to this perspective, which will be discussed below, but as this thesis has claimed, the contract law minimalist perspective is most suited for marine insurance contract law, and hence, for other sophisticated markets.

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[5] Malcolm Clarke, *Policies and Perceptions of Insurance Law in the Twenty-first Century* (OUP 2005) See also YongQiang Han, 'The Relevance of Adams and Brownsword's Theory of Contract Law Ideologies to Insurance Contract Law Reform in Britain: An Interpretative and Evaluative Approach' (PhD thesis University of Aberdeen 2013) Chapter 3.

[6] With the notable exception of Clarke ibid.

[7] Catherine Mitchell, 'Commercial Contract Law and the Real Deal' in Christian Twigg-Flesner and Gonzalo Villalta-Puig (eds), *The Boundaries of Commercial and Trade Law* (Sellier European Law Publishers, Munich, 2011) 21.

[8] Jonathan Morgan, *Contract Law Minimalism: A Formalist Restatement of Commercial Contract Law* (CUP 2013).

5.2 A Summary of the Main Findings

In answering the above-mentioned research questions, the bottom line findings of the thesis are as follows:

(i) The 2015 Act as seen through the case studies of warranties, risk control terms, and contracting out is a new type of regulation for marine insurance.

(ii) The remedy of suspension of liability for breach of warranty in s10 of the 2015 Act is a majoritarian default rule.

(iii) The design of the 2015 Act – as seen through the case studies of risk control terms and contracting out – reflects a contextualist approach which emphasises protectionist tendencies.

- The provision on risk control terms (s11) is designed as an open-textured default rule that has created an uncertain threshold until such time as there is judicial determination.
- Section 11 prevents reliance on a contractual defence where the requirements of s11 (3) have been met.
- Section 11 lacks specificity in that it is applicable to all commercial insurance parties.
- There are restrictions on how parties can contract out of the 2015 Act, which depends on contextual factors: 'the transparency requirements' and 'the qualifying transparency requirements'.
- Section 11 and the contracting out provisions are two new types of regulation.
- The protectionist approach is reflected in the design of these default rules as s11 is a penalty default and the contracting out provisions are a sticky default.
- Both s11 and the contracting out provisions adopt a more protectionist approach, which dilutes party autonomy in sophisticated commercial marine insurance contracts.

(iv) This protectionist type of statutory regulation should not be found in sophisticated commercial marine insurance markets.

(v) A more suitable form of regulation for sophisticated commercial marine insurance would have been a contract law minimalist approach, which requires clear, simple default rules.

(vi) The 2015 Act imposes a regulatory role on judges due to the contextualist design of the Act and the protectionist values underlying this design.

(vii) In determining the judicial role, the formalist-contextualist debate is not an accurate representation of the judicial role in relation to commercial insurance contracts as it is not a binary distinction.

(viii) Despite the 2015 Act being a contextual type of regulation, judges should adopt a minimalist approach in setting the regulatory thresholds in s11 and the contracting out provisions in the 2015 Act.

- Freedom of contract should be upheld, and preference given to a textual interpretation (after a consideration of relevant context).
- The sophistication of a party should lead to the adoption of a formalist judicial approach; the converse is that less sophisticated parties would have a contextual approach applied to their contracts.
- In adopting this approach, insurers should be free to stipulate in their policies the terms/defences that they require. When such protection is in fact stipulated in policies, then courts should adopt an approach of least interference to give effect to these terms and thereby maximise freedom of contract.

5.3 A Holistic Assessment

This section describes the tapestry by providing a holistic assessment of the main findings set out above. The next section examines the threads of the tapestry, that is, the major theoretical threads that weave together to form the holistic picture of the tapestry. In doing so, it positions the original research arising from this thesis against existing knowledge and literature. The first question that arises with a holistic assessment of this thesis is why it matters, or the familiar ‘so what’ question. The answer lies in what are often viewed as two disparate spheres: the law versus scholarship dichotomy. This thesis does not fall exclusively into either of these spheres but is rather an amalgam of both. Its focus is neither solely on the substantive aspects of insurance contract law nor is it on ‘contract

theory', which would entail an analysis of the doctrinal value of theories, such as relational theory to (insurance) contract law.

This thesis sits at the boundary between both spheres, and a better characterisation would therefore be as '(insurance) law in context'. This may seem ironic given that this thesis has been critical of the contextualist school of thought and has reaffirmed a minimalist approach (both statutory and judicial) to commercial marine insurance contract law. But contextualism (or 'context') is usually framed as being about the 'big picture' and, so is this thesis. There could be two different starting points to this thesis: either it starts with contract theory and uses warranties, risk control terms and contracting out as case studies, or it starts with these provisions and uses contract theory to explain the provisions. While the thesis does indeed explain the provisions and contributes to furthering knowledge in that area, its primary concern was with the former starting point. In other words, it used the case studies to explain the 'big picture' which is the type of regulation under the 2015 Act.

The rationale for this approach was because insurance contract law is entering a new age (which I shall return to shortly) and this thesis has used the provisions of the 2015 Act to explain this. The fact that insurance is entering a new age should not be in dispute given the substantial reform of insurance contract law over several years and the new 2015 Act. The dispute, however, arises with the implications of this emerging age on the development of insurance contract doctrine and insurance markets. As Bernard Rix has observed:

> whereas CIDRA has brought about a much-needed revolution, bringing consumer insurance back within the field of the rule of law, in commercial and non-consumer insurance the Insurance Act 2015 has rendered a revolutionary non-revolution. The Act is non revolutionary in that it allows widespread almost total contracting out. But it is revolutionary in the remedies for breach of duty or non-compliance with warranties and other terms excluding or limiting risk. The new remedies are more flexible, proportionate, and fairer than the old law.[9]

Most scholarship on the 2015 Act has taken this line of approach – at least initially. Nevertheless, there have been some changes, for example, the recent edition of Arnould

[9] Bernard Rix, 'Conclusion: General Reflections on the Law Reform' in Clarke and Soyer, *The Insurance Act 2015* (n 3) 122.

recognises that the contracting out provisions may be indicative of something different and unnecessary in commercial markets.[10] This thesis recognises that insurance contract law is at the cusp of something new, with a re-orientation of values from freedom of contract and legal certainty to fairness and proportionality. This requires an evaluation of the new regime (the 2015 Act) that is at the forefront of this emerging age. Such an evaluative approach also speaks to law reform issues that are beyond the scope of this thesis.

However, relevant here is the similarity of the approach to law reform by the Law Commissions in which they adopted a principles-based approach to regulation, which is very much in line with a 'soft law' approach such as regulation through the Financial Ombudsman Service. As was discussed, the FOS is in line with a consumer-welfarist approach to regulation and by implication, the 2015 Act likewise follows a consumer-welfarist approach. While that is not a problem in relation to the regulation of consumers and SMEs under the 2015 Act, it does represent a marked change in the nature of statutory regulation and the values underpinning it in relation to sophisticated commercial parties. Secondly, this new type of statutory regulation raises questions regarding the judicial role in this new age – at least in the early stages of development following the 2015 Act.

The Law Commissions intended for there to be a closer alignment between regulation via the FOS and regulation via the courts. Indeed one of the reasons for the reform of consumer insurance law was also that there was incompatibility in decisions from the FOS and courts.[11] The law –at least from a consumer perspective – was meant to correct that incompatibility.[12] But as was discussed, the FOS also applies to commercial parties at the less sophisticated end and the threshold for the FOS was recently increased to

[10] Jonathan Gilman and others, *Arnould Law of Marine Insurance and Average* (19th edn, 2018) [20A-11]. Arnould says that:

> Despite the wording, what appears to be contemplated is not so much clarity and a lack of ambiguity, but the giving of an explanation as to consequences *within the term itself*. It is not easy to understand why this is required, given the separate requirement that the relevant term—including, in an appropriate case, its consequences—must be drawn to the insured's attention.

[11] David Hertzell, 'The Insurance Act 2015: Background and Philosophy' in Clarke and Soyer, *The Insurance Act 2015* (n 3) 3.

[12] ibid.

include a greater proportion of these types of commercial parties.[13] The FOS is a form of public law regulation and this serves to highlight that the 2015 Act represents public law or welfarist concerns within private law. This points towards a 'hybrid' or a growing emergence of public law concerns in the context of not just consumer insurance – but also commercial insurance.

Insurance contract law in this new age is mirroring trends in general contract law. As was made clear in Chapter 2, there are varying levels of regulation pursuing different objectives and values. These have largely been grouped into two camps – the contextualists and the formalists – and these two camps have had a different reach in contract law and scholarship. There has been a move towards contextualism and relational theory in scholarship, but courts have been more reluctant to move this way (apart from contextual interpretation). Tan says that:

> Relational contract theory has been creeping into the courts. Though hardly entrenched, the concept of the 'relational contract' has been invoked with increasing visibility by parties and judges, especially in recent years.[14]

Some may argue that this debate has been rehearsed *ad nauseum* and should be confined to a dusty bookshelf.[15] However, I disagree and believe that an important part of contract law is recognising the promises and perils of the different aspects of this debate. The following reasons highlight why this debate remains contemporary and relevant. First, from a contract interpretation point of view, one does not have to identify as a contextualist to recognise that courts should be receptive to context. For example in *Arnold v Britton*,[16] the Supreme Court reaffirmed a commitment:

> to text and context by reading a contract in its 'documentary, factual and commercial context', taking into account 'commercial common sense' as one

[13] The Financial Ombudsman Service ('the FOS') considers complaints from consumer and micro enterprises its service has been extended to include a larger proportion of small and medium-sized enterprises (SMEs).

[14] Zhong Xing Tan, 'Disrupting Doctrine? Revisiting the Doctrinal Impact of Relational Contract Theory' (2019) 39 Legal Studies 98.

[15] A sentiment conveyed to me at a conference on the Future of the Commercial Contract organised by the Institute of Advanced Legal Studies, September 2018.

[16] [2015] UKSC 36.

> factor amidst textual meaning, the document as a whole, the purpose of the contract, and surrounding circumstances known to both parties.[17]

Hence, the precise reach of 'context' in interpretation remains a fluid concept. Secondly, courts are sceptical of relational theory but there has also been some judicial engagement with it and this could lead to a presumption that courts may increasingly start to take account of relational theory. However, there are also conflicting judicial views.[18] The influence of relational theory in the courts should not be over-emphasised (by the contexualists) nor under-emphasised (by the formalists). It is necessary to acknowledge that many believe that there is still a debate to be had about the 'doctrinal import of relational contract theory'.[19] Third, scholarship (and to a more limited extent, law) has rejected formalism and embraced contextualism for various reasons. In contract law, a formalist restatement along the lines of Morgan's minimalism was necessary due to the trajectory towards contextualism.

Given the importance of the debate to contract law and that insurance contract law should be aligned with contract law, a logical next step would be to extrapolate normative perspectives from the debate to reframe it in an insurance context. Through the lens of the case studies, it was found that the 2015 Act reflects contextualist tendencies, and the design of s11 and the contracting out provisions are protectionist. It was also found that these provisions dilute party autonomy and that these types of provisions should not be located in sophisticated markets, like marine insurance. This raises the issue of why sophisticated parties should be treated differently or have more autonomy, or similarly, why minimalism is the preferable approach over a contextualist approach in these

[17] Tan, 'Disrupting Doctrine?' (n 14) 117.

[18] *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111; *Alan Bates and Others v Post Office Limited* [2019] EWHC 606 (QB); *Baird Textile Holdings Ltd v Marks & Spencer plc* [2001] EWCA Civ 274, [2002] 1 All ER 737 at [16]; *Total Gas Marketing Ltd v Arco British Ltd* [1998] UKHL 22, [1998] CLC 1275 at 1286.; *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661 at [54], [61]; *BP Gas Marketing Ltd v La Societe Sonatrach* [2016] EWHC 2461 (Comm) at [242]; *Monde Petroleum SA v WesternZagros Ltd* [2016] EWHC 1472 (Comm) at [250], [254], [259]; *Ilkerler Otomotiv Sanayai ve Ticaret Anonim v Perkins Engines Co Ltd* [2017] EWCA Civ 183 at [28]; *Microsoft Mobile Oy (Ltd) v Sony Europe Ltd* [2017] EWHC 374 (Ch) at [67]–[69].

[19] Tan, 'Disrupting Doctrine?' (n 14) 98.

markets. These types of enquiries connect to the three main theoretical strands discussed below.

Regulation differs in different markets and default rules pursue different regulatory objectives. The 2015 Act is not a mandatory regime as that would not be justified in commercial insurance markets where parties are (presumed to be) symmetrically informed at the time of contracting. In relation to consumers or less sophisticated commercial parties there is information and inequality of bargaining power, which justifies a more paternalistic approach to ensure that parties make informed choices[20] and are protected from both procedural and substantive unfairness in contracts. This allows for greater statutory intervention into contracts. In relation to sophisticated commercial parties, these kinds of concerns are largely absent or diminished, and hence implies a different kind of regulation at both the statutory and judicial level. The 2015 Act governs non-consumer insurance and therefore applies to a range of commercial parties to insurance contracts.[21]

When considering regulation at a statutory level the design of default rules becomes relevant. The 2015 Act is a default regime, but it is not implied that this is a straightforward categorisation because default and mandatory rules exist on a continuum. Two points can be made here: that a more contextualist law may result in open-natured default rules (much like s11 of the 2015 Act) or a minimalist approach may result in clear, strict rules. This thesis recognises that party autonomy, default rules, and contextualism/minimalism are always a matter of degree. It would be an over-simplification to state that minimalism is compatible with party autonomy, whereas contextualism dilutes party autonomy. Indeed, the perspective differs between both as contextualism views context as a more complete approach to giving effect to the parties' contract and thereby upholding party autonomy. This thesis accepts that there is no such thing as unrestrained party autonomy, a claim that is not pursued in this thesis. Hence the real point of contention in this thesis is the acceptable degree of intervention in commercial marine insurance markets at both a statutory and judicial level.

From a scholarship perspective the approach that one adopts depends on one's background. For instance, Collins's relational/regulatory hybrid is written from a general

[20] For example in relation to the provision of financial services and consumer credit law.

[21] This thesis does not consider the consumer side of the IA 2015.

contract law perspective rather than with a focus on specific contracts. Collins's approach does not have commercial contracts in mind but is better suited for a consumer approach. Morgan, on the other hand, writes from a commercial perspective and hence views minimal regulation in commercial markets as the better form of regulation. There can be no one single value or strategy that would be correct for the regulation of all contracts. Minimalism is not advocated with consumers in mind; and Collins's model should not be aimed at sophisticated markets.

However, contextualists would argue that the very fact that context is considered would allow for differentiation between different type of contracts and parties, which would result in the most suitable outcome for those circumstances. While that outcome seems sensible, the problem lies with the application of such a sentiment. Gava has opined whether 'being an imperfect contextualist is worse than not being a contexualist at all.'[22] While that may seem far-fetched, there is some truth to Gava's statement. Minimalism recognises the existence of relational norms but emphasises that the contract is both the start and end point. If parties want something more, whether a more contextual or relational approach to their contract, then they should stipulate for it in their contract and when that is done, courts should enforce such terms. As Morgan says: '[s]ensitivity to context may actually require the exclusion of broad, contextual interpretation'.[23]

The discrepancy between the different theoretical approaches serves to highlight the uncertainty surrounding the judicial role in contract law generally and now in insurance contract law under the 2015 Act. This thesis has raised several questions to which there are no clear answers. For instance, should courts be taking on a more regulatory role, and if so, what would such a regulatory role entail? These questions raise issues that extend beyond interpretation and rather centre on how that process of interpretation should be undertaken and its implications for party autonomy.

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[22] John Gava, 'What We know About Contract Law and Transacting in the Marketplace – A Review Essay of Catherine Mitchell, *Contract Law and Contract Law Practice: Bridging the Gap between Legal Reasoning and Commercial Expectation* and Jonathan Morgan, *Contract Law Minimalism: A Formalist Restatement of Commercial Contract Law*' (2014) 2 Adelaide Law Review 409, 417.

[23] Morgan, *Contract Law Minimalism* (n 8) 233, referring to Catherine Mitchell, *Interpretation of Contracts* (London: Routledge-Cavendish 2007).

5.4 The Major Theoretical Strands

5.4.1 An Overview

Rather than adopt a descriptive approach that rehearses what has been done, this section connects the major themes of this thesis to the overall assessment above. In doing so, it identifies the strengths and limitations of this study. The major themes can be classified as follows:

(i) That the 2015 Act is a new type of 'contextualist' regulation as seen through the case studies on warranties, risk control terms, and contracting out.

(ii) That courts should adopt a formalist approach to the insurance contract when the parties are sophisticated, such as commercial marine insurance markets, and a more contextual/relational approach when parties are less sophisticated.

(iii) That contract law minimalism is a viable normative standard at both statutory and, in particular, at a judicial level.

5.4.2 Regulation and the Insurance Act 2015

The 1906 Act was a codifying statute whereas the 2015 Act is a reforming statute. The values and objectives underlying each therefore differ. The 1906 Act was a product of the Victorian codification movement and this reflected different values and recognised the understanding that law should not interfere with trade.[24] Legislative regulation tended to adopt a *laissez faire* approach which emphasised classical values of freedom of contract and legal certainty with an emphasis on procedural as opposed to substantive fairness. The 2015 Act, on the other hand, is a shift from form to substance and with a reorientation of values with fairness and proportionality outweighing that of freedom of contract and legal certainty. Under the 1906 Act the starting point was the insurance contract, but under the 2015 Act the starting point is the legislation.

The remedy of breach of warranty and how insurers relied on warranties was one of the most controversial aspects of insurance contract law in need of reform. Warranties are a contractual term that function as a means for insurers to properly circumscribe risk and to guard against an alteration of the risk that would render it materially different from the risk assumed by the insurer. Section 10 has amended some of the key problems with

[24] Along with other commercial law codifications such as the Bills of Exchange Act 1882 and the Sale of Goods Act 1893.

warranties by replacing the remedy of automatic discharge of all prospective liability with the remedy of suspension[25] and by allowing warranties to be remedied.[26] Section 10 applies only to warranties. It is the first layer of protection when an assured has breached a warranty. Overall s10 was found to be an acceptable reform, although there will be an initial period of uncertainty regarding its application.

Section 11 is intended to operate with s10 by preventing the reforms in s10 from being circumvented. A warranty can be drafted as another type of term and therefore fall outside the ambit of s10.[27] Section 11 was designed to catch all other risk control terms that may not be classified as warranties – although some warranties are risk control terms.[28] Section 11 is meant operate as the second layer of protection where insurers seek to rely on irrelevant warranties as a defence to a claim as s10 does not make provision for this. This raises the question of whether there could have been alternative designs for s10 and/or s11, for instance, could s10 have included a requirement of materiality?

To that end, alternative designs of s10 and 11 could have entailed a requirement that the warranty must be material to the risk insured against and in that case it would eliminate the need for s11. That is unlikely to have been sufficient, as the Law Commissions were conscious of not unduly infringing on party autonomy and such a requirement would have done so. The marine insurance markets would also have objected to a statutory rule that certain terms cannot be included in their insurance policies unless material to the risk insured against. The second reason why this alternative design would not have been acceptable is because it would not have solved the problem of insurers relying on irrelevant warranties. Materiality is important at the stage of incorporation of the warranty

[25] The IA 2015, ss 10(1) and (2).

[26] ibid, ss 10(4), (5) and (7)(b).

[27] For example, a warranty (term) that requires the vehicles owned by the assured company to be kept 'in a roadworthy condition at all times' versus 'this policy applies only when the insured vehicle is kept in a roadworthy condition' and this is stated in the policy under 'risk definition'. Soyer, 'Risk Control Clauses in Insurance Law' (n 3) 121.

[28] For example, warranties to install locks are designed to reduce the risk of theft, and hot works warranties are designed to reduce the risk of fire.

but when a loss occurs and a claim is made, it does not preclude an insurer from relying on that warranty, which may very well be irrelevant to the loss suffered.

Section 11 was found to be regulatory (unlike s10) as it limits party autonomy by preventing an insurer from relying on a contractual defence when the requirements of s11 (3) have been met. It is also a 'one-size-fits-all' rule, which means that it applies to all parties who have not contracted out of that provisions. Turning to the design of s11, the question was raised whether s11 would have been more acceptable if it made provision for judicial discretion along the lines of the Unfair Contract Terms Act 1977, or if it had a 'sliding scale' like the contracting out provisions to differentiate between different types of commercial assureds.[29] It was found that both these options do not suit the minimalist approach, which involves clear, simple rules. The contracting out provisions were also found to be regulatory as it has increased the threshold for contracting out to more onerous terms that dilute party autonomy and are a new type of regulation in commercial contracting.

The design of the default rules in the 2015 Act was examined by using default rules analysis. It was found that the provision on warranties (s10) is a majoritarian default rule which is a default rule that the majority of contractors would want. This type of rule reduces transaction (drafting) costs as more parties will be content with that rule because it satisfies 'reasonable expectations'.[30] Section 10 was viewed as necessary by the insurance industry given the criticism of the remedy for breach of warranty under the 1906 Act.[31] The marine insurance industry also welcomed the reform of the remedy of suspension of liability in s10.[32]

Section 11 on the other hand is a penalty default in relation to sophisticated commercial parties. A penalty default is an undesirable rule that is designed as such to compel parties

[29] The 'sliding scale' refers to s17(4) of the IA 2015 which takes into account the characteristics of insured persons, and the circumstances of the transaction, when determining if the requirements for contracting out have been met ('the qualifying transparency requirements').

[30] Morgan, *Contract Law Minimalism* (n 8) 92. But the debate regarding when default rules should be penal as opposed to majoritarian is irresolvable due to a lack of empirical data. See also Eric Posner, 'Economic Analysis of Contract Law After Three Decades' (2003) 112 Yale LJ 829

[31] The Marine Insurance Act 1906 ('The MIA 1906'), s33 (3) which stipulated the remedy that an insurer is automatically discharged of all prospective liability on breach of warranty.

[32] Special Public Bill Committee, *Insurance Bill* (HL 2014, 81) 19.

to contract out of it. In so doing, parties reveal information that allows the agreement to be more transparent and more fully-informed.[33]The contracting out provisions were found to be a sticky default rule and are an example of a kind of 'soft' paternalism on the basis that a rule is not made mandatory by lawmakers but difficulties are created in displacing the default rule.

It was claimed that the 2015 Act resembles consumer protection statutes. There has been a move to a similar underlying rhetoric as found in protectionist statutes, like the Consumer Rights Act 2015, the Consumer Insurance (Disclosure and Representations) Act 2012, and the Unfair Contract Terms Act 1977. This is not to say that insurance contract law should be divorced from general contract law. This thesis supports the view of academics such as Clarke who say that insurance contract law should be aligned with contract law.[34] The claim expounded here – that contract law minimalism is the better approach for the regulation of sophisticated commercial marine insurance markets – is not particular to insurance but is a sentiment that should apply to other sophisticated commercial markets – as set out by Morgan.

There were two main tests identified in relation to risk control terms in s11: 'the category of loss' test[35] and 'the connection test'.[36] 'The category of loss' test determines whether the term is one where compliance with it would tend to reduce the risk of loss of a particular kind, at a particular location, and/or at a particular time.[37] It was found that the term can be linked to more than one type of loss and each of these kinds of loss would qualify as a particular kind of loss.[38] The 'connection test' was meant to provide an alternative to a causation test yet it is unclear whether it has been successful in this respect.

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[33] Ayres and Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 Yale LJ 87.

[34] (n 5).

[35] The IA 2015, s 11(1).

[36] ibid, s 11(3):

> insured satisfies this subsection if it shows that the non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

[37] ibid, s11(1)(a), (b) and (c).

[38] *Arnould, Law of Marine Insurance and Average* (n 10) 19-43.

There is much uncertainty surrounding the interpretation and application of these tests, but the point has been made that both tests are context-based and encourage factual enquiries by the courts. The interface between both tests has also created confusion until such time as this has been clarified by courts. The design of the 'category of loss test' encompasses general types of losses, whereas 'the connection test' applies to specific types of losses (discussed below). This largely centres on whether the focus should be on the purpose of the term or the type of loss that results. The rationale is stated to be the latter as s11 (3) is seemingly concerned with the probability of loss in that category rather than awareness of the actual loss that occurred. In other words, the purpose of the term is potential control of the type of losses rather than considering the actual loss itself. However, as has been shown, these provisions are interpreted by scholars and the Law Commissions in a way that considers the purpose of the term in relation to the type of loss. It is difficult to argue that the design of s11 leads to this type of analysis.

Based on the objectives of law reform, s11 was meant to leave the determination to courts *ex post* by relying on evaluative triggers, such as those in s11(1) and (3). But in fact its effect is that of a rule that dictates a fairly determinate responses from the courts: s11 obliges a court to act when s11 (3) has been met. Notwithstanding that, the threshold question in s11 (3) determines how courts should approach these provisions. In other words, should the threshold be a broad or weak connection? Consider the example of an alarm warranty: how would a court determine what type of losses are likely to result from a breach of that warranty? The question is compounded by the design of this provision as it is not the particular kind of loss suffered that is pertinent (loss through fire damage) but rather, to quote s 11(3) again, 'the circumstances in which it [the loss] occurred'. Hence, in the example, the circumstance could be a fire breaking out on the premises due to faulty wiring. Clearly the insurer should be liable seeing that non-compliance with the term could not have increased the risk of a fire occurring.

As the saying goes,' hard cases make bad law'. The pressure point with s11 lies with the hard cases. Consider the example where a fire is caused by an arsonist entering the property through a back door during the period when the alarm was deactivated. In such circumstances the insured would find it difficult to show that the breach of the term in question (to keep the alarm activated whenever the premises are unoccupied) could not have increased the risk of a person entering the property and setting fire to the premises. The Law Commissions were adamant that s11 (3) is not about the way in which the loss

occurred as this contradicts the purpose of this provisions, which is to prevent reliance on irrelevant warranties. Yet the design of s11 (3) does not confirm this view.

The contracting out provisions, in my view, are not a saving grace. These provisions require that the disadvantageous term is drawn to the assured's attention before the contract is entered into', and 'it is clear and unambiguous as to its effect' ('the transparency requirements').[39] In determining if the above requirements have been met, the characteristics of insured persons of the kind in question, and the circumstances of the transaction, are to be taken into account ('the qualifying transparency requirements').[40] It is unclear at this stage what would be required to satisfy these provisions – judicial determination is awaited. But it has been noted that this has increased the threshold for contracting out and is also a contextual enquiry like s11. Even the writers' of Arnould say that we will have to wait and see if the contracting out provisions have set the bar too high.[41]

Having considered the substantive law changes, the following points arise, which will be dealt with below. First, the 2015 Act applies to all commercial parties including marine insurance. However, marine insurance was not the focus of the reforms – the reforms targeted the mainstream commercial market.[42] This thesis does not call for marine insurance to be regulated by a separate statute or not to be regulated at all. Secondly, the 2015 Act is 'contextualist', as has been seen through s11 and the contracting out provisions discussed above. If applied to the 2015 Act, Mitchell's reasoning would mean that s11 and the contracting out provisions are not regulatory but are simply a means to guide interpretation. But even if that were the case, the scenario is still contextualism. This raises the question of how the judicial role should be reconfigured, and as this thesis submits, how this role should be reconfigured in a minimalistic way. The final point is that these types of provisions should not be found in sophisticated commercial markets.

[39] The IA 2015, ss 17(2) and (3). The latter adopts the test on contractual incorporation of terms but goes further. The incorporation test is principally concerned with whether reasonable notice of the existence of the term has been given rather than with whether the customer ought to have been aware of its existence.

[40] ibid, s17 (4).

[41] *Arnould, Law of Marine Insurance and Average* (n 10) 1.5-21.

[42] SPBC, *Insurance Bill* (n 50) 3.

5.4.3 Commercial Insurance Contract Law and Party Sophistication

An important second aspect to this thesis is the application of contract theory to insurance contract law, particularly the application of the contextualist-(neo) formalist debate to understanding the 2015 Act and, more notably, the judicial role in interpreting and applying the 2015 Act. This debate is relevant because it is not just about text/context but about how judges can moderate competing objectives of party autonomy and welfarism. Contextualist and formalists can both be at far ends of the spectrum and Collins and Gava are examples of this. Collins's normative framework goes too far as he says that courts can bypass the written contract in some instances where the written contract does not represent the true agreement between the parties. This would not impact on party autonomy as effect is being given to the parties' actual intentions. Conversely, Gava's strict formalism does not account for the fact that context is ever-present. Contextualism and formalism are not binary and cannot be divorced from each other. Legal reasoning should factor in both formalism and contextualism.

Contextualism is useful in directing attention to the context in which the contract is made and performed. A contextual approach can result in the application of formal norms to resolve a dispute, and a formalistic approach is in fact consistent with the existence of extra-legal norms. From an insurance perspective, Feinman has said that insurance is a form contract, but the law should go beyond this and look at the relationship between the parties – a relational approach.[43] This thesis has noted the value of the contextualist and relational theory school of thought but has reaffirmed support for a neo-formalist approach in sophisticated commercial marine insurance contract law (for the reasons discussed below).

Scholarship on the (neo) formalist- contextualist debate raises important questions about the reconfiguration of legal reasoning and about the regulatory role of judges, and it is to this aspect that I now turn. The point was made that commercial law is not a limited market but one that has a diversity of commercial participants. The law that results from commercial contracts should therefore govern all contractual dealings in the general commercial contracting community rather than specific types. Generality and differentiation are aspects that arise in relation to s11 and the contracting out provisions respectively. Section 11 was said to lack specificity as it applies to all commercial parties

[43] Jay Feinman, 'Contract and Claim in Insurance Law' (2018) 25 Connecticut Insurance Law Journal 159, 162.

and assumes that all assureds need this protection, whereas the contracting out provisions specifically allow for differentiation based on the parties and the transaction in question. This general approach in s11 has been identified as a problem in sophisticated markets, thus most insurers in marine insurance contexts plan to contract out of this provision.

This thesis has suggested that the sophistication of the parties should determine whether courts should apply a formalist or contextual approach to legal reasoning. Often a court's indication that a party is 'sophisticated' is used to signal that even though the result may seem harsh, it should be interpreted as fair.[44] The famous dictum delivered by Lord Wilberforce in *Photo Production*[45] regarding the judicial approach to exemption clauses in commercial contracts recognises this sentiment:

> in commercial matters generally, when the parties are not of unequal bargaining power, and when risks are normally borne by insurance, not only is the case for judicial intervention undemonstrated, but there is everything to be said for leaving the parties free to apportion the risk as they think fit and for respecting their decisions.[46]

If parties are sophisticated courts should adopt a formalist approach and give effect to the contract. If parties are less sophisticated then a more contextual approach can be applied to give protection where needed. As applied to the 2015 Act, this would mean that as the contracting out provisions specifically allow for differentiation, courts should give effect to that by taking a less interventionist approach when sophisticated parties contract out. In that instance the contracting out provisions should be upheld even in instances where it undoes the reforms. Where parties are less sophisticated courts can take a more interventionist approach to determine if contracting out satisfies the requirements.

Turning to s11, the issue here does not lie with the 'easy' cases. For example, if there is a warranty to maintain a burglar alarm and the loss is due to flooding by a heavy storm the insurer should be liable as breach of the term (the warranty to maintain a burglar alarm) could not have increased the risk of loss that actually occurred (loss by flooding)

[44] Meredith Miller,' Contract Law, Party Sophistication, and the New Formalism' (2010) 75(2) 493, 495.

[45] [1987] 1 AC 827 (HL).

[46] ibid. See also *Watford Electronics v Sanderson* [2001] 1 All ER (Comm) 696; *Granville Oil & Chemicals Ltd v Davis Turner & Co. Ltd* [2003] EWCA Civ. 570.

in the circumstances (through a storm). However, the thrust of this thesis becomes relevant in relation to 'hard' cases as discussed with the example above. Where there is a warranty to maintain a burglar alarm and a person enters and sets fire to the premises. In that case, breach of the term (the warranty to maintain the alarm) *could* have increased the risk of loss (loss by fire) in the circumstances (by someone entering the property). The insurer would not be liable: the issue is, should a court interpret that threshold in a broad or narrow way? The former would accord with the reasoning above (as it accounts for any entry), whereas a narrow approach would look to the specific circumstances of the entry. In that instance, the court is upholding the terms of the contract between the parties.

Courts should think in regulatory terms, but they are reluctant to do so. They are cautious about taking a broader policy approach. Lessons can perhaps be learned from the Financial Ombudsman Service ('the FOS'). The FOS applies differential criteria to determine the sophistication of parties to then determine the level of intervention and protection that is appropriate. The FOS will prevent insurers from rejecting claims for breach of warranty that are not connected to the loss.[47] This type of intervention is undertaken when the party is classified as unsophisticated. If the FOS thinks the policyholder is 'sophisticated,' the existence of a direct link becomes less relevant and the emphasis shifts to the category of loss that the term is concerned with. Section 11 has clearly been drafted along similar lines, and even though a direct connection is not said to be required in s11, if courts act as regulators, this type of differentiation between un/sophisticated would allow them to determine the type of intervention that is appropriate.

Looking behind contractual labels is more uncertain than just looking at the contractual label that has been agreed to between the parties. Thus is in relation to sophisticated commercial parties who know what they have agreed to, effect should be given to the agreed terms. Smaller parties could be regulated by FOS or have differentiation in the statute. The label of marine insurance should not lead, however: even though marine insurance is a sophisticated market this should not lead to an automatic imposition of

[47] The English and Scottish Law Commissions, *Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties* (Law Com CP 204, 2012; SLC DP 155, 2012) 152-3.

formality by courts. Context should be used to give meaning to the written contract. This answers the question of 'how contextual and, above all, which context?'[48]

5.4.4 Contract Law Minimalism

The main theses of minimalism were stated to be:

(i) That commercial contract law serves a central purpose to facilitate trade and commerce;
(ii) That it is fundamentally optional in nature in that it comprises default rules;
(iii) That these default rules should be clear, simple and formal; and
(iv) That these rules are for dispute resolution not contract governance.[49]

The findings were that the 2015 Act is contextual but that it should have been designed in a minimalist way, and the judicial approach to the 2015 Act should be minimalist. This position should apply in relation to sophisticated commercial marine insurance contract law. Minimalism is the approach of least interference in the regulation of commercial contracts thereby maximising the classical values of freedom of contract and certainty.[50] A more benign approach to freedom of contract makes it easier to predict the outcome than in a paternalistic regime.

Regarding the design of default rules for commercial contract law, minimalism calls for clear, simple, 'non-sticky' rules. This is because default rules are a starting point and are meant to facilitate contracting out. Insurance contract law should be shaped by pragmatic concerns, such as producing workable rules that will promote certainty in market dealings[51] and in ensuring that there are clear and simple rules, which allow the parties to make contracts with the comfort of knowing how they will be enforced.[52]

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[48] Morgan, *Contract Law Minimalism* (n 8) 233.

[49] ibid xiii.

[50] ibid 87.

[51] See eg Lisa Bernstein, 'Merchant Law in a Merchant Court: Rethinking The Code's Search for Imminent Business Norms' (1996) 144 University of Pennsylvania Law Review 1765; Lisa Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms and Institutions' (2001) 99 Michigan Law Review 172.

[52] See generally Morgan, *Contract Law Minimalism* (n 8).

Minimalism is compatible with a contextual approach, but minimalism emphasises the written agreement. Parties should be free to contract out of default rules and the law should not place hurdles in the way. When parties do contract out, courts should give effect to the contract – whether through formalist, contextual or relational standards. Freedom of contract should be retained as a dominant value in relation to sophisticated markets. But why should sophisticated parties, such as parties to a marine insurance contract, be held to a different standard – why should they have more party autonomy?

As discussed in Chapter 1, it can be presumed that sophisticated parties relative to each other have the experience, knowledge and resources to be aware of the terms of the contract and to be able to negotiate those terms from a fairly even keel and order contract risks sensibly (although parties are never of an exact equal footing). In these transactions, freedom of contract should prevail and parties should be held to their bargains unless there is strong public policy considerations weighing against that outcome. Conversely, where a party is not so sophisticated a less formalistic approach may be more appropriate.[53] This sentiment has been expressed by some members of the judiciary by being cautious about intervening in contracts between commercial parties.[54]

At a judicial regulation level, the debate discussed above boils down to which is the better alternative for commercial marine insurance contract law. This goes back to the question posed in Chapter 1: how much regulation, and the design of that regulation. The approach and findings in this thesis were not intended to be a complete explanation of the 2015 Act or claim that the approach suggested in this thesis is the best approach to marine insurance. As was made clear, no such theory can claim to be the best approach as each has its benefits and limitations. Rather, based on the empirical evidence conducted in contract law, and due to the comments of the marine insurance market during the law reform process, this thesis has advocated that the minimalist approach to statutory and judicial regulation is the most suitable hypothesis for marine insurance law.

[53] Miller,' Contract Law, Party Sophistication, and the New Formalism' (n 44) 497-8.

[54] (n 46).

5.5 Significance/Originality

The significance and originality of this thesis was discussed in Chapter 1. This section identifies the specific original components of this thesis that have contributed to and furthered knowledge in this area. These are:

(i) The research questions: an analysis of the 2015 Act as a new type of statutory regulation is original as is the implications that flow from that for judicial regulation.

(ii) The methodology: application of contract theory to marine insurance contract law.

(iii) The use of default rules analysis in the context of marine insurance contract law and the claims that s10 is a majoritarian default rules, s11 is a penalty default rule, and the contracting out provisions are a sticky default rule.[55]

(iv) The claim that the 2015 Act is a new type of regulation that reflects contextualist tendencies.

(v) The classification of s11 as an open-textured default rule that has created an uncertain threshold until such time as there is judicial determination.

(vi) The claim/finding that s11 and the contracting out provisions are regulatory, which dilutes party autonomy.

(vii) The claim/finding that s11 lacks specificity and is of general application to all commercial parties.

(viii) The recognition and classification of the two tests in s11: the 'category of loss test' (s11(1)) and the 'connection test'(s11(3)).

(ix) The recognition and classification of the two tests in the contracting out provisions: the 'transparency requirements' and the 'qualifying transparency requirements' (s17(2), (3) and (4)).

(x) The claim/finding that the contracting out provisions have increased the threshold for contracting out.

(xi) The claim that the 2015 Act bears resemblance to consumer protection legislation.

[55] See also James Davey, 'Utmost Good Faith, Freedom of Contract and the Insurance Act 2015' [2016] Insurance Law Journal 247.

(xii) The application of contract law minimalism to insurance contract law and the claim/finding that it is the better form of regulation in commercial insurance contract law.

(xiii) The claim/finding that the contextualist design of 2015 Act is not suited to sophisticated commercial marine insurance markets.

(xiv) The claim/finding that the 2015 Act imposes a more serious regulatory role on judges.

(xv) The claim/finding that judges should adopt a minimalist approach in setting the regulatory thresholds in s11 and the contracting out provisions in the 2015 Act.

(xvi) The claim/discussion regarding the regulatory role of judges in insurance contract law and the analogy drawn with the FOS.

(xvii) The claim/finding that the sophistication of a party should determine the judicial approach.

5.6 Concluding Remarks

This is one of the first PhD theses to emerge following the 2015 Act. Throughout this thesis it has been highlighted that scholarship and law are different strands, but with the possibility of convergence and overlap in some instances.[56] Insurance contract law is entering a new age given the changes that have taken place at a statutory level. There is therefore a greater need for scholarship that explains and seeks to understand this 'new age'. This is even more pressing given that there has not yet been any case law on the law of warranties, risk control terms and contracting out.

This thesis is important because of the doctrine of precedent – the first cases that come before the courts will set the judicial tone for later cases.[57] In so doing, it has recognised that there is a key choice facing the judiciary as to how to approach the 2015 Act. The importance of this is because the choice of judicial approach will shape judicial attitudes to party autonomy in these sophisticated markets. Either judges may interpret in a highly regulatory manner, or they may interpret in a manner that upholds freedom of contract.

[56] For example, in contractual interpretation both scholars and the judiciary have embraced context.

[57] Marc Galanter, 'Why the "Haves" Come out Ahead: Speculations on the Limits of Legal Change' in R Cotterrell, *Law and Society* (Adershot, Dartmouth 1994).

My thesis contributes to informing that judicial choice in the future development of insurance contract law.

Undeniably so, that is an ambitious task. Nevertheless, this thesis was not meant to be an end but a starting point that raises questions. The answers to these questions may change or evolve as one moves further away from the starting point. Morgan's monograph on Contract Law Minimalism was prompted by the popularity of the contextualist school of thought in scholarship and a need to temper that with a formalist restatement of commercial contract law. There has been a lack of engagement with the (neo) formalist-contextualist debate in an insurance context, yet the 2015 Act is reflective of a trend towards contextualism in the design of the Act and in terms of how judges should approach it. Therefore, this thesis was prompted by similar concerns to Morgan's albeit in an insurance context.

Morgan's neo-formalist view is the minority viewpoint in contract scholarship in the UK. It is likely that the views expounded in this thesis are also likely to be met with criticisms from scholars (and possibly judges). That is understandable but would nevertheless be a positive development in insurance contract law. The point of this thesis was that it is not just about the new rules of insurance law as laid out by the 2015 Act but about the implications of these rules for the regulation of insurance transactions and markets. The (neo) formalist-contextualist debate is essential to understanding the type of statutory regulation and, more importantly, the judicial role after the 2015 Act. Whether these debates could or should influence law is a moot point but as seen in general contract law, this debate is one that must be engaged in. There is no better time for this debate to be had in insurance contract law than when entering a new age.

As claimed in this thesis, Morgan's contract law minimalism sets a viable normative standard for courts to apply, and this thesis affirms support for a formalist restatement of commercial marine insurance contract law. This is just the starting point, but one that is worth exploring further, and for that reason my research questions and methodology remain seminal for future research in this area.

Appendix 1: The Insurance Act 2015

10 Breach of warranty

(1) Any rule of law that breach of a warranty (express or implied) in a contract of insurance results in the discharge of the insurer's liability under the contract is abolished.

(2) An insurer has no liability under a contract of insurance in respect of any loss occurring, or attributable to something happening, after a warranty (express or implied) in the contract has been breached but before the breach has been remedied.

(3) But subsection (2) does not apply if—

(a) because of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract

(b) compliance with the warranty is rendered unlawful by any subsequent law, or

(c) the insurer waives the breach of warranty.

(4) Subsection (2) does not affect the liability of the insurer in respect of losses occurring, or attributable to something happening—

a. before the breach of warranty, or

b. if the breach can be remedied, after it has been remedied.

(5) For the purposes of this section, a breach of warranty is to be taken as remedied—

(a) in a case falling within subsection (6), if the risk to which the warranty relates later becomes essentially the same as that original contemplated by the parties,

(b) in any other case, if the insured ceases to be in breach of the warranty.

(6) A case falls within this subsection if—

a. the warranty in question requires that by an ascertainable time something is to be done (or not done), or a condition is to be fulfilled, or something is (or is not) to be the case, and

b. that requirement is not complied with.

(7) In the Marine Insurance Act 1906—

a. in section 33 (nature of warranty), in subsection (3), the second sentence is omitted,

b. section 34 (when breach of warranty excused) is omitted.

11 Terms not relevant to the actual loss

(1) This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole, if compliance with it would tend to reduce the risk of one or more of the following—

(a) loss of a particular kind,

(b) loss at a particular location,

(c) loss at a particular time.

(2) If a loss occurs, and the term has not been complied with, the insurer may not rely on the non-compliance to exclude, limit or discharge its liability under the contract for the loss if the insured satisfies subsection (3).

(3) The insured satisfies this subsection if it shows that the non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

(4) This section may apply in addition to section 10.

15 Contracting out: consumer insurance contracts

(1) A term of a consumer insurance contract, or of any other contract, which would put the consumer in a worse position as respects any of the matters provided for in Part 3 or 4 of this Act than the consumer would be in by virtue of the provisions of those Parts (so far as relating to consumer insurance contracts) is to that extent of no effect.

(2) In subsection (1) references to a contract include a variation.

(3) This section does not apply in relation to a contract for the settlement of a claim arising under a consumer insurance contract.

16 Contracting out: non-consumer insurance contracts

(1) A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects representations to which section 9 applies than the insured would be in by virtue of that section is to that extent of no effect.

(2) A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects any of the other matters provided for in Part 2, 3 or 4 of this Act than the insured would be in by virtue of the provisions of those Parts (so far as relating to non-consumer insurance contracts) is to that extent of no effect, unless the requirements of section 17 have been satisfied in relation to the term.

(3) In this section references to a contract include a variation.

(4) This section does not apply in relation to a contract for the settlement of a claim arising under a non-consumer insurance contract.

17 The transparency requirements

(1) In this section, "the disadvantageous term" means such a term as is mentioned in section 16(2).

(2) The insurer must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into or the variation agreed.

(3) The disadvantageous term must be clear and unambiguous as to its effect.

(4) In determining whether the requirements of subsections (2) and (3) have been met, the characteristics of insured persons of the kind in question, and the circumstances of the transaction, are to be taken into account.

(5) The insured may not rely on any failure on the part of the insurer to meet the requirements of subsection (2) if the insured (or its agent) had actual knowledge of the disadvantageous term when the contract was entered into or the variation agreed.

Appendix 2: Explanatory Note

EXCERPTS

INSURANCE ACT 2015

EXPLANATORY NOTES

INTRODUCTION

Warranties and other terms

15. Under the current law, breach of a warranty in an insurance contract discharges the insurer from liability completely from that point onwards, even if the breach is remedied. An insurer may also avoid liability even if the breached term would not have increased the risk of the type of loss occurring which was actually suffered. The Act abolishes "basis of the contract" clauses, which have the effect of converting precontractual information supplied to insurers into warranties. It also provides that the insurer's liability will be suspended, rather than discharged, in the event of breach of warranty, so that the insurer is liable for valid claims which arise after a breach has been remedied. Further, it provides that non-compliance with a warranty or other term relating to a particular type of loss should not allow the insurer to escape liability for a different type of loss, on which the non-compliance could have had no effect.

Contracting out

19. The Act provides that, as far as it applies to consumer insurance contracts, an insurer will not be able to use a contractual term to put a consumer in a worse position than they would be in under the terms of the Act. For non-consumer insurance, the provisions of the Act are intended to provide default rules and parties are free to agree alternative regimes, provided that the insurer satisfies two transparency requirements.

COMMENTARY ON SECTIONS

PART 3: WARRANTIES AND OTHER TERMS

Section 10: Breach of warranty

85. Section 10 replaces the existing remedy for breach of a warranty in an insurance contract, which is contained in section 33(3) of the 1906 Act. Under that section, the insurer's liability under the contract is completely discharged from the point of breach.

Section 34(2) makes clear that remedying a breach of warranty does not change this. Sections 10(1) and 10(7) repeal these existing statutory rules, and any common law equivalent.

86. However, the Act does not make any change to the definition of warranty. Warranties are defined in section 33(1) of the 1906 Act with regard to marine warranties, and the common law has developed in parallel in regard to other types of insurance. A warranty "must be exactly complied with, whether material to the risk or not".

87. The effect of section 10(2) is that breach of warranty by an insured suspends the insurer's liability under the insurance contract from the time of the breach, until such time as the breach is remedied. The insurer will have no liability for anything which occurs, or which is attributable to something occurring, during the period of suspension.

88. Section 10(4)(b) makes explicit that the insurer will be liable for losses occurring after a breach has been remedied. It acknowledges, however, that some breaches of warranty cannot be remedied.

89. The "attributable to something happening" wording is intended to cater for the situation in which loss arises as a result of an event which occurred during the period of suspension, but is not actually suffered until after the breach has been "remedied".

90. Generally, a breach of warranty will be "remedied" where the insured "ceases to be in breach of warranty". This is set out in section 10(5)(b). However, some warranties require something to be done by an ascertainable time. If a deadline is missed, the insured could never cease to be in breach because the critical time for compliance has passed. Sections 10(5)(a) and 10(6) are intended to mean that this type of breach will be remedied if the warranty is ultimately complied with, albeit late.

91. Section 10 applies to all express and implied warranties, including the implied marine warranties in sections 39, 40 and 41 of the 1906 Act.

Section 11: Terms not relevant to the actual loss

92. Section 11 applies to any warranty or other term which can be seen to relate to a particular type of loss, or the risk of loss at a particular time or in a particular place. In the event of non-compliance with such a term, it is intended that the insurer should not be able to rely on that non-compliance to escape liability unless the noncompliance could potentially have had some bearing on the risk of the loss which actually occurred.

93. Section 11(1) refers to contractual terms which, if complied with, "would tend to reduce the risk" of loss of a particular kind, or loss at a particular location or time. This is intended to enable an objective assessment of the "purpose" of the provision, by

considering what sorts of loss might be less likely to occur as a consequence of the term being complied with.

94, Section 11(1) does not apply only to warranties and may catch other types of contractual provision such as conditions precedent or exclusion clauses – provided those terms relate to a particular type of loss or loss at a particular location or time. Section 11 does not apply to clauses which define the risk as a whole. This is expected to include, for example, a requirement that a property or vehicle is not to be used commercially.

95. If a loss occurs and a contractual term to which section 11 applies has not been complied with, sections 11(2) and 11(3) mean that the insurer cannot rely on that noncompliance to avoid or limit its liability for the loss, if the insured shows that the noncompliance could not have increased the risk of the loss which actually occurred in the circumstances in which it actually occurred. For example, where a property has been damaged by flooding, it is expected that an insured could show that a failure to use the required type of lock on a window could not have increased the risk of that loss. In this case the insurer should pay out on the flood claim.

96. A direct causal link between the breach and the ultimate loss is not required. That is, the relevant test is not whether the non-compliance actually caused or contributed to the loss which has been suffered.

97. Section 11(4) provides that sections 10 and 11 may apply together. This will only arise where the relevant term is found to be a warranty, because section 10 only applies to warranties.

PART 5: GOOD FAITH AND CONTRACTING OUT

Section 16: Contracting out: non-consumer insurance

120. This section applies to all non-consumer insurance contracts. It concerns the situations in which an insurer can "contract out" by using a term of the non-consumer insurance contract to put the insured in a worse position than it would be in under the default rules contained in the Act.

121. Section 16(2) provides that, generally speaking, parties can agree to contract terms which are less favourable to the insured than provisions of the Act. Such terms may appear in the insurance contract itself or any separate contract. However, such terms will only be valid if the insurer has complied with the "transparency requirements" contained in section 17.

122. There is only one situation in which the insurer cannot contract out to the detriment of the insured, which is set out in section 16(1). This is the prohibition on basis of the contract clauses and similar provisions in section 9.

Section 17: The transparency requirements

123. As discussed above, section 16(2) provides that a contractual term which puts the non-consumer insured in a worse position than it would be in under the terms of the Act is of no effect unless the requirements of section 17 are satisfied. Such a term is referred to in section 17(1) as a "disadvantageous term".

124. The section 17 conditions (the "transparency requirements") are set out in sections 17(2) and 17(3).

125. The requirement, in section 17(2), that the insurer take sufficient steps to draw the term to the insured's attention is intended to ensure that the insured is given a reasonable opportunity to know that the disadvantageous term exists before it enters into the contract.

126. Under the general law of agency, this requirement could also be satisfied by taking sufficient steps to draw the term to the attention of the insured's agent. Section 22(4) is also relevant here. That section explicitly states that references to something being done by or in relation to the insurer or the insured include its being done by or in relation to that person's agent.

127. If the insured (or its agent) has actual knowledge of the disadvantageous term, section 17(5) makes clear that an insured may not claim that the insurer has failed to draw the term sufficiently to its attention.

128. Under section 17(3), the term must also be clear and unambiguous as to its effect. This is intended to require the effects of the disadvantageous term to be set out explicitly, not merely that the language is clear and unambiguous.

129. Section 17(4) provides that that in determining whether the transparency requirements have been met, the characteristics of insured persons of the kind in question should be taken into account, as should the circumstances of the transaction. What is sufficient for one type of insured may not be sufficient for another.

130. The extent to which the term is required to spell out the consequences will depend on the nature of the insured party and the extent to which it could be expected to understand the consequences of the provision.

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