



**Law
Commission**
Reforming the law

Reforming Insurance Contract Law

Introductory Paper

**Section 83 of the Fires Prevention (Metropolis) Act 1774:
should it be reformed?**

INSURANCE CONTRACT LAW REVIEW:

INTRODUCTORY PAPER

SECTION 83 OF THE FIRES PREVENTION (METROPOLIS) ACT 1774: SHOULD IT BE REFORMED?

- 1.1 In December 2005 the Law Commission and Scottish Law Commission published a Joint Scoping Paper¹ asking for views on the scope of our joint review of insurance contract law. Among other things, we asked whether section 83 of the Fires Prevention (Metropolis) Act 1774² should be considered for repeal. The majority (82%) of respondents (92 in total) said that section 83 should be part of our review.
- 1.2 In the course of this introductory paper we summarise the law and issues related to section 83, give a brief textual analysis of it, consider the uses to which it has been put and present the options available for us to recommend. You will see that our tentative view is to recommend that nothing be done.
- 1.3 We ask questions of you at the end of the paper. We are seeking **responses by 8 June 2009**, to the address given at the end of this paper.

IN SUMMARY

- 1.4 Section 83 deals with cases where buildings are damaged by fire. Broadly, it gives “interested persons” the right to demand that insurance money is used to reinstate the property, rather than being paid to the policyholder. Originally, this was seen as a way of preventing arson and insurance fraud.
- 1.5 Now, however, its main use is quite different. The section has been used to solve problems that may arise when the person who has suffered loss as a result of fire damage is not the policyholder.
- 1.6 It is normal, for example, for a tenancy agreement to require the landlord to effect insurance, and to apply the insurance money to reinstate the property. The tenant pays the premium to the landlord and expects to be covered in the event of fire. However, several things may go wrong with this arrangement. The term may be badly drafted, so that the landlord is not legally obliged to use the money to reinstate the property. Another problem is that the landlord may lose its insurable interest in the property (by, for example, selling it). Section 83 has been used as a long-stop to assist tenants, by giving the tenant the right to apply to the insurer directly to obtain reinstatement.

¹ Available at http://www.lawcom.gov.uk/docs/ins_scoping.pdf.

- 1.7 It is possible that section 83 may give some benefit to tenants in the event of the insolvency of a landlord following a fire. If an insolvent landlord receives money from an insurer, it is likely to be treated as its own money and thus liable to be divided between all creditors under ordinary insolvency rules. However, section 83 appears to confer a more direct right upon an interested party, so that the money would not be treated as the insolvent landlord's money and not be subject to ordinary insolvency rules. The scenarios in which this would happen are unlikely, but possible.
- 1.8 However, where a landlord's insurance policy covers the landlord's liability to the tenant, the tenant would also in most cases be assisted by the Third Parties (Rights Against Insurers) Act 1930.³ The same would broadly be true in relation to the proposed Third Parties (Rights Against Insurers) Bill.⁴
- 1.9 The interested people who may apply to insurers under section 83 are not limited to tenants. The list includes landlords⁵ (for example if the tenant is the policyholder), mortgagees,⁶ and purchasers prior to completion.⁷ It may also include those with an option to purchase, or easement holders (where, for example, house-owners on an island are dependant on a bridge that burns down). In these circumstances, the interested person may not be adequately protected by contractual terms. Again, section 83 may provide protection.

THE TEXT OF SECTION 83

- 1.10 Section 83 reads as follows:

And in order to deter and hinder ill-minded persons from wilfully setting their house or houses or other buildings on fire with a view of gaining to themselves insurance money, whereby the lives and fortunes of many families may be lost or endangered be it further enacted by the authority aforesaid that: it shall and may be lawful to and for the respective governors or directors of the several insurance offices for insuring houses or other buildings against loss by fire, and they are hereby authorised and required, upon the request of any person or persons interested in or intitled unto any house or houses or other buildings which may hereafter be burnt down, demolished or damaged by fire, or upon any grounds of suspicion that the owner or owners, occupier or occupiers, or other person or persons who shall have insured such house or houses or other buildings have been

² 14 Geo 3 c 78.

³ In *Re OT Computers (In Administration)* [2004] EWCA Civ 653 the Court of Appeal made clear that the contractual liabilities as well as liabilities in tort could be covered under the 1930 Act.

⁴ See Third Parties – Rights Against Insurers (2001) Law Com No 272; Scot Law Com No 184. It is currently being considered for introduction to the House of Lords under the new procedure for Law Commission Bills.

⁵ *Vernon v Smith* (1821) 5 B & Ald 1.

⁶ *Sinnot v Bowden* [1912] 2 Ch 414.

⁷ *Rayner v Preston* (1881) 18 Ch D 1.

guilty of fraud, or of wilfully setting their house or houses or other buildings on fire, to cause the insurance money to be laid out and expended, as far as the same will go, towards rebuilding, reinstating or repairing such house or houses or other buildings so burnt down, demolished or damaged by fire, unless the party or parties claiming such insurance money shall, within sixty days next after his, her or their claim is adjusted, give a sufficient security to the governors or directors of the insurance office where such house or houses or other buildings are insured, that the same insurance money shall be laid out and expended as aforesaid, or unless the said insurance money shall be in that time settled and disposed of to and amongst all the contending parties, to the satisfaction and approbation of such governors or directors of such insurance office respectively.

Meaning of section 83

1.11 Below, we have broken section 83 down into more manageable segments.

- (1) The section is meant to deter people from purposely setting fires to their buildings. Such people might otherwise do so to make a profit by fraud, at the expense of insurance companies, and at risk of the life and property of other people.
- (2) To deter people from doing that, it is required that an insurer of a building which is damaged or destroyed by fire shall not pay the policyholder and instead shall do what is mentioned in (3) below if:
 - (a) a person with an interest in the property requests it, or
 - (b) the insurer has grounds for suspicion⁸ that the fire was started by someone who would benefit from the policy with a view to defrauding the insurer.
- (3) If either of the conditions in (2) is satisfied, the insurer must rebuild, reinstate or repair the building unless:
 - (a) the policyholder provides sufficient security within 60 days that would guarantee the reinstatement of the property; or
 - (b) the money that would have been paid to the policyholder is paid directly to the parties interested in a sum representing their shares.

Scope

1.12 The scope of application of section 83 is limited in the following respects. It applies to:

- (1) England⁹ and not to Scotland,¹⁰ nor Northern Ireland;¹¹

⁸ It is not clear who should have the suspicion as this situation has never arisen in the courts. Presumably this is because in such a situation in practice the insurer will either seek to avoid the policy altogether or at least exercise a contractual option to reinstate.

- (2) damage to buildings, but not to fixtures;¹²
- (3) insurance companies, but not to Lloyd's underwriters;¹³ and
- (4) fire and not to any other peril.

APPLICATION OF SECTION 83

Original purpose of section 83

- 1.13 Section 83 was designed as a shield. It was designed to deter arson and insurance fraud. Its mechanism of action is to empower those with a recognised concern in the reinstatement of a burnt building to intervene and to prevent an insurer paying out to the potential arsonist/fraudster. The legislators' thinking appears to have been that, if such people were given a right to intervene, they would be able to deter potential arsonist/fraudster policyholders. If not, the intervention would, at least, prevent an arsonist/fraudster from benefiting from their ill-gotten gain.
- 1.14 Section 83 was not specifically intended to create a right in a person who is not a policyholder to gain from a policy of insurance. The interested parties appear to be used mainly as a tool to prevent the policyholder from gaining from an insurance fraud.

Effect of section 83

- 1.15 Despite the fact that section 83 is designed to prevent payment, there have been no reported cases involving the insurers' requirement to reinstate where they have grounds of suspicion.
- 1.16 Instead, section 83 has been used to overcome certain difficulties with policies that benefit third parties. These difficulties exist elsewhere in the law of insurance, where the party with the contractual right to pursue its insurer is not the party that has directly incurred the loss covered by the policy.

Cases

- 1.17 Since 1900 there have been fewer than ten reported cases which mentioned section 83 (and considerably fewer which actually applied it). Below we give details of the two most recent cases that have featured the section.¹⁴

⁹ *Ex p Gorely* (1864) 4 De G J & S 477; applied in *Re Quicke's Trusts* [1908] 1 Ch 887; *Sinnot v Bowden* [1912] 2 Ch 414. The cases have caused the territorial extent of section 83 to be applied in a way contrary to a logical conclusion that would be reached on a plain reading. On a plain reading, it is difficult to see why section 83 would apply only to England (and not to Scotland), unless it is read to apply only to London.

¹⁰ *Westminster Fire Office v Glasgow Provident Investment Society* (1888) 13 App Cas 699, by Lord Watson.

¹¹ *Andrews v Patriotic Ass Co of Ireland* (1886) 18 LR Ir 355, at 366, by Palles CB.

¹² *Ex p Gorely* (1864) 4 De G J & S 477, at p 482.

¹³ *Portavon Cinema Co Ltd v Price & Century Ins Co* [1939] 4 All ER 601, at 607-8.

Vural Ltd v Security Archives Ltd¹⁵

- 1.18 In *Vural* the plaintiff was a tenant of a factory. Under the terms of its lease the defendant landlord was required to keep the premises insured and to apply any insurance monies it received to repair and reinstate the property. The landlord effected adequate insurance as agreed.
- 1.19 A fire occurred, which damaged the factory floor. The landlord proposed to effect certain repairs that the tenant considered inadequate. If the insurers were required to reinstate, they would have been obliged to carry out repairs to a standard demanded by the tenant. However, the landlord did not make a claim under the policy and did not receive any monies from the insurer. The central issue of the case was whether there was an implied duty on the landlord to pursue the claim against insurers.
- 1.20 Counsel for the landlord argued that such a duty could not be implied out of necessity because in such circumstances section 83 granted the tenant rights as against the insurer. Counsel for the tenant argued that section 83 did not grant such a right to an interested party in the absence of a claim being made by the insured. Mr Justice Knox, *obiter*, accepted counsel for the landlord's characterisation of section 83, saying:

The 1774 Act in my judgment does allow the person who has interest in the demised premises but is not the insured person to apply to the insurers before the insured makes a claim. In terms it authorises and requires the insurers to act upon the request of any person interested in or entitled unto the demised premises without specifying any time before such request may be made.

- 1.21 However, he went on to find in this case that the landlord had an obligation under the lease to pursue the claim against the insurer on behalf of the insured. He considered that section 83 alone would be inadequate to deal with all relevant situations. However, it is not clear whether the landlord's obligations arose by implied term or on a proprietary basis. The proprietary basis would have arisen because the tenant was obliged to pay for insurance and it ought therefore to enjoy the benefit of it.
- 1.22 In summary, if one follows *Vural*, the difference that section 83 makes to tenancy agreements is to the effect that a tenant, despite not being a policyholder, is able to apply directly to the insurer for the insurance monies that would have been the responsibility of the landlord to obtain.

¹⁴ We say, "featured", because we cannot say that section 83 was strictly speaking applied. We cannot even say with certainty that section 83 had a decisive effect on the outcome of the cases.

¹⁵ (1990) 60 P & CR 258.

Lonsdale & Thompson Ltd v Black Arrow Group Plc and Another¹⁶

- 1.23 In *Lonsdale*, the plaintiffs were tenants of a warehouse. The defendants were the landlord and the landlord's insurer. The lease required the tenants to pay a sum of money for fire insurance to be arranged. The sum of money was to be paid as premium by their landlord to an insurer. In the event of insurance monies being payable, the lease also required the landlord to apply those monies in reinstatement. The landlord arranged the insurance, but there was no requirement that the tenant become a co-insured under the policy and so it was not made one.
- 1.24 The landlord contracted to sell the warehouse subject to the lease. Before completion of the sale, the warehouse was destroyed by fire, but the purchaser paid the full value of the property. Completion then took place. Although the risk had passed to the purchaser, the right to the insurance monies had not.
- 1.25 The plaintiff as an interested party for the purposes of section 83 demanded the reinstatement of the warehouse from the insurers. It faced a difficulty, despite section 83. The insurer argued that the landlord had no loss and so no money was payable. The landlord had received full value for the purchase of the property. The plaintiff had no claim against the landlord as it had complied with the terms of the lease and obtained the insurance required.¹⁷
- 1.26 The court considered that the insurer's liability should be in respect of the landlord's loss at the time it took place. However, Jonathan Sumption QC, sitting as a Deputy High Court Judge, was unconvinced by the argument that the landlord did not have a relevant loss at that time. He decided that account would have to be taken of the landlord's legal obligation to pass on to the tenant a sum representing the latter's interest in the warehouse. The indemnity principle would not be offended, as the landlord would not keep more money than it was required to expend. The landlord's receipt of full value of the property from the purchaser would not have resulted in an overpayment.
- 1.27 The possible difference section 83 made to this case is that it made it easier to cut through a knot. The problem was that the insured had no obligation to pay the tenant unless the insurer paid out insurance monies. The insurer on the other hand, had no obligation to pay the insured, unless the insured had an obligation to pay the tenant. Perhaps, because of section 83, the court was able to look at the relationship between the tenant and the insurer and simply say that the knotty problem did not offend the indemnity principle. Section 83 allowed the tenant then to obtain a remedy from the insurer.

¹⁶ [1993] Ch 361.

¹⁷ There may have been a claim possible against the purchaser, but the tenant chose not to pursue that avenue.

- 1.28 In both *Vural* and *Lonsdale* section 83 assisted claimants to overcome technical objections that would have stood in the way of what could be seen as just compensation. Neither case generally solves the wider problems that occur when one party obtains insurance that covers the interest of another. As Professor Sparkes has pointed out in relation to the *Vural* case, it would be all too easy to exclude the implication of a term in a business lease, for example, simply by stating that all insurance monies shall be the property of the landlord.¹⁸ Parties should therefore be aware that section 83 is rarely likely to assist. Lawyers should continue to give careful consideration to designing tenancy arrangements which protect the tenant's expectations of insurance payments.

OPTIONS FOR REFORM

- 1.29 Section 83 has not been applied for its original purpose. It has been occasionally used to correct certain anomalous situations.
- 1.30 There are three options. We could repeal, replace or do nothing.
- 1.31 Repealing section 83 would remove controversies about its territorial extent, and its use or abuse.
- 1.32 That would be fairly simple to do. However, we are cautioned by the following statement made by Professor Birds:

Judging by the dearth of reported cases, disputes concerning section 83 of the Fires Prevention (Metropolis) Act 1774 appear to be rare. Indeed, it is sometimes commented that this provision... seems to be of little use these days. The recent decision in *Lonsdale & Thompson Ltd v Black Arrow Group plc* is of interest partly because it gives the lie to the idea that section 83 is largely a dead letter, although its significance really lies in its holding on scope of the reinstatement remedy and in its potential for the further development of thinking about third parties' interests in insurance policies.¹⁹

It appears that there may still be cases in which tenants and other interested parties might wish to rely on section 83 in order to obtain the benefit they thought they had paid for under an insurance contract.

- 1.33 Secondly, we could replace section 83 with a clearer version and with consideration of the issues to which it may generally have a useful purpose. We could write a version of section 83 that would contain a general concept, clear parameters to its application and that resolves any controversy as to its territorial extent.
- 1.34 A re-written section 83 might help a wider variety of tenants and other interested parties. It could, for example, give a right to any tenant to enforce an insurance contracts where the tenant has made a substantial contribution to the premium, even though the tenant is not a party to the contract. Unlike section 83, it need not be limited to fire risks, but could cover the full range of perils to property.

¹⁸ P Sparkes, "Case Comment - Implied terms relating to reinstatement after fire damage" (1991) *Conveyancer and Property Lawyer*.

- 1.35 In order to proceed with this option, however, we would need to be convinced that there was a serious problem which requires a remedy. We think that most problems that might arise can be covered adequately through the correct drafting of tenancy agreements. It is not necessarily the role of statutory reform to protect tenants against inadequate drafting.
- 1.36 Finally, we could simply do nothing. Our tentative view is that it would be best to do just that. Section 83 has the potential to do justice in a small number of cases.
- 1.37 We do not know exactly how section 83 will be interpreted or used in the future. It does not appear capable of doing harm in the sense that it impedes the fulfilment of certain rights. On the contrary, albeit by accident rather than by design, it may fulfil certain rights that would otherwise be confounded by the indemnity principle.
- 1.38 Although our general preference would be for clarity in the law, we would be more concerned in this case about preventing progressive development. Re-writing section 83 in plainer language may be at the cost of possible applications that have as yet not been discovered.

QUESTIONS

- 1.39 **We would like to responses in relation to the following matters.**
- (1) Are you aware of any problems that arise in this area? In particular, are you aware of any cases in which tenants and other parties with an interest in property were unable to obtain reinstatement of the property because they are not parties to the relevant insurance contract? If so, we would be interested to receive full details of the cases.**
 - (2) Of the above options – repeal, reform or do nothing – which do think would be appropriate and why?**
 - (3) If you express a preference in answer to (2), it would be helpful if you could give reasons and say whether you feel strongly, moderately or mildly about your view.**

¹⁹ J Birds, "Insurable interest and reinstatement" (1994) *Journal of Business Law* 188.

We would be grateful for responses to the questions by **8 June 2009**. Please send comments to the Law Commission either -

By email to:

commercialandcommon@lawcommission.gsi.gov.uk; or

By post to:

Michael Harakis, Law Commission, Steel House, 11 Tothill Street, London SW1H 9LJ (Tel: 020-3334-0285).

It would be helpful if, where possible, comments sent by post could also be sent on disk, or by email to the above address, in any commonly used format.

Freedom of Information

As the Law Commission will be the recipient of responses, we will treat all responses as public documents in accordance with the Freedom of Information Act and we may attribute comments and include a list of all respondents' names in any final report we publish. Those who wish to submit a confidential response should contact the Law Commission before sending the response. We will disregard automatic confidentiality disclaimers generated by an IT system.

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