Rarely an easy way out of a contract for the insured

DAVID MCCARTHY and DAVID PARKER consider policy cancellation in a recession

THE FINANCIAL crisis has focused some policyholders' attention on the question of whether they can cancel existing policies and obtain a return of premium. These policyholders may be able to secure more cost-effective coverage elsewhere or have decided their existing insurance programmes need to be rationalised.

A general right to cancel?

A policyholder does not have a right to cancel unless the policy itself contains express provisions allowing for cancellation (there may be limited statutory rights to cancel in certain circumstances, for example, pursuant to the Financial Services and Markets Act 2000, an individual customer is entitled to cancel certain insurance contracts within specified time periods). Cancellation provisions will not generally therefore be implied into a policy by the courts.

This principle is strictly enforced. Such is the vigour of that enforcement it has been suggested coverage under an insurance policy containing no terms providing for either cancellation or duration may continue indefinitely (see *General Accident v Robertson* [1909] AC 404 – in this case, the insurance policy concerned contained a provision that determined the cover if a specified event occurred and insurers had the power to cancel).

Where a policy contains no express term allowing an insured to cancel, the policy may therefore only be cancelled by mutual agreement or where one party commits such a serious breach the other party may elect to treat the breach as a repudiation.

Should premium be returned?

Assume a policy includes a term allowing one party to cancel, but is otherwise unspecific as to the consequences of cancellation. If that right is exercised, is the (re)insured entitled to a return of premium?

If the risk has not run its full course, it might seem unfair if an underwriter is not obliged to refund the part of the premium that correlates to the part of the risk he did not cover.

As a general principle of English law, once an insurer is imperilled with a risk, the premium is fully earned, irrespective of whether or not the full term of the risk is run. This principle stems from 18th-century marine cases: "... if the risk of that contract of indemnity has once commenced, there shall be no apportionment or return of premium afterwards" (*Tyrie v Fletcher* [1777] 2 Cowp 666, 668 (Lord Mansfield)).

The crucial question, therefore, is whether the risk can properly be said to have attached and started to run. If not, the principles of general contract law dictate the premium should be returned as consideration has wholly failed.

These common law principles were enshrined in s84(1) of the Marine Insurance Act 1906: "Where the consideration for the payment of the premium totally fails, and there has been no fraud or illegality on the part of the assured or his agents, the premium is thereupon returnable to the assured."

Although not all provisions of the Act have been held to be equally applicable to non-marine insurance, this provision has been (see *Swiss Reinsurance Co v United India Insurance Co Ltd* [2005] EWHC 327 (Comm)).

There is, therefore, no general entitlement to either a partial or a full return of premium unless the risk never commences. In the case of cover that is divisible (eg, an insurance policy divided into separate and identifiable time periods for which a separate premium can be identified in respect of each period), there may be a case for arguing premium relating to periods after the cancellation of a policy should be refunded.

However, it is unlikely an insured would be able to claim a return of premium (or more accurately that full premium was not due on cancellation) where cover was provided on an annual basis, with premium due in instalments.

The parties can, of course, modify these principles by express policy terms and the inclusion of clauses to deal with a pro rated return of premium is now common place.

Broker's right to commission?

In the absence of policy or other terms governing the amount of premium to be refunded, the the broker's right to commission will have an impact on the amount to be refunded.

As a matter of English law, the broker earns its commission at the time of placement (see *Velos Group Ltd v Harbour Insurance Services Ltd* [1997] 2 Lloyd's Rep 461).

If the policy is later cancelled (even if the cancellation is *ab initio*, on the basis the risk never attached), the broker will have a strong argument it remains entitled to the full commission. Thus, even if a policy is never fully or partially encumbered with a risk, the broker is nonetheless going to demand the full amount of its commission payable for placing the policy.

The debate about who actually pays the broker's commission has not yet run its course (see *Carvill America Inc v Camperdown UK Ltd* [2005] Lloyd's Rep IR 55). There are authorities on both sides of the divide:

1) That the commission is payable by the (re)insurer (see *Grace v Leslie Godwin Financial Services Ltd* [1995] LRLR 472) as consideration for placing the business with it; or
2) That commission is payable by the (re)insured (see *Velos*) as principal for the placement and claims services provided by the broker. This is potentially a topic in itself: However, the more traditional view is it is the (re)insurer that pays the broker its commission.

In the absence of a contractual term governing the amount of premium to be returned (ie, gross or net of the broker's commission), the position in English law is not entirely clear. An underwriter might validly look to argue only the net amount should be refunded, given that reflects the actual amount received in consideration for undertaking the insured risk. An alternative view is the insured is entitled to a refund of the gross premium (ie, the amount actually paid) if the policy is cancelled.

In practical terms, there may not be agreement on who bears the commission before a refund of premium. A (re)insurer will therefore have to decide whether to return the premium gross or net of commission.

(Re)insurers will often have already addressed the general principle that the broker fully earns premium on placement through its Terms of Business Agreement (TOBA) with the broker. (Re)insurers commonly include a clause in TOBAs granting themselves a contractual right to a refund of commission from the broker in the event a policy is cancelled (usually on a pro rata basis).

The overall position

Policyholders wanting to cancel their existing policies for a return of premium will, in the absence of express cancellation rights, face considerable difficulty doing so. Even if such a cancellation can be obtained, the refund may be net of commissions paid to the broker.

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