The duty of fair presentation in non-consumer insurance contracts - does one size fit all?

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Introduction

The duty of disclosure historically played a central part to the conclusion of all types of insurance contracts. Codified under the Marine Insurance Act 1906 (the 1906 Act), it traces its origins back to 1766, when Lord Mansfield enshrined the duty into the common law.[1] It was believed that the policyholder would have all relevant knowledge of risks, creating an information asymmetry between the parties. [2] Thus, the duty was designed to protect an insurer and a failure to observe that obligation would allow him to invoke the 'all or nothing' remedy of avoidance. The duty of disclosure itself did not change for over 250 years, but courts played a vital part in clarifying its scope.

However, the 21st century can be described as an era of digitalization. The way we gather, share and store information has changed significantly since the days when insurance was bought in Lloyd's Coffee House.[3] Modern insurance practice is characterised by complex data management systems and specialised underwriting processes, which allows an insurer to obtain information easier than ever before. Furthermore, insurance is no longer considered to be a privilege of a few but has become an everyday necessity for businesses and individuals. With the emergence of various types of clients, the insurance industry adapted its practice to meet their needs. In spite of this, the archaic law remained unchanged.

The unitary position of consumer and non-consumer insurance contract law came to an end with the enactment of Consumer Insurance (Disclosure and Representations) Act 2012 (the 2012 Act). By virtue of the 2012 Act, a consumer is no longer required to volunteer information to an insurer. In contrast, the Insurance Act 2015 (the 2015 Act) retained this obligation in the form of the duty of fair presentation for non-consumer insurance contracts. It is noteworthy that the 2015 Act also introduced a number of significant changes which go beyond the scope of this article.

The separation of consumer and non-consumer insurance contract law regimes was mainly driven by the need to protect vulnerable consumers who did not understand the extent and implications of the duty of disclosure. Following the same line of argumentation, it was suggested that micro-businesses should also fall under the consumer regime as they share similar characteristics that make them susceptible to abuse. This article will attempt to explore whether the Law Commission and the Scottish

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[1] *Carter v Boehm* (1766) 3 Burr. 1905 at 1910.

[2] Dr Zhen Jing and Dr Ming Zhong, 'Limitations on the Insured's Duty of disclosure in Chinese law: a comparative analysis with English, Australian and German laws' (2015) I.C.C.L.R. 224, 224.

[3] Lloyd's History and Chronology - Fact Sheet 2, <https://www.lloyds.com/~/media/lloyds/reports/top%20100%20pdfs/lloydshistoryandchronologyfactsheet2.pdf> accessed 28 March 2016.

Law Commission (the Law Commissions) made the right decision to reject the initial proposal of extending the consumer regime to micro-businesses. It will focus on scenarios when the insurance cover is bought without an intermediary service in a domestic insurance market.

The first part of the article will demonstrate that finding a workable definition of a 'micro-business' in the insurance contract law context may appear onerous, but that this should not act as a bar for adopting a fair policy choice. The second part will examine the insurance contract law reform through the lens of the two clashing goals that the Law Commissions had to balance when arriving at the decision not to include micro-businesses in the consumer regime. On the one hand, it was necessary to protect most vulnerable non-consumer insureds. On the other hand, the Law Commissions had to take into account the realities of the insurance industry which favoured already established insurance practices thereby, safeguarding the holy grail of business certainty in all commercial transactions. Finally, the proposition to extend consumer protection to micro-businesses was mainly based on the assumption that the duty of disclosure, as defined under the 1906 Act, was unfair to the policyholder. The ex-ante analysis of the new framework will assess whether the needs of different business insureds may be met by flexible rules.

1. Cautionary Tales in the Quest of the "Micro-business" Definition

1.1. No Uniform Definition of a "Micro-business"

In 2009, the Law Commissions called for responses to their joint issues paper[4], with the intention to include micro-businesses in a newly constructed consumer regime, which is now found in the 2012 Act. From the social policy perspective, it appears to be reasonable to include and protect a group which has similar characteristics to consumers. [5] However, if micro-businesses are to be placed within the consumer insurance regime, the term has to be defined. [6] Eventually, the proposal has been abolished, and one of the given explanations was the disagreement upon the defining criteria. [7] The importance of picking a correct wording cannot be overstated, as statutory definitions are to be interpreted narrowly. [8] The policymaker must avoid falling into the trap of making arbitrary distinctions. The Law Commissions wrote:

> "What is "small" in this context? What is magic about having less than a particular number of employees or a turnover of less than a particular figure? Sometimes, as

[4] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009).
[5] See for example, Federation of Small Businesses (FSB), 'Protection of Small Businesses when purchasing Goods and Services: Call for Evidence 2015' (30 June 2015), 9 <http://www.fsb.org.uk/docs/default-source/Publications/consultation-responses/fsb-response---small-businesses-as-consumers-call-for-evidence---june-2015.pdf?sfvrsn=0> accessed 25 March 2016.
[6] Locke Lord LLP, Publication of responses to Law Commission's proposals concerning micro-businesses (*Lexology*, 10 November 2009) <http://www.lexology.com/library/detail.aspx?g=a9fbafed-53d2-4a40-9a5d-178ad2c14100> accessed 23 March 2016.
[7] Law Commission, *Insurance Contract Law: the Business Insured's Duty of Disclosure and the Law of Warranties,* (CP No 155, 2012) para 4.16.
[8] Andrew Hicks and S. H. Goo, *Cases and Materials on Company Law* (6th edn, OUP 2008) 491.

> with unfair terms in general, we have concluded that arbitrary rules are essential, but in the context of our proposals for insurance, and particularly the proposal on standard form contracts, we think they may not be."[9]

The statement captures a strong need for a clear and systematic guidance for the insurance industry. However, the process of finding a workable definition was not without hope. A viable case was made for the Financial Ombudsman Service (FOS) jurisdiction definition. For the purposes of this article, it is necessary to establish a definition which would be used when referring to micro-businesses hereinafter.

For many years, there was no single, uniform definition of a small firm. [10] In 1971, the Bolton Committee had a task "to consider the role of small firms in the national economy, the facilities available to them and the problems confronting them."[11] When defining a small company, the Committee not only assessed the usual statistical measures, including turnover and number of employees or assets, but also the market sectors in which they operate.[12] The findings had demonstrated that definitions vary depending on the sector.[13] As a result, the Bolton Committee has created a list of indicative criteria according to which a business is defined as small if: "it occupies a relatively small share in their respective market; it is managed by its owners or co-owners in a personalized way and not through the medium of a formalised management structure; is independent and does not form part of a larger enterprise". [14] One is inclined to conclude, that even though small businesses share some common traits, having one definition for all sectors would not be a pragmatic approach. For instance, "manufacturing is very different from retailing. A 200 employee firm in the first is quite small while in the second it is quite large. Whether the turnover is large or small is also specific to a particular sector".[15] Arguably, the same line of argumentation would apply to the case of defining a micro-business in the insurance contract law context, as a catch-all definition would always be biased towards certain types of businesses.

On the other hand, modern company law has demonstrated that heterogeneity of small firms should not prevent finding a workable definition. A number of targeted measures are adopted across various areas of law to favour smallest businesses, each defining them differently. Some of the best illustrations of the government's initiatives may be found in the tax regulations. For example, entities with a turnover of less than £82,000 per annum are not required to register for VAT. [16] Furthermore, according to the Budget 2016, "businesses with a property with a rateable value of £12,000 and below will receive

[9] Law Commission, *Consumer Insurance Law: Pre-Contractual Disclosure and Misrepresentation*, (Law Com No319, 2009) , para 5.171.
[10] David John Storey, *Understanding the Small Business Sector*, (Routledge 1994) 8.
[11] J. E. Bolton, *Small Firms: Report of the Committee of Inquiry on Small Firms*, (Cmnd. 4811, 1971), v.
[12] David Waite, 'The Economic Significance of Small Firms' [1973] 21 2 J Ind Econ 154, 154.
[13] David John Storey, *Understanding the Small Business Sector*, (Routledge 1994) 9, see also J. E. Bolton, *Small Firms: Report of the Committee of Inquiry on Small Firms*, (Cmnd. 4811, 1971), Table 2.1.
[14] J. E. Bolton, *Small Firms: Report of the Committee of Inquiry on Small Firms*, (Cmnd. 4811, 1971), 1.
[15] David Waite, 'The Economic Significance of Small Firms' [1973] 21 2 J Ind Econ 154, 156.
[16] VAT Registration, <https://www.gov.uk/vat-registration/when-to-register> accessed 23 March 2016

100% relief and businesses with a property with a rateable value between £12,000 and £15,000 will receive tapered relief".[17] A number of other examples may be found in the UK corporate law including exemptions from accounting requirements and from health and safety regulations amongst other things.[18] Notwithstanding differences, there is one overarching feature that binds these definitional choices together - they are designed for legislative measures that specifically target micro-businesses. In contrast, a workable 'micro-business' definition in the insurance contract law context has been necessary to fit this group into the consumer framework, which would be modelled primarily on consumer needs. Even though the distinction is subtle, it allows the reader to envisage why the policymaker will face more dilemmas when constructing a 'micro-business' definition for overarching consumer insurance contract law principles.

It is noteworthy that the Small Business, Enterprise and Employment Act (SBEEA) 2015 has recently established a statutory definition for a 'micro-business'. Section 33 (2) defines it as a business which has "a headcount of staff of less than 10, and it has a turnover or a balance sheet total, of an amount less than or equal to the micro business threshold".[19] The definition was drafted using the EU "micro-enterprise" definition example, therefore creating consistency between regulations on both the EU and domestic levels. [20] The explanatory notes state that the new definition will be available to supplement design of the secondary legislation. [21] Although the uniform 'micro-business' definition is welcomed,[22] it is not complete. According to the Act, further definitional details would need to be outlined in regulations. [23] In effect, the legislature provided policymakers with the template for the definition, but the need to tailor it for a particular purpose remains. Therefore, in practice, disparities between micro-business definitions in different market sectors will continue to prevail.

1.2. Definition for the purposes of Financial Ombudsman Service Jurisdiction

In the insurance contract law context, the Law Commissions have attempted to design a definition that would allow micro-businesses to be placed within the consumer regime. The first two proposals were

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[17] HM Treasury, *Budget 2016* (16 March 2016), para 4.5. <https://www.gov.uk/government/publications/budget-2016-documents/budget-2016#fn:123> accessed 17 March 2016.

[18] Centre for Strategy and Evaluation Services, *Evaluation of Thresholds for Micro Entities: Final Report* (2008), 84 <http://ec.europa.eu/finance/accounting/docs/studies/micro_entity_en.pdf> accessed 23 March 2016, also note, 'small business' is defined under the s.384 of the Companies Act 2006.

[19] Small Business Employment and Enterprise Act 2015, s. 33(2).

[20] Department for Business, Innovation and Skills, *Small Business, Enterprise and Employment Act: Regulatory Reform fact sheets* (2015), 7 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/417323/bis_15_271_SBEE_Act_Regulatory_Reform_fact_sheet.pdf> accessed 27 March 2016.

[21] Explanatory Notes for the Small Business Employment and Enterprise Act 2015, para234.

[22] The BIS endorsed the new definition, see Department of Business, *Innovation and Skills, Protection of Small Businesses when Purchasing Goods and Services: Government Response to the Call for Evidence*, (2016) para3.15 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/496469/bis-16-32-protection-of-small-businesses-when-purchasing-goods-and-services-government-response.pdf> accessed on 27 March 2016.

[23] Small Business Employment and Enterprise Act 2015, s.3 (4).

based solely on the size of the turnover[24] or a number of employees[25] and were immediately rejected by the majority of consultees as too simplistic.[26] Single quantity criteria, though simple, will always lead to arbitrary results. [27] These two propositions will not be discussed in further detail.

In the third proposal it was suggested that the basic part of the definition should reflect the FOS jurisdiction limit. This received predominant support from the consultees as the most sensible and logical option. [28] Accordingly, a micro-business is "a business with fewer than 10 employees and a turnover of less than €2 million which is assessed at the time of entering the contract".[29] The Law Commissions have also proposed a number of filters that would prevent sophisticated businesses entering the consumer regime. This definition will be used for the purposes of this article. Had the reform gone ahead, it may have needed some revisiting with respect to the extra sophistication filters. However, the definition is sufficient to allow the reader to envisage the general characteristics of this targeted group, as the discussion is not about sophisticated businesses that ought to be excluded, but micro-businesses that arguably should be protected.

Even though the basic part of the FOS definition was welcomed by the consultees for its consistent approach with the industry practice, the Law Commissions suggested that the two-limb test is too complex.[30] This argument is facile, considering that it would be onerous to have different rules in relation to the pre-contractual information and the access to the FOS.[31] Furthermore, the complexity of the two-limb test is mitigated by the fact that most insurers are already familiar with the FOS service.[32] The FOS jurisdiction limit has recently[33] been amended to create consistency with the definition of the 'micro-enterprise' according to the wording chosen by the European Commission.[34] The UK government has already embraced the definition for targeted legislation-making, and the SBEEA 2015 is a reflection of that. The fact that business turnover figures will need to be converted into sterling at the time of the purchase[35] may add some complexity to the definition. However, in practice, it merely

[24] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009), para 7.9-7.14.
[25] Ibid, para 7.20-7.32.
[26] Law Commission, *A Summary of Responses to Issues Paper 5: Micro-businesses* (November 2009), para 5.3.
[27] J. E. Bolton, *Small Firms: Report of the Committee of Inquiry on Small Firms,* (Cmnd. 4811, 1971), 1.
[28] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009), para 5.36.
[29] Ibid, para 5.27.
[30] Law Commission, *Insurance Contract Law: the Business Insured's Duty of Disclosure and the Law of Warranties,* (CP No 204, 2014) para 4.16.
[31] Law Commission, *A Summary of Responses to Issues Paper 5: Micro-businesses* (November 2009), para 5.33.
[32] Ibid, para 5.36.
[33] By virtue of FOS 2009/1 Payment Services Instrument 2009 Annex A <https://www.handbook.fca.org.uk/instrument/2009/FOS_2009_1.pdf> accessed 29 March 2016, which implemented Directive 2007/64/EC Art4 (26).
[34] Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises [2003] OJ L 124, Annex Title 1 Art.2 (3).
[35] Law Commission, *Insurance Contract Law: the Business Insured's Duty of Disclosure and the Law of Warranties,* (CP No 204, 2014) para 2.24; Law Commission, *Issues Paper 5: Micro-Businesses*

requires insurers to set up an adequate standard operating procedure. Thus, the basic part of the definition should not be regarded as controversial as it would fit consistently within the UK's general approach towards defining micro-businesses.[36]

On the other hand, the basic criteria on their own are not sufficient to exclude highly sophisticated micro-businesses that operate as part of complex group structures from the consumer regime.[37] The Law Commissions raised particular concerns about the special purpose vehicles (SPVs) or project companies.[38] SPVs are entities set up by a sponsor firm to fulfil a specific purpose, for instance, for debt securitisation. They are "usually set up as an 'orphan company' with shares settled on non-charitable trust and with professional directors provided by an administration company in order to maintain independence between the underlying assets and the sponsor." [39] Despite being part of a highly sophisticated business structure, a SPV would not show up on its originator's balance sheet, making it difficult to trace a connection between them. As a result, by appearing to be a small company, a SPV could, in theory, meet the basic micro-business criteria.

In regards to quasi-subsidiaries, it was found that the top 50 companies had the arithmetical average of 230 subsidiaries per company, excluding unlisted, private companies, suggesting that the group phenomenon cannot be quantified in concrete terms.[40] Evidently, the business sophistication issue cannot be omitted when designing an effective law. In the FOS practice, it is the ombudsmen who would exercise discretion in deciding whether the micro-business is a sophisticated one on the grounds of the size of business turnover, its structure and type of services or products they sell.[41] The outcome of such discretion may depend on the individual ombudsman's opinion, which provides an element of arbitrariness. However, there is no ideal way to address the problem in practice.

The Law Commissions have proposed an 'associated business' filter. "The turnover or number of employees in any associated or group company should be added to the total when calculating the figure for the basic test."[42] The success of such provision would depend upon the drafting of the 'associate business' definition itself. The list of possible definitions included the definition designed for the Unfair Contract Terms Bill that would apply to "bodies corporate, unincorporated associations or

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Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms? (April 2009), para 7.40.

[36] Note, there have been suggestions to change the definition and reduce a number of employees to 5, see 'Smallest Businesses need more Support, say MPs' (*BBC News* 23 November 2011) <http://www.bbc.co.uk/news/business-15864898> accessed on 26 March 2016.

[37] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009), para 8.1.

[38] Ibid.

[39] Roberto Perotti, 'The Economics of Structured Finance' (11 September 2016) 1 <http://www.rperotti.com/corso30442/chapter1120160922v10.pdf> accessed on 7 September 2017.

[40] Andrew Hicks and S. H. Goo, *Cases and Materials on Company Law* (6th edn, OUP 2008) 499.

[41] Financial Ombudsman Service, 'Online Technical Resource: Misrepresentation and Non-Disclosure', (2015) <http://www.financial-ombudsman.org.uk/publications/technical_notes/misrepresentation-and-non-disclosure.htm> accessed on March 2016, Financial Services and Markets Act 2000, s.228 (2) - "what is fair and reasonable in the given circumstances".

[42] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009), para 1.23.

partnerships and control is defined as securing that a party's affairs are conducted according to another party's wishes, directions or instructions".[43] *De facto* control was an important consideration as it would catch companies that are not legally owned by controlling companies.[44] The Law Commissions were evidently lenient towards this wording and stressed that proposed "affiliate"[45] definition would carry similar substance, while the Income and Corporation Taxes Act 1988 definitions of control under s.839 and s.840 were perceived as too complicated.[46]

It was decided that 'associated business' definition would not catch all sophisticated companies that will find a way to deny any connection with the controlling company.[47] Two extra sophistication filters were proposed. Firstly, businesses that spend more than a certain amount[48] on any one insurance premium would be excluded. According to the Association of British Insurers (ABI), the main problem for the proposal is the fact that it would be biased towards businesses that take more expensive insurance products because of the nature of their business or its location.[49] However, as long as the threshold for the premium would be set carefully taking into account all types of insurance covers for micro-businesses, the arbitrariness should be kept at a minimum. The second proposed extra filter would be based on assets which are worth more than £10 million or an annual turnover of more than £10 million.[50] The additional requirement to assess these figures carefully before the inception of the contract would impose a huge burden on both parties concerned.[51] The Law Commissions have defended the extra filter by suggesting that the threshold would be set at a very high level, and as a result, most of the micro-businesses would not need to consider it.[52] The extra filters received only marginal support and were highly criticised as being overly complicated.[53]

Notwithstanding the complexity of sophistication filters, they would, in practice, be applied to a very limited group of businesses. Most of micro-businesses concerned would fit neatly in the new 'consumer box', leaving an insurer little doubt about their structure. Furthermore, the British Insurance Law Association (BILA) has pointed out that there are not that many claims involving sophisticated businesses.[54] Such conclusion is logical. For example, SPVs dealing with huge risk projects[55] are not

[43]Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009), Appendix A2.
[44] Law Commission, *Unfair Terms in Contracts: Report on a reference under section 3(1)(e) of the Law Commissions Act 1965,* (Law Com No 292, 2005), para 5.53.
[45] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009), Appendix A3.
[46] Ibid, Appendix A4.
[47] Ibid, para 8.6.
[48] Initially proposed threshold was £15,000, see Law Commission, *A Summary of Responses to Issues Paper 5: Micro-businesses* (November 2009), para.6.20-6.22.
[49] Law Commission, *A Summary of Responses to Issues Paper 5: Micro-businesses* (November 2009), para 6.23.
[50] Ibid, para 6.29.
[51] Ibid, para 6.30 .
[52] Ibid, 6.31.
[53] Ibid, para6.32-6.33, only four out of seven consultees agreed for using each of the extra filter.
[54] Ibid, para 6.9

likely to obtain their insurance cover negligently or carelessly as the stakes are high. Sophisticated businesses are not typical micro-businesses that would lack resources to obtain professional products. Therefore, instead of focusing on designing perfect sophistication filters, the Law Commissions could have accepted relatively complex proposals in order to protect a vulnerable business group.

1.3. Making a Policy Choice

With a strong policy argument in place, the daunting task of finding the right 'micro-business' definition should not prevent the adoption of one. There are no perfect criteria to separate micro-businesses from their larger counterparts, and the best a legislature can do is to accept a workable definition. As was outlined before, the primary function of the micro-business definition in the insurance contract law reform context was to fit the smallest businesses into the consumer regime. In the financial services context, this is not a novel proposition. In 1971, The Crowther Committee explored the issue in relation to consumer credit agreements. It was concluded that 'the position of small unincorporated businesses buying on credit or raising a loan was often not much different from that of an individual buying or borrowing for personal or family use.'[56] In recent insurance contract law reform, the Law Commissions echoed a similar line of argumentation with a difference being that in the consumer credit context the policy has been adopted in the Consumer Credit Act 1974 (the 1974 Act).

By virtue of the Consumer Credit Act 2006 (the 2006 Act) which has amended the original wording of the 'individual' definition,[57] it now includes sole traders, partnerships with not more than three partners and unincorporated associations.[58] Consumer protection extends to loans up to £25,000.[59] The provision serves as a sophistication filter of a kind, as small businesses dealing with high-risk projects would usually be financed by the controlling company and the threshold for the loan, in general, would be too low. The eligibility criteria for smallest businesses are straightforward and easy to apply in practice. However, it evidently draws an arbitrary line, dividing businesses as worthy of protection primarily based on their chosen form. It has been suggested that there is a little difference between incorporated and unincorporated businesses. The requirements for setting up a company in the UK are minimal.[60] Nevertheless, by deliberately choosing to incorporate a business, its owners are entitled to take advantage of the limited liability and separate legal personality[61] thereby, mitigating a risk of personal accountability in regards to company's credit agreements. In effect, the definition of 'individual' was extended to entrepreneurs who assume personal responsibility for their business

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[55] For instance, SPV was engaged in projects for government ministry, with a total net project value of £0.5bn, see Hedley Smith and Andrew Edkins, 'Relationship management in the management of PFI/PPP projects in the UK' (2007) 25 IJPM 3 232, 236.
[56] Committee on Consumer Credit, *Consumer Credit: Report of the Committee* (Cmnd 4596, 1971) para 1.1.3.
[57] See Consumer Credit Act 2006, s.189: "'individual' includes a partnership or other unincorporated body of persons not consisting entirely of bodies corporate".
[58] Consumer Credit Act 2006, s.1.
[59] Consumer Credit Act 1974, s.16B.
[60] HC Deb 25 January 2005 Consumer Credit Bill Col No 12.
[61] *Salomon v Salomon & Co Ltd* [1896] UKHL 1.

matters. Despite the fact that some equally vulnerable incorporated businesses are excluded from the consumer credit regime, the 2006 Act provides a credible example of the government's active pursuit of a fair policy choice for the most susceptible businesses instead of focusing on finding a perfect definitional criterion.

On the other hand, the extension of consumer protection to the smallest businesses is an 'anomaly'[62] and treating micro-businesses as consumers is not a generally accepted policy choice in the UK. Most significant consumer protection legislation does not contain special provisions for small or micro-businesses,[63] despite the policy arguments to the contrary.[64] Consequently, the term "consumer" would draw a dividing line between the consumer and non-consumer regimes. In the insurance contract law context, the 2012 Act 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".[65] Lord Hertzell explained:

> "One needs to look at the purpose of the insurance contract that is being taken out, which at the end of the day is, I am afraid, fact specific. Therefore, we were unable to come up with anything that was more precise than that. What we have in mind is business extensions on car policies, dual-use computers and so on, where the main use of the item is for the consumer but people send the odd e-mail from the computer or make the occasional business trip in the car."[66]

It has been suggested that the provision will inevitably catch some "mixed purpose" insurance contracts.[67] In line with the 2012 Act, the FCA has also slightly extended its definition of a consumer within Insurance Conduct of Business Sourcebook (ICOBS) by adding the term 'mainly'.[68] Even though the wording may be criticised for creating uncertainty for small businesses, the definition is in line with the general common law practice. It appears that in situations of ambiguity, the courts are

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[62] Brown S, 'Protection of the Small Business as a Credit Consumer: Paying Lip Service to Protection of the Vulnerable or Providing a Real Service to the Struggling Entrepreneur? '(2012) 41 Comm. L. World Rev. 59, 59.

[63] Amelia Fletcher and Antony Kreutzmann-Gallasch, 'Small Businesses as Consumers: Are They Sufficiently Well Protected?' (January 2014) para 1.7 <http://competitionpolicy.ac.uk/documents/8158338/8264594/fsb+project_small_businesses_as-consumers.pdf/f1ed4da5-14cf-4b80-a1d8-ff76a0781def> accessed 27 March 2016, see also Consumer Rights Act 2015 s.2 (3), s.3(1), s.33(1), s.48(1), s.61(1).

[64] Citizens Advice Bureau, 'Consumer Rights Bill House of Commons Report Stage' (13 May 2014) <https://www.citizensadvice.org.uk/global/migrated_documents/corporate/citizens-advice-briefing-report-stage-consumer-rights-bill-13-05-14.pdf> accessed 27 March 2016.

[65] Consumer Insurance (Disclosure and Representations) Act 2012, 1(a).

[66] Special Public Bill Committee, *Consumer Insurance (Disclosure and Representations) Bill* [HL] 11 October 2011, Q10.

[67] Graham Charkham, '6th April 2013: all Change in Insurance Law? A Guide to the Consumer Insurance (Disclosure and Representations) Act 2012', (*20 Essex Street* 2013) para.9.

[68] Amelia Fletcher and Antony Kreutzmann-Gallasch, 'Small Businesses as Consumers: Are They Sufficiently Well Protected?' (January 2014), 23 <http://competitionpolicy.ac.uk/documents/8158338/8264594/fsb+project_small_businesses_as-consumers.pdf/f1ed4da5-14cf-4b80-a1d8-ff76a0781def> accessed on 23 March 2016.

inclined to interpret circumstances to favour micro-businesses. [69] Nevertheless, each case will be judged on its own merits, and a slightly broad definition of a 'consumer' does not go as far as to give micro-businesses the same protections as the consumer regime would.[70] A clear policy choice has been made which goes beyond finding the right definition.

2. Protecting the Weak - Public Policy Argument for Extending Consumer Regime to Micro-businesses

2.1. Treating like Cases alike

In the insurance contract law context, both consumers and micro-businesses represent vulnerable groups and therefore, in theory, should be covered by the same regime. The key driver for such proposition relates to the legal principle of 'normative coherence' - or the principle of 'treating like cases alike'.[71] The Law Commissions wrote: "Most micro-businesses are hardly, if at all, more sophisticated than consumers. Most are sole proprietorships, have relatively small turnovers and have no more experience in buying insurance than consumers."[72] Considering from the availability of resources perspective, small businesses are closer to consumers than large businesses under any definition of a micro-business.[73] This part of the article will analyse why including micro-businesses in the consumer insurance contract law regime could have been a sensible response to the challenges that they face.

To begin with, most micro-business owners and consumers share similar characteristics. Both groups evidently lack the sophisticated knowledge necessary to understanding fully the extent and implications of the duty to volunteer information to the insurer. Many smallest business owners are relatively young, with 25% being 25 or younger. 5.5% of entrepreneurs have no educational qualifications at all, 30% did not pursue any higher education.[74] Considering that even specialised risk managers often failed to grasp the extent and quality of the old duty of disclosure,[75] in relative terms, the obligation was even more burdensome on micro-businesses. It may be argued that the duty of fair presentation

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[69] Sarah Brown, 'Protection of the Small Business as a Credit Consumer: Paying Lip Service to Protection of the Vulnerable or Providing a Real Service to the Struggling Entrepreneur? '(2012) 41 Comm. L. World Rev. 59, 77.

[70] Amelia Fletcher and Antony Kreutzmann-Gallasch, 'Small Businesses as Consumers: Are They Sufficiently Well Protected?' (January 2014), 23 <http://competitionpolicy.ac.uk/documents/8158338/8264594/fsb+project_small_businesses_as-consumers.pdf/f1ed4da5-14cf-4b80-a1d8-ff76a0781def> accessed on 23 March 2016.

[71] Amelia Fletcher and Antony Kreutzmann-Gallasch, 'Small Businesses as Consumers: Are They Sufficiently Well Protected? (January 2014), 14 <http://competitionpolicy.ac.uk/documents/8158338/8264594/fsb+project_small_businesses_as-consumers.pdf/f1ed4da5-14cf-4b80-a1d8-ff76a0781def> accessed on 23 March 2016.

[72] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009), para 4.3.

[73] Larry Gavin, 'Small Businesses and the False Dichotomies of Contract Law' (2004) Ohio State Public Law Working Paper No.1, 12.

[74] Law Commission, *Consumer Insurance Law: Pre-Contractual Disclosure and Misrepresentation*, (Law Com No319, 2009), para 2.9.

[75] Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* (Law Com No 353, 2014), para 5.9.

under the 2015 Act is designed to provide more clear rules for better compliance. However, just because the legal obligations are clearer to professionals, does not change the fact that micro-businesses may lack general understanding of statutory standards or complexity of insurance products. For instance, consider the 2.7 million self-employed people working from home in the UK, with 42% converting a room in their house into an office.[76] 26% of micro-business owners are said to be unaware that having an insurance cover is a necessity with 24% claiming not to know that running a business from home could invalidate the home insurance.[77] Thus, a lawyer insuring his house as a consumer will have a much better understanding of the duty and its implications than the fishmonger insuring his business premises. [78]

In addition, micro-businesses are as susceptible as consumers to having policy terms imposed on them by insurers.[79] Imbalance of bargaining powers puts the insured in an uncomfortable position when negotiating insurance contract terms.[80] The policyholder also lacks a real choice between different insurance providers, as the market is homogeneous and operates according to the by-and-large uniform principles.[81] Regrettably, the extent of the effects of the problem in practice has not been proven.[82]

Admittedly, hiring a broker may mitigate the situation.[83] However, as illustrated by the Charles River Associates International report, around half of the companies with a turnover of less than £500,000 would buy the cover directly, without the help of the intermediary and this trend is increasing,[84] which suggests that the problem is likely to become progressively more significant.

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[76] Lloyd's Banking Group, 'Home is where the business is' (26 November 2014) <http://www.lloydsbankinggroup.com/Media/Press-Releases/2014/lloyds-bank/home-is-where-the-business-is/> accessed 29 March 2016.

[77] 'More than eight out of 10 UK Micro Businesses adapt Homes for Workspace' (*EquityBites* 26 Nov 2014) <http://search.proquest.com/docview/1628045321/8DE31679540F4D88PQ/28?accountid=8155> accessed on 23 March 2016.

[78] Sir Andrew Longmore, 'An Insurance Contracts Act for a new Century?' (Pat Saxton Memorial Lecture, 5 March 2001), para 42.

[79] Department of Business, Innovation and Skills, *Protection of Small Businesses when Purchasing Goods and Services: Government Response to the Call for Evidence*, (February 2016) para 2.15-2.28 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/496469/bis-16-32-protection-of-small-businesses-when-purchasing-goods-and-services-government-response.pdf> accessed on 26 March 2016.

[80] Law Commission, *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (CP No 182, 2007), para 5.4.

[81] YongQiang Han, *The Relevance of Adams and Brownsword's Theory of Contract Law Ideologies to Insurance Contract Law Reform: An Interpretative and Evaluative Approach*, (University of Aberdeen 2013) 83.

[82] Department of Business, *Innovation and Skills, Protection of Small Businesses when Purchasing Goods and Services: Government Response to Call for Evidence*, (2016) para 3.5. <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/496469/bis-16-32-protection-of-small-businesses-when-purchasing-goods-and-services-government-response.pdf> accessed 26 March 2016.

[83] Law Commission and Scottish Law Commission, *Insurance Contract Law: a Joint Scoping Paper* (2006) para 1.18.

[84] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009), para 2.14, see also: CRA International, *Commercial Insurance Commission Disclosure: Market Failure Analysis and high Level Cost Benefit Analysis the Right Decision Matters*, (2007)

Finally, the Association of Insurance and Risk Managers in Industry and Commerce (AIRMIC) research demonstrated that complying with the duty to volunteer information posed a significant burden on the insured. "Three-quarters of respondents would spend from two to six months preparing information for insurers. For example, 38% of submissions for property risks exceeded 50 pages".[85] However, micro-businesses often lack the time and financial resources to invest in preparing a disclosure. The 2015 Act provides some ease to the process as the "knowledge" is now defined,[86] adding certainty as to which information needs to be declared. On the other hand, from a micro-business owner's perspective, lack of general understanding of insurance products combined with the failure to grasp legal requirements may inhibit compliance. For businesses, obtaining an insurance cover is an ancillary activity[87] and micro-businesses cannot afford to dedicate time to it. Mike Cherry, Policy Director for the Federation of Small Businesses, observed:

> "Smaller businesses are the hardest hit by the skills gap. They are more likely to suffer significant impacts as a result of the shortfall. This includes: increased workload for staff, higher operating costs, and loss of business to competitors."[88]

Paradoxically, while micro-businesses often lack adequate resources to prepare information for disclosure, they may be far more dependent on their insurance policy and the stakes, in relative terms, are higher than for consumers.[89]

However, it may be argued that an entrepreneur who chose to take advantage of having a certain legal business form should abide by the conditions attached. Even though running a business requires a significant amount of effort, it may also reap substantial rewards, including financial gains. Such rewards are out of reach for individuals who buy goods and services for personal consumption and therefore, it would not be fair to treat consumers and micro-businesses equally. Lack of resources does not suggest that micro-businesses do not need to hire specialists when obtaining professional products.[90] Weak entrepreneurs, who are impulsive, inexperienced and uninformed, should suffer the consequences of their mistakes.[91] Fortunately for micro-businesses, social Darwinism is not the

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<http://www.crai.co.uk/sites/default/files/publications/commercial-insurance-commission-disclosure.pdf> accessed 26 March 2016.

[85] Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* (Law Com No 353, 2014), para 5.16.

[86] Insurance Act 2015, ss.4-6.

[87] Law Commission, *Insurance Contract Law Issues Paper 1 Misrepresentation and Non-Disclosure* (September 2006) para 7.6.

[88] Federation of Small Businesses, 'Small Businesses hit hardest by UK Skills Gap' (28 January 2016) <http://www.fsb.org.uk/media-centre/latest-news/2016/01/28/small-businesses-hit-hardest-by-uk-skills-gap> accessed 27 March 2016.

[89] Martijn W. Hesselink, 'Towards a Sharp Distinction between B2B and B2C? On Consumer, Commercial and General Contract Law after the Consumer Rights Directive' (2009) Centre for the Study of European Contract Law (CSECL), para 4.2.1 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1416126> accessed 27 March 2016.

[90] Law Commission, *A Summary of Responses to Issues Paper 5: Micro-businesses?* (November 2009), para 2.9.

[91] Ibid, para 4.2.5.

approach taken by the UK government[92] and protecting weaker parties would not generally go against the spirit of the law.

2.2. The Industry Practice and the Financial Ombudsman Service

Over the years, the insurance industry has adapted its practice to favour weaker parties to the contract, including micro-businesses. [93] Furthermore, the existence of the FOS helped to form one of the most prominent arguments against the extension of consumer insurance contract law regime to include micro-businesses. However, relying on the industry itself and the FOS to address inefficiencies of primary law is inappropriate and risky.

The role of the FOS is stated in the FSMA s.225 (1): "a scheme under which certain disputes may be resolved quickly and with minimum formality by an independent person".[94] According to Lord Hunt, "speed, informality and independence" [95] are crucial considerations for understanding the purpose and the approach that the FOS takes. By virtue of section 228 (2), ombudsmen are obliged to decide the complaints in the light of what is "fair and reasonable in all the circumstances of the case". Therefore, it offers an exceptionally attractive means of obtaining a result which goes beyond constraints of the strict application of the statute. In regards to micro-businesses, ombudsmen would treat their claims as if they were consumers.[96] As a result, the statutory obligation to volunteer information to the insurer appears to play a minor role in the cases handled by the FOS.

On the other hand, the evidence suggests that the FOS clientele is not aware of the favourable approach of the ombudsmen.[97] A problem arises as there are no publicly available documents that would represent what the systematic FOS position would be in relation to different types of claims. Micro-business owners may find themselves in fear of wasting time and eventually decide not to bring a viable claim. One of the main publicly available sources of the FOS decisions is the *Ombudsmen News* publication. The information about cases found in the news is generic, lacks representation of the FOS methodology and does not address micro-businesses' claims adequately. It comes in the form of a technical note which merely contains contact details encouraging interested businesses to inquire

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[92] For example, see Lord Young, *Growing your Business: a Report on Growing Micro-businesses*, (May 2013), <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198165/growing-your-business-lord-young.pdf> accessed on 27 March 2016.

[93] Law Commission, *Consumer Insurance Law: Pre-Contractual Disclosure and Misrepresentation*, (Law Com No319, 2009) para 2.28.

[94] Lord Hunt, 'The Independent Review of the Financial Ombudsman Service, Opening up, reaching out and aiming high, An Agenda for Accessibility and Excellence in the Financial Ombudsman Service' (Beachcroft LLB 2005), 2 (The Hunt Review) <http://www.financial-ombudsman.org.uk/news/Hunt_report.pdf> accessed 27 March 2016.

[95] Ibid.

[96] Ombudsman News from December 2008/January 2009, also see Law Commission, *Issue Paper No 1: Misrepresentation and Disclosure* (September 2006) para 4.23, Ombudsman News Issue 46 (May/June 2005) 9 <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/46/46.pdf> accessed 27 March 2016.

[97] Law Commission, *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (CP No 182, 2007) para 3.61.

further.[98] Furthermore, Lord Hunt's Independent Review (2008) and the FOS transparency campaign[99] resulted in the creation of a search engine providing easier access to different cases.[100] Regretfully, contents of the cases remain unchanged. The FOS service can be described as robust and transparent in the informal dispute resolution context. However, it does not have a clear mandate or the legal competence to set standards for the industry.

Finally, the FOS serves as an additional safeguard to micro-businesses' interests only to the extent that they are aware of their rights. The investigations of the Law Commissions show that out of 197 sample FOS cases only 4% were brought by business insureds and only 5 cases were related to non-disclosure, making a sample of 12 cases in total.[101] One of the reasons for this relates to the fact that the FCA Handbook does not require insurers to inform micro-businesses whose claims have been refused that they have a right to take a complaint to the FOS. There has been a proposition that the FCA Handbook should be amended to create an obligation for insurers to notify eligible micro-businesses about their entitlement to bring their claim to the FOS, should the insurance company decide to reject it. [102] This reform would be welcomed for it would contribute to raising awareness about the FOS approach thereby, allowing micro-business owners to make more informed decisions.

The FOS analysis demonstrates that even though micro-businesses are eligible to use it, they are not treated as consumers for all intents and purposes. There are areas of improvement that could provide micro-businesses with more transparent and accessible service. Consequently, the insurance contract law reform deliberately placing micro-businesses in the consumer regime cannot be replaced but only supplemented by the FOS.

3. The One Size Does Fit All

Extending consumer protection to include micro-businesses would have been a bold step not only in relation to the insurance contract law but also to overall financial services regulation in the UK. Though it is beyond doubt that micro-businesses and consumers share certain traits that make them vulnerable to unfair treatment, the argument is overly simplistic. In fact, there are fundamental differences between the two groups that provide a sensible justification for the outcome of the reform.

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[98] Financial Ombudsman Service, 'A quick Guide to Helping you resolve Complaints' <http://www.financial-ombudsman.org.uk/publications/technical_notes/QG6.pdf > accessed on 27 March 2016/.

[99] Financial Ombudsman Service, 'Transparency and the Financial Ombudsman Service, Publishing Ombudsman Decisions: Next Steps' (September 2011), <http://www.financial-ombudsman.org.uk/publications/policy-statements/publishing-decisions-sep11.pdf> accessed on 27 March 2016

[100] Financial Ombudsman Service, Ombudsman Decisions < http://www.ombudsman-decisions.org.uk/> accessed on 26 March 2016.

[101] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009), para 2.20.

[102] Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com 319, 2009), para 2.22.

Insurance regulation has many purposes, and they are in a considerable conflict with one another. [103] The Law Commissions recognised that it would be impossible to design a system which would please all businessmen.[104] The reform followed the one-size-fits-all approach to all non-consumer contracts. This part of the article will analyse the reasons why it has been argued that the new regime is flexible enough to serve micro-businesses' interests.

3.1 Legal Certainty

The insurance industry is at the heart of the UK financial services sector. Not only does it provide necessary services to individual customers, but it also underpins almost all forms of economic activity and promotes a generation of welfare. [105] Even though the duty of disclosure was subject to criticisms for decades, the research showed that the UK insurance market is strong, credible and competitive on the domestic and international levels.[106] Also, despite being described as a major source of uncertainty,[107] the duty of disclosure triggered merely 26 cases which reached the trial stage in the last decade.[108] Only 5% of AIRMIC members litigated on the matter. [109] Thus, evidence appears to support the view that there was no necessity for the radical alteration of the insurance contract law. Some commentators go as far as to suggest that English insurance contract law certainty has been jeopardised by introducing the new features. [110]

Legal certainty is a grand theme in the UK commercial law context[111] and insurance law is no exception. When the Marine Insurance Bill was presented to the House of Lords, Lord Herschell quoted Willes J in Lockyer v Offley[112]:

> "As in all commercial transactions the great object is certainty, it will be necessary for this Court to lay down some rule, and it is of more consequence that the rule

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[103] Spencer L. Kimball, 'The purpose of Insurance Regulation: A Preliminary Inquiry into the Theory of Insurance Law' (1961) 45 Minn. L. Rev. 471, 524.
[104] Bruce Hepburn and David Hertzell, 'Contracting out of the Insurance Act 2015' (*Mactavish* 22 December 2015) <http://www.mactavishgroup.com/news/contracting-out-of-the-insurance-act-2015/ > accessed on 26 March 2016 .
[105] Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* (Law Com No 353, 2014), para 1.1.
[106] Ibid.
[107] Ibid, para 1.38.
[108] ABI Response to the Law Commissions Joint Consultation Paper on Insurance Contract Law: the Business Insured's Duty of Disclosure and the Law of Warranties (September 2012) <https://www.abi.org.uk/~/media/Files/Documents/Consultation%20papers/2012/09/Insurance%20Contract%20Law%20The%20Business%20Insureds%20Duty%20of%20Disclosure%20and%20the%20Law%20of%20Warranties.pdf > accessed 27 March 2016.
[109] Peter Jaffe, 'Reform of the Insurance Law of England and Wales - Separate Laws for the Different Needs of Businesses and Consumers' (2013) 87 Tul. L. Rev. 1075, 1100.
[110] Peter Jaffe, 'Reform of the Insurance Law of England and Wales - Separate Laws for the Different Needs of Businesses and Consumers' (2013) 87 Tul. L. Rev. 1075, 1119.
[111] See Ministry of Justice, *A Common European Sales Law for the European Union – A proposal for a Regulation from the European Commission: the Government Response* (13 November 2012) 6, Iain MacNeil, 'Uncertainty in Commercial Law' (2009) 13 Edinburgh L. Rev. 68, 72, L S Sealy and R J A Hooley, Commercial *Law: Text, Cases and Materials* (2003) 10, *Vallejo v Wheeler* (1774) 1 CowpT 143 at 153.
[112] *Lockyer v Offley* I.T.R. 252 13 [1776].

> should be certain, than whether it is established one way or the other. The belief is that business people would rather have a clear rule that might operate harshly and against their interests in a particular case than an unclear rule designed to produce a fair and equitable result in each case but that might require a lengthy and costly process to apply."[113]

This discussion may have happened 100 years ago but it is still relevant today. The insurance industry consistently resisted any legislative changes that would undermine the rules of the duty of disclosure. For example, in 1977 the ABI issued the Statements of Practice as a trade-off for achieving exemption for insurance industry from the Unfair Contract Terms Act 1977 as the new rules allegedly would have led to too much uncertainty and disputes.[114] Extending the consumer regime to include micro-businesses would have caused immensely troubling changes to insurance practice. Furthermore, the Law Commissions did not make a case for a systematic problem that would justify the proposed reform.[115] Even though micro-businesses and consumers share some similarities, there are fundamental differences when it comes to insurance placing processes.

Firstly, if one is an individual acting in a private capacity, he will always remain a consumer. Significant changes in the characteristics of a person, for example, a deteriorating health condition, may only affect the terms of the policy itself, but not the status of the policyholder. The situation is far more complicated when it comes to micro-businesses. No policy can be formulated without considering the significance of business failure and growth.[116] In a short period of time, the structure and organisation of the smallest business can be altered to such extent that it would fall outside the definition of micro-business, and therefore outside the consumer regime altogether. However, it is hard to predict the success of a business at an early stage. [117] Undisputed empirical evidence demonstrates that business failure rates are inversely related to the size of the business. [118] As a result, the dynamic nature of a micro-business itself would pose severe monitoring challenges for insurers.[119] Rigorous procedures would need to be invented not only to place a potential customer under the correct legal framework but also to follow their status during the policy term. Therefore, in practice, insurers would be internally complying with three separate sets of rules.

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[113] Howard Bennet, 'The Marine Insurance Act 1906: Reflections on a Centenary' (2006) 18 SAcLJ 669, 673.
[114] Judith Summer, *Insurance Law and the Financial Ombudsman Service* (Informa 2010) para 1.1.4.
[115] Pinsent Masons, 'Reforming Business Insurance Law: Disclosure' (*Out-Law* August 2015) <http://www.out-law.com/topics/insurance/insurance-law-and-liability/reforming-insurance-law-business-insurance/> accessed on 23 March 2016.
[116] David John Storey, *Understanding the Small Business Sector*, (Routledge 1994), 109.
[117] Lord Young, 'Growing your Business: a Report on Growing Micro-businesses' (May 2013) 12 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198165/growing-your-business-lord-young.pdf> accessed on 27 March 2016.
[118] David John Storey, *Understanding the Small Business Sector*, (Routledge 1994), 92.
[119] Law Commission, *A Summary of Responses to Issues Paper 5: Micro-businesses?* (November 2009), para 2.20.

Secondly, both consumer and business groups are very diverse. However, a number of consumers applying for the same insurance product will usually deal with very similar risks.[120] In contrast, businesses with similarly sized turnovers and a similar number of employees may be exposed to unpredictably varied hazards. As an example, the ABI used the comparison of a hairdresser with a small builder or an oil refinery compared with a retail chain.[121] Assuming that under the consumer regime micro-business owners would not have a positive duty to volunteer information insurers would need to have sufficient expertise about their business to ask thorough questions.[122] It has been suggested that many insurers would already specialise and ask knowledgeable questions about small businesses they tend to cover,[123] but such practice is far from uniform. Standardised questionnaires that work well in regards to collecting information about individuals could not be applied to different business practices. Therefore, by including micro-businesses in the consumer regime, insurers would need to find new ways of gathering business specific information and consequently increase their compliance costs. It reinforces the idea that micro-businesses would not fit within the consumer insurance legislation.

3.2 Reaction from the Industry

The one-size-fits-all approach to non-consumer insurance contracts has received strong support from the insurance industry and practitioners. For the reasons outlined above, including micro-businesses in the consumer regime meant that insurers would internally be complying with three separate regimes. In addition, business respondents did not show overwhelming support for the reform either. The Law Commissions received 49 responses to their Issues Paper,[124] with 20% coming from insurers and insurance associations and 53% from business insureds and business associations. Only 10 consultees agreed that including micro-businesses in the consumer insurance contract law regime is a viable proposition.[125] Even though initially the Law Commissions were vocal about micro-businesses' preference to be treated as consumers in relation to the duty of disclosure,[126] considering the composition of the questionnaire respondents it is clear that enthusiasm was limited. In hindsight, such outcome is understandable. The reasons for this reaction are rooted in the potential consequences the reform would have had on the smallest businesses themselves.

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[120] Special Public Bill Committee Consumer Insurance (Disclosure and Representations) Bill [HL], Memorandum submitted by the Association of British Insurers <http://www.publications.parliament.uk/pa/ld201012/ldselect/ldspbc/219/21912.htm> accessed 27 March 2016.

[121] Ibid.

[122] Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* (Law Com No 353, 2014), para 6.28.

[123] Law Commission, *A Summary of Responses to Issues Paper 5: Micro-businesses?* (November 2009), para 2.23.

[124] Law Commission, *Issues Paper 5: Micro-Businesses Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (April 2009).

[125] Law Commission, *A Summary of Responses to Issues Paper 5: Micro-businesses?* (November 2009), para 1.23- 1.24 and para 2.4.

[126] Ibid, para 2.11-2.14.

Unsurprisingly, the reform would have resulted in financial drawbacks to micro-businesses.[127] As insurers would be exposed to greater risks for covering micro-businesses, the logical response is the raising of the premiums.[128] It would also be expected for some insurers to withdraw their services for micro-businesses altogether. Consequently, the premiums may increase even further, as the market would offer micro-business insureds less choice.[129] Considering that the smallest businesses are most likely to have the tightest budgets, every additional expense matters. In most extreme circumstances, this may serve as a deterrent to obtain an insurance cover at all. Adopting certain measures only makes sense if they achieve the pursued aim. Alas treating micro-businesses as consumers in the insurance contract law context is likely to pose more costs than benefits.

3.3 Assessment of Insurance Act 2015 Reforms

The proposal to extend the consumer insurance contract law regime to include micro-businesses was primarily based on the criticisms of the duty of disclosure under the 1906 Act. However, the Law Commissions attempted to tackle the outlined problems by producing a balanced reforms package.[130] It will be demonstrated that the new framework is flexible enough adequately to address micro-businesses' needs and vulnerabilities.

According to the Law Commissions, to grasp the main difference between consumer and non-consumer insurance contracts, it is crucial to understand the rules on contracting out.[131] For consumers, the 2012 Act creates a mandatory regime, and the insurer cannot put the insured in a worse position than the statutory threshold.[132] In contrast, the duty of fair presentation under the 2015 Act is part of the default regime.[133] It means that the insurer may make significant alterations to the terms of the insurance contract. For example, the 2015 Act allows the policyholder to satisfy their duty of fair presentation by providing "sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing…material circumstances." [134] The insurer may decide to impose a more stringent duty on the insured and therefore exclude this clause from the

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[127] Special Public Bill Committee Consumer Insurance (Disclosure and Representations) Bill [HL], Memorandum Submitted by the Association Of British Insurers <http://www.publications.parliament.uk/pa/ld201012/ldselect/ldspbc/219/21912.htm> accessed 27 March 2016.

[128] R. Edwards, 'Case Study: What impact will the Consumer Insurance Act have?'(*Money Marketing*, May 16, 2013) <http://search.proquest.com/docview/1352115254?rfr_id=info%3Axri%2Fsid%3Aprimo> accessed 23 March 2016.

[129] Ibid.

[130] Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* (Law Com No 353, 2014), para 29.17.

131 Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* (Law Com No 353, 2014), para 2.13.

[132] Insurance Act 2015, s.15.

[133] Ibid, s.16.

[134] Insurance Act 2015, s. 3 (4) (b).

insurance contract. However, for such alteration to be legal, the Law Commissions have deliberately[135] introduced two transparency requirements[136] which are meant to ensure fairness to all types of businesses.

Firstly, the insurer is required to take sufficient steps to draw the relevant term to the insured's attention before entering into the contract. Secondly, the term itself has to be clear and unambiguous.[137] Whether the requirements have been met will be assessed taking into account the characteristics of the particular insured. [138] Logically, contractual terms departing from a default regime should be least intelligible to businesses that lack legal expertise. Most of the bigger companies would have an in-house legal department reviewing their documentation. It would follow that the less sophisticated the business, the stronger would be the burden on the insurer to address any contractual deviations from the 2015 Act. Therefore, the new flexible test will benefit a majority of micro-businesses with higher transparency standards. Inevitably, these new requirements will need to be tested by the courts and until then, some degree of uncertainty about the provision is bound to prevail.

The extent to which the new contracting out provisions will be used in practice is difficult to predict.[139] Their application can be expected to be proportionately more widespread in more complex market segments. Specialist and bespoke markets are likely to continue to use many aspects of the 1906 Act to facilitate established practice and commercial certainty. [140] Nevertheless, smallest businesses rarely resort to buying tailor-made insurance products but are most likely to use standardised insurance placement processes. However, the use of contracting out provisions in standardised insurance contracts is expected to be less common because insurers would also be required to design highly sophisticated compliance procedures to satisfy the two transparency requirements outlined above. Therefore, the contracting out provisions should have limited practical effects on micro-businesses.

Furthermore, the major source of criticism about the duty of disclosure under the 1906 Act was the "all or nothing" avoidance remedy. It is noteworthy that according to the Mactavish research, insurers rarely rescinded micro-business contracts for an innocent breach.[141] As Professor Clarke pointed out, the insurer is usually motivated by the size of the claim, not the point of law. He is the one calling the shots at the time that the breach occurs. [142] Therefore, as micro-businesses are not likely to have a significant claim, the practical effects of the avoidance remedy were limited. The introduction of the new proportionate remedies in the 2015 Act has been described as the most significant change to the

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[135] B. Hepburn and D. Hertzell, 'Contracting out of the Insurance Act 2015' (*Mactavish* 22 December 2015) <http://www.mactavishgroup.com/news/contracting-out-of-the-insurance-act-2015/> accessed on 26 January 2016.
[136] Insurance Act 2015, s.17.
[137] Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* (Law Com No 353, 2014), para 6.22.
[138] Insurance Act 2015, s.17(4).
[139] BLM, 'Time for Change: BLM Guide to Reform of Commercial Insurance Law' (2015), 2 <http://www.blmlaw.com/images/uploaded/File/Time_for_Change.pdf> accessed on 26 March 2016.
[140] Ibid.
[141] Mactavish, 'Corporate risk & Insurance the Case for Placement Reform. The Mactavish Protocols', (March 2011), 12.
[142] Malcolm Clarke, *Policies and Perceptions of Insurance Law in the Twenty-First Century* (UOP 2005) 303.

old rules[143] and welcomed despite fears of the unknown scale of potential litigation and unexpected outcomes.[144]

The new scheme for remedies represents a significant deviation from the position under the 1906 Act.[145] Qualifying breaches, as explained under s.8 of the 2015 Act, allow the insurer to use a number of remedies set under Schedule 1. The insurer is still entitled to avoid a policy altogether and retain paid premiums if the qualifying breach was deliberate or reckless.[146] The burden of proof is on the insurer.[147] This approach reflects the position taken in the 2012 Act.[148] However, in the absence of deliberate or reckless breach, the insurer, who knowing all the facts would not have entered into the contract, is entitled to avoid the policy and return the premiums paid.[149] Finally, if the insurer would have entered into the contract, but on different terms, he may proportionately reduce the amount to be paid on the claim according to the introduced formula.[150]

The concept of "proportionate remedies" has been known in the British insurance contract law context but it never gained momentum before the reforms. The Kerr Committee in its 1980 report[151] assessed the UK insurance contract law and concluded that avoidance was a disproportionate remedy, punitive on the insured. The pro-rata recovery was considered as an alternative option. However, it was rejected on two main grounds. First, it was suggested that had the insurer known all the facts, he may have refused to cover the risk at all. The proposal did not go as far as to address this situation. Secondly, the calculation of the premium would pose significant problems, as it is difficult to find an accurate figure based on the hypothetical circumstances.[152] The current proportionate remedies scheme attempted to address these criticisms. In regards to the former, the insurer now has a range options available to him when dealing with a breach. [153] The latter problem of accurately adjusting premiums remains unsolved. The ABI suggested that it will be difficult to apply the new scheme for substantial claims. Hypothetical scenarios of what would have been done are difficult to prove, and an underwriter can rarely be specific about alternative terms. [154] However, each case would be judged on its own merits.[155] The

[143] Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* (Law Com No 353, 2014), para 2.33.
[144] Peter Jaffe, 'Reform of the Insurance Law of England and Wales - Separate Laws for the Different Needs of Businesses and Consumers' (2013) 87 Tul. L. Rev. 1075, 1103.
[145] Franziska Arnold-Dwyer, 'Disclosure of Unfounded Allegations in Business Insurance' (2014) 3 UCLJLJ 173, 194.
[146] Insurance Act 2015, Sch.1 (2).
[147] Ibid, s.8(6).
[148] Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* (Law Com No 353, 2014), para11.38.
[149] Insurance Act 2015, Sch.1 (4).
[150] Ibid, Sch.1 (5).
[151] Law Commission, *Insurance law: Non-disclosure and Breach of Warranty* (Law Com No 104, 1980).
[152] Law Commission, *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (CP No 182, 2007) para 4.160.
[153] Ravi Aswani, 'Non-disclosure in Insurance Law: a more practical Approach' (2006) 64Amicus Curiae 10, 13.
[154] Association of British Insurers, 'ABI Response to the Law Commissions Joint Consultation Paper on Insurance Contract Law: the Business Insured's Duty of Disclosure and the Law of Warranties' (26 September 2012) para 3.65
<https://www.abi.org.uk/~/media/Files/Documents/Consultation%20papers/2012/09/Insurance%20Con

evidence of how the insurer would have acted may be drawn from various sources, ranging from expert witnesses to pricing manuals and models.[156] Also, despite the fears that setting up new procedures to gather and store information will result in immense costs for insurers,[157] it is evident that many already offer proportionate remedies clauses. The ABI has stressed that the reform will not necessarily change the practice but will foster the confidence levels in the industry itself. [158] New remedies should, at least in theory, provide a better bargaining position for business insureds. Without their "Damoclean sword" of avoidance,[159] insurers will now be inclined to be more generous during the settlement negotiations.[160]

Non-consumer and consumer remedies schemes differ in the following respects. Firstly, under the 2015 Act the insurer is entitled to have a remedy even if the breach of the duty of fair presentation was innocent, provided that he was induced to enter into the contract.[161] Thus, the insurance contract may be avoided even in the absence of fraud or recklessness. In contrast, such outcome is not possible in relation to consumer insurance contracts. [162] However, the proportionate remedies scheme for non-consumer insurance contracts is designed to take into account the mind of the insured at the time of the breach. Therefore, the 2015 Act puts micro-businesses in a far more favourable position than the 1906 Act, as most innocent non-disclosures would no longer lead to substantial losses. Secondly, in direct contrast to consumer legislation, the remedies scheme under the 2015 Act forms a default regime, leaving an open possibility to contract out of the provisions. However, it should be noted that even prior to the 2015 Act, many insurance companies offered contract terms which restricted the application of the rescission *ab initio* remedy[163] and provided draft clauses with proportionate remedies

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tract%20Law%20The%20Business%20Insureds%20Duty%20of%20Disclosure%20and%20the%20Law%20of%20Warranties.pdf> accessed on 23 March 2016.

[155] Ibid.

[156] Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment*, (Law Com No 353, 2014), para 11.76, see also BLM, 'Time for Change: BLM Guide to Reform of Commercial Insurance Law' (2015), 5 <http://www.blmlaw.com/images/uploaded/File/Time_for_Change.pdf> accessed on 26 March 2016.

[157] Association of British Insurers, 'ABI Response to the Law Commissions Joint Consultation Paper on Insurance Contract Law: the Business Insured's Duty of Disclosure and the Law of Warranties' (26 September 2012) para 3.65 <https://www.abi.org.uk/~/media/Files/Documents/Consultation%20papers/2012/09/Insurance%20Contract%20Law%20The%20Business%20Insureds%20Duty%20of%20Disclosure%20and%20the%20Law%20of%20Warranties.pdf> accessed on 23 March 2016.

[158] Special Public Bill Committee Consumer Insurance (Disclosure and Representations) Bill [HL], Memorandum submitted by the Association Of British Insurers. <http://www.publications.parliament.uk/pa/ld201012/ldselect/ldspbc/219/21912.htm> accessed 27 March 2016

[159] Law Commission, *Insurance Contract Law: a Joint Scoping Paper* (January 2006) para1.21.

[160] Law Commission, *Insurance Contract Law Analysis of Responses and Decisions on Scope* (August 2006) para 7.22.

[161] Malcolm Combe, 'The Insurance Act 2015: risky business, reform' [2015] S.L.T. 63, 65.

[162] Julie-Anne Tarr, 'Transforming insurance law: A comparative review of recent insurance law reform in the United Kingdom and Australia' [2016] Insur Law J 28 (1) 10, 17.

[163] For example, *Toomey v Eagle Star Insurance Co Ltd (No.2)* [1995] 2 Lloyd's Rep 88.

of some sort.[164] Therefore, contracting out of the proportionate remedies regime is unlikely to become a standard practice, but is likely only to be used in exceptional cases.

The new remedies regime for non-consumer insurance contracts introduced some new concepts which will be tested by the courts. However, by labelling it as a default regime, the Law Commissions have exercised caution in their application. It has been suggested that this approach is neutral and the new provision does not over-compensate the insurer, nor does it penalise the insured.[165] Taken together with the more intelligible duty of fair presentation, it creates a balanced response to the shortcomings of the previous insurance contract law regime in relation to micro-businesses.

Conclusion

The insurance contract law in the UK has undergone a period of scrutiny and change. It is evident that the Law Commissions dealt with the reform by embracing an evolutionary approach, honouring the already established industry practice and common law principles. The short-lived attempt to include micro-businesses in the consumer insurance contract law regime reconfirms the importance of commercial certainty in the financial services sector context.

The Law Commissions based their decision to treat micro-businesses as non-consumers in the insurance contract law context on two main arguments. First, there was no agreement upon the definitive criteria of what constitutes a 'micro-business'. Secondly, there was not enough evidence of a systematic problem that would justify reform. However, one is compelled to ask – what is a definition if not a means to achieve a purpose? Had the Law Commissions strongly supported a seemingly fair policy choice to include micro-businesses in the consumer insurance contract law, the task of finding a workable definition would also have been achieved.

The artificiality of the Law Commissions' argumentation for its decision to exclude micro-businesses from the consumer regime creates a desire to find an underlying reason behind it. There appears to be a deeper conflict between social policy arguments for treating micro-businesses as consumers in the insurance contract law context and the realities of the insurance industry practice. The Law Commissions had to make a balanced policy choice. Favouring the former would have posed immense costs for insurers and opened the floodgates of questions into other areas of commercial law. Furthermore, it has been demonstrated that the proposed change of law would have resulted in more costs than benefits not just for insurers but also for micro-businesses themselves.

The outcome of the insurance contract law reform is justified and pragmatic. The duty of fair presentation under the 2015 Act may lack revolutionary impact, but it does provide enough flexibility

[164] For example, Airmic has developed a draft clause, but its inclusion in the contract is not automatic, see Airmic, *Disclosure of Material Facts and Information in Business Insurance: Airmic Guide to developing and implementing suitable and sufficient Disclosure*, 4 <http://www.airmic.com/sites/default/files/Disclosure_of_material_facts_and_information_in_business_insurance_0.pdf> accessed on 27 March 2016.

[165] Franziska Arnold-Dwyer, 'Disclosure of Unfounded Allegations in Business Insurance' (2014) 3 UCLJLJ 173, 198.

and solutions to address the issues associated with the previous regime. Its smart design allows the insurer to treat different business insureds according to their sophistication and majority of micro-businesses will benefit from a more flexible and transparent insurance contract law.