

davies arnold cooper
reviews the year's highlights



property &
construction
insurance

top ten 2006

DAVIES ARNOLD COOPER

index

Foreword

- 1 **Conditions precedent – is delay on its own enough?**
Shinedean v (1) Alldown Demolition (London)
(in liquidation) (2) AXA Insurance UK
- 2 **Early disclosure of fire investigation notes – food for thought?**
Wessanen Foods v Jofson
- 3 **Non-disclosure: times a-changin'?**
North Star Shipping v Sphere Drake Insurance
- 4 **“But I didn’t mean to...” – what is “wilful”?**
Christopher Patrick (a child) v Royal London Mutual Insurance Society
- 5 **Fraud – the smallest measure may be fatal**
Danepoint v Allied Underwriting Insurance
- 6 **Insured not let off the hook**
Nasser Diab v Regent Insurance Company
- 7 **A Tonkin in the High Court?**
Tonkin and Another v UK Insurance
- 8 **Construction – employer's insurance: a long or short game?**
TFW Printers v Interserve Project Services
- 9 **Issuing the wrong policy – and getting away with it?**
Kyle Bay (t/a Astons Nightclub) v Underwriters Subscribing
Under Policy No 019057/08/01
- 10 **Alteration in risk – bad baking of bones?**
Forrest & Sons v CGU Insurance

About Davies Arnold Cooper

property & construction insurance top ten 2006

davies arnold cooper reviews the year's highlights

foreword

Last year saw a number of important decisions which we are pleased to summarise in our **Property & Construction Insurance Top Ten 2006**. The scope of this review is of great width, and our view of what should appear and where each case ranks is inevitably subjective. We have selected in this booklet cases specific to property and construction insurance. Insurance and reinsurance cases of more general lines of interest appear in a separate booklet summarising the **Insurance & Reinsurance Top Ten 2006**.

Whilst not at watershed level, the cases we have seen are interesting on a number of grounds. In relation to conditions precedent, we have one case where an insured's arguments as to inequity and lack of prejudice failed (**Shinedean**) and another (**Diab**) where there was a suggestion that a short delay in compliance may not have led to a claim failing. We also have a couple of cases on reinstatement, where one such scheme was fraudulent (**Danepoint**) and another simply exaggerated (**Tonkin**), with the latter giving rise to interesting points on claims handling strategy.

We also report on what happened when the wrong policy was issued by mistake (**Kyle Bay**), on the correct procedures in fire investigation claims (**Wessanen**), and on a non-disclosure moral hazard judgment (**North Star**). There have also been a few cases on the court's interpretation of policy wordings: we report on the court's treatment of an exclusion for wilful acts (**Patrick**), of a term under a JCT contract dealing with the extent of an employer's duty to insure (**TFW**) and of a term allowing avoidance following alteration of risk (**Forrest**).

On a wider scale 2006 did not see any major disasters impacting on available capacity or rates in the UK or the worldwide property insurance market. However, as 2006 drew to a close, the publication of the Stern Report on climate change, which suggested a possible 20% net effect on global productivity, caused significant disquiet and provided further evidence that climate change was the overarching issue in UK society in 2006. This again prompted the ABI to re-emphasise its call to increase, not cut, the country's annual flood defence budget.

Finally there remains on the horizon two significant legislative developments that will have a defining effect on the insurance market generally, including the property insurance arena: the Law Commission review of insurance law, and the proposed new Fraud Bill.

As the work of the Law Commission continues we can expect to see demands for insurance law to become more consumer-friendly and commercial risks also to become more strictly regulated.

If the Fraud Bill, which galloped through Parliament in 2006, receives Royal Assent in 2007, we hope to see an end to insurance fraud being a square peg in the round hole of the criminal justice system.

As ever, we will be delighted to receive your feedback on our selection of cases.

Davies Arnold Cooper
January 2007

The Insurance Top Ten 2006 publications are not a substitute for detailed advice on specific transactions and problems and should not be taken as providing legal advice on any of the topics discussed.

conditions precedent – is delay on its own enough?

Shinedean Ltd v (1) Alldown Demolition (London) Ltd (in liquidation)
(2) AXA Insurance UK Plc
Court of Appeal 20 June 2006

1

facts

Shinedean employed a contractor, Alldown, to do demolition and excavation works at 113 Kirkdale Road, Sydenham. Alldown negligently excavated a hole beside number 111, the property of Mr and Mrs Patel. On 24 April 2002, Mr and Mrs Patel's flank wall began to collapse into the hole. Shinedean settled the Patels' withdrawal of a support claim for £110,000 in June 2004.

Alldown went into liquidation in September 2002. Shinedean obtained judgment in default for damages to be assessed against Alldown. Alldown's insurer, AXA, was joined as second defendant in about March 2005 and the claim was amended to include a claim for indemnity under the Third Party (Rights Against Insurers) Act 1930.

AXA's CAR insurance policy included a condition precedent that *"in the event of a loss likely to give rise to a claim, the Insured should... deliver to AXA at the Insured's reasonable expense, all such proofs and information relating to the claim as might reasonably be required"*. In June 2003, AXA notified Alldown that it declined indemnity under the policy because of Alldown's failure to provide AXA with information and assistance in accordance with the policy. The judge at first instance found that the insurer received limited information in June 2003, and the bulk of the documents in late 2004 / early 2005.

decision

It was common ground in the Court of Appeal that (i) where an insurer reasonably requires relevant proof and information, the insured must deliver "within a reasonable time" and (ii) performance of the obligation here was a condition precedent to the insurer's liability. The question was whether, in deciding the question of a reasonable time, the court had to take into account prejudice to the insurer and if so, whether such prejudice was a determinative factor.

As it was accepted that the settlement of Mr and Mrs Patel's claim was reasonable, the only prejudice to AXA was that it was unable to close its books for the accounting period in question, which the trial judge had described as "minuscule". Nevertheless, the court upheld the traditional view that prejudice did not have to be established where there is a condition precedent, and found for AXA. The rationale was that insurers are entitled to know where they stand and AXA was entitled to receive the information in good time, whether it was in the end prejudiced by failure to achieve this or not.

comment

It is noteworthy that in this case, loss adjusters had asked for the relevant information on no less than six occasions prior to AXA declining indemnity. The Court of Appeal found that the information had been provided more than two years after it was available to the insured. It is in these circumstances easy to understand why the court would not accept that the insured had complied with a requirement to provide information within a reasonable time. Nonetheless, the Court of Appeal's decision is a useful restatement of the law and nips in the bud what may have been a whole new area of argument in what should be relatively straightforward cases.

early disclosure of fire investigation notes – food for thought?

Wessanen Foods Ltd v Jofson Ltd
1st instance 8 June 2006

2

facts

On 9 July 2002, a fork-lift truck at the food factory owned and operated by the claimant caught fire and caused extensive damage to the factory, materials and food products stored there. The truck was owned by the defendant company and hired out to the claimant. The claimant alleged that the fire was caused by defects in the truck.

decision

Judge Peter Coulson QC found for the defendant. What is interesting about the case is the observations made regarding how fire disputes should be conducted. The judge focused on three issues which he considered to be of relevance to all insurers who offer fire cover:

- **Contemporaneous notes**

The judge quoted Lord Pearce in **Onassis v Vergottis** 1968: *"It is a truism, often used in accident cases, that with every day that passes the memory becomes fainter and the imagination becomes more active. For that reason a witness however honest, rarely persuades a Judge that his present recollection is preferable to that which was taken down in writing immediately after the accident occurred."*

The judge stated it was unsatisfactory that the claimant's fire investigators' notes were not provided to the defendant until service of the experts' reports. He encouraged all those involved in the fire investigation industry to make full notes of their findings, including noting all interviews with those involved, and to make such notes available to all at an early stage of litigation, so that issues can be promptly refined.

- **Role of fire investigators**

The judge commented that the fire investigators had reached the point where they agreed what had caused the fire and thereafter there was very little on

which they could provide helpful evidence. He hoped in future parties would carefully assess joint reports and decide whether oral evidence was really necessary or appropriate.

- **Testing**

A number of tests were carried out on fork-lift trucks and cable storage by the defendant's experts. Some were carried out without the claimant's experts being present or, indeed, knowing that such tests were being performed. The judge disapproved of unilateral testing and quoted the second edition of the TCC Guide, which provides that *"It is imperative that, wherever possible, the parties' experts co-operate fully with one another. This is particularly important where tests, surveys, investigations, sample gathering or other technical methods of obtaining primary factual evidence are needed."* The obvious risk is that unilateral tests may have to be repeated by the other expert later, causing unnecessary and additional costs.

comment

The decision advocates a more open exchange of information between parties and encourages early identification of key issues to endeavour to keep costs to a minimum. The court made it clear that these suggestions were very much guidelines with a view to cases being conducted more efficiently with the inevitable saving of costs. In the same way that courts have encouraged Alternative Dispute Resolution (ADR) and have penalised parties for refusing to resolve their disputes by way of ADR, it is likely that failure to adhere to these guidelines may well result in costs consequences.

non-disclosure: times a-changin'?

North Star Shipping Ltd and Others v Sphere
Drake Insurance Plc and Others
Court of Appeal 7 April 2006

3

facts

The North Star, a vessel, was insured on a total loss only basis on a war risks policy placed in April 1994. In July 1994 the North Star was bombed and deemed a constructive total loss. Insurers rejected the claim, arguing that the owners had been complicit in the bombing of the vessel, and that the policy could be avoided on the grounds of non-disclosure. The insured failed to disclose, prior to placement of the policy, that two individuals who controlled the company were alleged to have committed fraud and were facing criminal charges in Greece and civil proceedings in Panama. The insured argued that the non-disclosure of allegations of dishonesty was not material and that allegations that related to risk could be distinguished from allegations of dishonesty, which had nothing to do with insurance. Notwithstanding the allegations were false and dismissed before insurers avoided the policy, insurers argued the allegations of dishonesty were material in that they would have affected a prudent underwriter's assessment of the risk at the time of the placement. Insurers succeeded on both grounds at first instance. The insured appealed, with the non-disclosure point being heard first.

decision

It was not open to the insured to argue that the dishonesty allegations would not be material to a prudent underwriter's assessment of the risk, simply because they were untrue. This had been considered and rejected by the Court of Appeal in **Brotherton v Aseguradora Colseguros SA** 2003. Instead, the insured argued that the allegations of dishonesty made against the individuals were not material, because they did not concern insurance and were unrelated to the risk in question.

The court recognised the potential injustice to insureds faced with false accusations of dishonesty, but considered it constrained to find against the insured, utilising the "prudent underwriter" test and having the benefit of expert underwriting evidence. Lord Justice Waller commented that under the present state of the law, the only way that disclosure relating to moral hazard could be restrained was "*either by underwriters giving evidence that they would not be influenced and would not take into account an*

allegation of dishonesty, or by a robust Judge rejecting an Underwriter's evidence that he would take it into account". However, the court considered it extremely unrealistic that an underwriter would give evidence that he would not be influenced by such allegations of fraud.

comment

The court accepted that this area of the law can produce serious injustice, which brings into sharp focus the problems of the present state of the law regarding non-disclosure.

In January 2006, the Law Commission launched its investigation into the operation of insurance law with a view to wide-ranging reform. In September, the Law Commission published the first position paper on misrepresentation and non-disclosure. The paper distinguishes between consumer and business policies. The paper recommends the abolition of the duty of disclosure in consumer contracts and suggests insurers take the burden of obtaining information by specific questions. In contrast, the paper recommends the retention of the duty of disclosure in business contracts.

In relation to materiality, the abolition of the "prudent insurer" test and replacement with the "prudent assured" test is recommended in both consumer and business policies. The test advocated is whether the fact in question would appear to a reasonable assured to be material to the underwriter. In relation to business policies, this test will apply to both disclosure and representations whereas with consumer contracts the test will apply solely to representations, as is the case with consumer contracts. Remedies available to insurers are also under review and it is proposed that the circumstances in which a policy can be avoided will be greatly reduced. Watch this space!

“but I didn’t mean to ...” – what is “wilful”?

Christopher Patrick (a child) v Royal London
Mutual Insurance Society Ltd
Court of Appeal 30 March 2006

4

facts

In May 1997, 11-year-old Christopher Patrick and his friend built a den using pallets in a derelict part of a mill in Derbyshire. The boys smoked inside the den for a short time and then set fire to it. Whilst the den was still burning they left the mill. Christopher believed the flames had died down, but the fire spread into Ronson’s packaging unit, destroying £850,000 of stock.

Ronson’s insurers provided an indemnity and sought to exercise subrogation rights against Christopher. His mother had a standard Householder’s Contents Policy, which covered the family for accidental damage to third-party property, but excluded claims and liabilities arising from “*any wilful, malicious or criminal acts*”.

The key question was whether Royal London could avoid liability on the basis that Christopher’s decision to set fire to the den was a wilful act and thus excluded. The court at first instance held that a person acts wilfully only if he intends to produce the consequences in fact produced by the conscious act and that the exclusion did not apply because Christopher had not intended to burn down the mill, even though he had intended to set fire to the den. The court relied on Christopher’s statement that “*At no time did I think that this fire would lead to the whole mill being burnt down.*” Royal London appealed.

decision

The Court of Appeal was unaided by any authorities on the meaning of “wilful”. Lord Justice Tuckey turned to legal dictionaries and indicated that wilful “*always means deliberate and that it will take any further meaning from the word or words which it qualifies and its context*”.

He indicated the adjectives in the policy cover of “*wilful, malicious or criminal acts*” qualify or characterise the excluded acts, and looked to the quality of the act and the state of mind of the actor. He concluded that the word “wilful” was coloured by the words “malicious” and “criminal”, and taken in context, a wilful act must be some act which is blameworthy, and more than deliberate or intentional.

Lord Justice Tuckey held that if the act were deliberate and intended to cause damage of the kind in question, it would be within the exclusion. However, he did not think it was necessary to go that far. It would be enough to show that the insured was reckless as to the consequences of his act. If the insured was aware that what he was about to do risked the kind of damage which gave rise to the claim or did not care whether there was such a risk or not, he would act recklessly if he went ahead and did it.

This interpretation did not affect the result of the case. Lord Justice Tuckey found that whilst Christopher’s conduct could be described as stupid, it could not be described as reckless. Christopher’s statement showed he was unaware of the risk that his fire might burn down the mill and there was nothing to show that he did not care whether it might have done so or not.

comment

Lord Justice Tuckey appreciated that the construction of “wilful” in this case would be important to others in the insurance industry. It is now clear that the test is subjective, but it is not necessary to show that there was an intention to cause the damage of the kind in question. Any statement provided by the insured will therefore be crucial. Courts may well interpret seemingly reckless acts as acts of mere stupidity, which would not fall within the exclusion.

fraud – the smallest measure may be fatal

Danepoint Ltd v Allied Underwriting Insurance Ltd
1st instance 20 October 2005 (but widely reported in 2006)

5

facts

The claim arose out of a fire at the insured's premises in London in June 2001. The property was divided into thirteen flats entirely sublet to tenants. The insured made a claim under the policy for cost of reinstatement and repair and for lost rent. The reinstatement and repair claim was agreed in August 2001 at a total of £83,000. Insurers paid £25,000 on account. The loss of rent claim was first presented at £59,227.50, and later reduced to £53,487.40.

The policy included a provision that:

"If the insured shall make any claim knowing the same to be false or fraudulent as regards amount or otherwise, this policy shall become void and all claims thereunder shall be forfeited."

In December 2001, the insurer's solicitors notified the insured that they proposed to rely on the clause and seek return of the £25,000 already paid. The insurer alleged that the repair claim was fraudulent as the approved contractor had been replaced without the insurer's knowledge by a contractor associated with the insured, whose fees allegedly massively exceeded the value of work conducted.

In addition, whilst the adjusters were informed that all tenants had vacated the premises, and the loss of rent claim was calculated on that basis, when the adjusters made enquiries, the insured replied that not all of the tenants had agreed to vacate the premises, despite being told to do so. The insurer argued that the claim, even now reduced, was fraudulent.

decision

On the repair claim, the judge found for the insured, on the grounds that any dishonesty in relation to the replacement contractor was not material, given the replacement was bound to be revealed. Similarly, even if the contractor's invoices were fraudulent, that was not material as they were on an interim basis and subject to the insurer's inspection.

However, the insurer succeeded on the loss of rent point. Although in some ways similar to the repair claim and made in the knowledge that large parts of it were unsustainable, there was a crucial difference. Detailed scrutiny by loss adjusters was impossible, and therefore the insured lost the benefit of doubt. The claim would always depend on the documents, which the insured itself would provide and would therefore control. In accordance with established law, the judge found that the entire claim was tainted by the fraud on the rental claim and accordingly the insurer was successful.

comment

The claim is interesting because it raises the possibility of an insured being able to argue that the insurer should not be able to rely on a fraud defence where the fraud had little prospect of success. Put another way, a poorly-schemed fraud should not lead to a forfeited claim, but a more cunning fraud may!

insured not let off the hook

Nasser Diab v Regent Insurance Company Ltd
Privy Council 19 June 2006

facts

The insured, Mr Diab, owned commercial premises in Belize, which were destroyed by fire. Within days of the fire, Mr Diab met the managing director of the insurer and was told that it was believed that the fire was deliberately set and that any claim made would be fraudulent.

It was a condition precedent of the policy that, within fifteen days of a loss, a claim in writing should be submitted together with whatever particulars of the items damaged or destroyed could be provided at that time. It was accepted between the parties that no such particulars had been submitted at all.

Mr Diab issued proceedings against his insurer under the policy. In addition to alleging fraud (an allegation which was subsequently withdrawn at trial), the insurer argued that the insured had not complied with the condition precedent. In response to this, Mr Diab argued that the insurer had repudiated the claim at the meeting shortly after the fire and therefore Mr Diab was relieved of his obligation to comply with the condition. Alternatively, Mr Diab argued that the insurer had either waived the requirement to comply with the condition or was estopped from relying upon it.

decision

The main issues before the Privy Council were firstly, whether the insurer did repudiate the claim at the meeting and secondly, if so, whether that repudiation meant that Mr Diab did not need to comply with the condition precedent and submit full written details of the claim within fifteen days. The Privy Council held that the insurer had simply sought to persuade Mr Diab not to pursue a claim under the policy, rather than relieve Mr Diab of policy requirements in the event that a claim was pursued. Furthermore, as the insurer had repudiated the claim on the grounds of arson or fraud, this was unconnected to Mr Diab's non-compliance with the particular condition in the policy. Accordingly, Mr Diab was required to comply with the condition precedent and as he had failed to do so, his claim under the policy failed. The Privy Council also rejected Mr Diab's arguments regarding waiver and estoppel.

comment

While this case, being a Privy Council decision, is not strictly binding on the English courts, it would be at least a persuasive authority, and provides useful confirmation of the law that insurers can insist upon compliance with relevant policy terms and conditions even after repudiation. The decision allows insurers to rely upon a breach of policy conditions in order to avoid liability, even when the initial reasons for repudiating a claim cannot later be substantiated.

The Privy Council made some interesting comments about the strictness of the duty of an insured to comply with a condition and suggested that the outcome would have been different had Mr Diab complied with the condition shortly after the expiry of the fifteen-day period. The **Shinedean** case however shows that there will be a limit to the court's indulgences.

The obvious lesson to be learnt by insureds is to ensure strict compliance with any requirements stipulated by the policy and if deadlines cannot be met, seek agreement from insurers to extend those deadlines. This remains so even if the insurer seeks to repudiate and the insured wishes to challenge that decision.

a Tonkin in the high court?

Tonkin and Another v UK Insurance Ltd
1st instance 18 May 2006

facts

In May 2006, Mr Justice Coulson QC took the first step towards resolving four years of bitter conflict between the claimants and their insurer. The claimants' home, a barn in Sussex, was destroyed in a fire in September 2002. The parties could not agree on a scheme for its reinstatement. The principal issue between the parties was the quality and reliability of information provided by the claimants in support of their claim. The claimants relied on what the insurer described as a *"hopelessly deficient"* reinstatement scheme. The insurer put forward its own reinstatement scheme and provided a re-costing; unsurprisingly at a substantially lower figure. The claimants also sought damages for the delay in settling the claim and relied on a clause in the policy which came under the heading *"Caring for you"* which stated that insurers would *"act quickly to provide ... protection"*.

decision

The judgment is substantial (83 pages) and covers issues from estoppel to fraud. For the purpose of this booklet, we focus on the reinstatement issue and the resultant costs order. The judge determined that there were three options for an insured to take when making a claim for reinstatement. These were:

- reinstatement mirroring what had existed before
- minor improvements
- significant improvement to the original footprint.

An insured can choose any of the above options but any improvement must be adequately costed and highlighted. The judge found that the claimants were seeking to make some significant improvements to their home while attempting to pass the scheme off as a straightforward reinstatement of what had existed before the fire. While he disagreed that they had been fraudulent, he was critical of their conduct. He did not accept their scheme, and found that had the insurer not put forward an alternative, the claimants would have recovered nothing.

He also held that the claimants were not entitled to any damages for the delay in settling the claim. He found that the critical delay was referable to the claimants and that in any event any delay to pay quickly could be compensated in interest not damages. He also found that the claimants' conduct had been unreasonable and, at times, reprehensible. Despite a payment ordered in favour of the claimants, the insurer was found to be the successful party and was entitled to recover costs on an indemnity basis. The claimants had failed to beat a Part 36 payment, and the judge felt that they had pursued a case that was *"very weak indeed"*.

comment

This case highlights the advantages for insurers in making an early assessment of their likely outlay and should encourage insurers to take a realistic view of litigation notwithstanding that their opponents might be taking an aggressive and unrealistic view themselves. The insurer had explored ADR and had assessed its exposure so was able to take advantage of the procedures, including a Part 36 payment, to protect itself against the unreasonable conduct of the claimants. The insurer might be left wondering whether it ought not to have disclosed its own scheme of reinstatement but kept it for its own purposes, because the judge's comments suggest that had it done so it would not have had to pay the claimants a penny. Whether this was a case decided on its own facts remains to be seen; clearly, where insurers face obviously exaggerated reinstatement schemes, some interesting claims handling strategy issues arise.

construction – employer’s insurance: a long or short game?

TFW Printers Ltd v Interserve Project Services Ltd
Court of Appeal 27 June 2006



facts

TFW was required under clause 6.3B of the JCT Minor Works Form of Contract (MW80) to obtain insurance cover for renovation works to its premises. This clause requires an employer to insure in the joint names of the employer and contractor against loss or damage to the structure and the works, caused by a number of specified perils, including flood. However, the clause is silent as to how long an employer is obliged to maintain such insurance and merely states that such insurance is to be maintained “*at all material times*”.

In May 1999, after practical completion had occurred but before the end of the twelve-month defects liability period, TFW’s premises suffered flood damage. The primary issue was whether TFW’s obligation to insure ended at practical completion, or whether it carried on into the twelve-month defects liability period to cover the time when the building was flooded. If the obligation did continue until then, the question was whether such an obligation to insure in the joint names of the employer and the contractor would prevent a claim by TFW against Interserve for its alleged negligence. The court was asked to presume for the purpose of a preliminary issue that Interserve was responsible for the flood.

decision

The Court of Appeal held that the employer’s obligation under clause 6.3B to insure against the risk of loss or damage caused by perils such as flood would cease upon practical completion for four reasons. Firstly, the reference to “works” in clause 6.3B was a reference to work and materials required to complete the project and not a description of the finished state. Secondly, the contractual machinery did not support the continuance of the obligation past practical completion. Thirdly, the obligation to insure under the alternative clause 6.3A specifically ceased at practical completion. Fourthly, it made better commercial sense for the insurance of the building and its contents to be a matter for the employer alone once the contractor had completed the works.

comment

The guidance on when insurance obligations cease under the MW80 contract should be welcomed. Insurers should be aware that as the date of practical completion is often extended backwards in time as a project progresses, employers will often seek to extend the required period of such insurance cover. Insurers need to make sure that they are kept fully informed as to the progress of a project in order to avoid any confusion over applicable insurance.

Due to its findings on the first preliminary issue, the Court of Appeal did not consider the second issue on whether such a claim by an employer against a contractor would be prevented. The court at first instance had held that such a claim would be barred, due to the decisions in **Co-Operative Retail Services Ltd v Taylor Young 2002** and **Scottish & Newcastle v GD Construction 2003** that a claim cannot be brought against a co-insured. This limb of the first instance judgment therefore remains good law and brings the MW80 contract into line with the current judicial approach on other JCT contracts.

issuing the wrong policy – and getting away with it?

Kyle Bay Ltd (t/a Astons Nightclub) v Underwriters
Subscribing Under Policy No 019057/08/01
1st instance 29 March 2006



facts

The claimant, Kyle Bay Ltd (KB), which operated a nightclub in Bridgend, Wales, sought a quotation for insurance on a “non-average declaration-linked basis”. In such a case the insured gives an estimate of its gross profits for the coming year and pays an interim premium; at the end of the year, the premium is adjusted to take account of actual gross profits. In the event of a loss, the insured is entitled to recover actual lost gross profits (subject to a ceiling, normally 133%, of the original estimated gross profits). Insurers considered the policy should be written on a “gross profits basis”, whereby a sum is agreed for gross profits and premium is paid on that figure, thereby avoiding any problem in collecting any premium shortfall. In the event of a loss, an average would be applied if the sum insured proves to be less than the actual gross profit.

Insurers crossed out the declaration-linked part of the proposal, but due to an administrative error, the final quotation presented to KB stated that the cover was declaration-linked. KB accepted the quotation and the policy was issued on a declaration-linked basis. Shortly after inception, KB’s nightclub was destroyed by fire.

KB subsequently agreed, on the advice of loss assessors, to compromise its claim on the basis that the policy was written on a gross profits basis subject to average, as asserted by insurers. Following settlement, however, KB’s loss assessor concluded that the policy had in fact been on a declaration-linked basis and that average ought not to have been applied. KB sought to have the settlement set aside.

decision

The court held that the policy, combined with the schedule, was on its face declaration-linked. Rectification of the policy to a gross profits basis was not justified as insurers’ original intention had not been communicated to KB, and so the mistake was unilateral only.

Both parties had plainly made a mistake when the settlement agreement was concluded as they had both proceeded on the basis that the policy was a gross profits policy subject to average, whereas in reality it was a declaration-linked policy. However, the

court held that this mistake did not render the settlement agreement impossible of performance, nor was the subject matter of the contract essentially and radically different from the subject matter that the parties believed to exist. The settlement agreement was therefore not void for mistake. It was simply a poor deal for KB.

As for misrepresentation, the court held that the assertion by insurers as to the contents of the policy was not a representation, but merely a statement of insurers’ understanding of the overall effect of the policy, and that insurers had acted in good faith. The court also rejected the final argument that there was an express or implied condition precedent to the settlement agreement under which, if an average was not applicable, the settlement would lapse. The judge stated that had KB wanted to reserve its position, it could have done so expressly, and the settlement actually stated that it was final.

comment

Unsurprisingly, the loss assessor was criticised and the judge indicated that KB may have a remedy against him. KB has appealed and the appeal was heard in December 2006. At the time of going to press the judgment on appeal has not been handed down. In considering the application for permission to appeal, the Court of Appeal stated that it was arguable that the letter from insurers as to the basis of policy coverage could be a misrepresentation. In addition, the court commented that the settlement agreement was entered into on the firm understanding of both parties that the policy was written on a gross profits basis, and such a policy could be said to be radically different from a declaration-linked policy, thereby rendering the settlement agreement potentially void for mistake.

Clearly, despite this decision, insurers must be careful not to mislead insureds as to policy terms, otherwise insurers may face having settlement agreements rescinded for misrepresentation. Both parties should of course always check policy terms carefully before finalising any settlement.

alteration in risk – bad baking of bones?

Forrest & Sons Ltd v CGU Insurance Plc
1st instance 23 September 2005

10

facts

Forrest, a pet food manufacturer, deep-fried animal bones in open tanks heated by gas burners in an outbuilding to its factory. Following a fire, it acquired an enclosed oven instead, which was installed in its factory building.

CGU, Forrest's insurers, surveyed the premises in May 1999 and noted that although the bone-rendering operation was now carried out by baking which was intrinsically safer, the oven was inefficient and the location of the operation meant that any incident was likely to be more serious. Both before and subsequent to CGU's survey, Forrest experienced difficulties with the oven overheating and leaking fat. It commenced an action against the manufacturer.

Forrest advised CGU that as of 19 July 1999 the oven had been disconnected. This was confirmed by a survey which stated Forrest had reverted to frying bones in the outbuilding, but was operating that site in accordance with CGU's requirements. Forrest brought the oven back into use in the factory in either November 1999 or November 2000. At a CGU survey in May 2001 it was apparent there was an oven in use, although the surveyor was not aware the oven was the troublesome one which CGU had previously been told was not being used. A fire occurred on 2 November 2001, caused by the faulty oven.

CGU denied the claim in reliance on condition 3(b) of Forrest's policy which provided that:

"This policy shall be avoided with respect to any part hereof in regard to which there may be any alteration after the commencement of this insurance

(b) ... whereby the risk of loss, destruction, damage, accident or injury is increased."

decision

CGU was entitled to rely upon condition 3(b). The judge considered an alteration in risk clause made it necessary to carry out a comparison between the risk immediately before and immediately after the alteration. The extent of the damage resulting from a fire in the main factory was likely to be greater than damage from a fire in the outbuilding, and so bringing back the faulty oven into use was an alteration which increased the risk and the policy was avoided.

Forrest argued CGU waived its rights in relation to the alteration of risk clause given its May 2001 inspection. However, it was accepted there could have been no waiver by election, which involves a choice by the waiving party between two inconsistent courses of action. The judge decided there was no waiver by estoppel as there was no clear and unequivocal representation by CGU it would not insist on its right to treat the insurance cover as discharged.

comment

The decision confirms that where an alteration in risk clause uses the words "shall be avoided", the policy becomes void on the happening of the alteration, and is not merely voidable. Moreover, the clause operated on an increased risk of loss. This contrasts with the common law rule that an insurer is discharged from liability only where there is a fundamental change to the nature of the risk, according to the Court of Appeal in **Kauser v Eagle Star** 2000, which was not referred to in **Forrest**. Finally, the two waiver points are useful reminders that waiver arguments, often articulated, are rarely successful.

about davies arnold cooper

Davies Arnold Cooper is an international law firm specialising in dispute resolution and real estate. Our dispute resolution capability includes leading teams advising on insurance, construction and product liability matters as well as general commercial litigation.

Our team of more than 80 specialist insurance lawyers advises in relation to fraud, professional indemnity, directors' and officers' liability and property and construction insurance for both insurers and corporate buyers of insurance as well as companies operating in the Lloyd's market, underwriting agents, brokers, intermediaries and risk managers.

Property and construction insurance

Our specialist property and construction insurance group continues to advise on the most complex and high-value property losses in respect of coverage issues, liability, claims and recoveries.

Over the years we have acted for insurers connected with high-profile public disasters from Piper Alpha, Hillsborough and the Bradford City fire through to more recently the Avonmouth chemical explosion, the Hatfield and Potters Bar derailments and the East Sussex firework factory explosion, amongst others. In between we have helped insurers to launch new products, enter new markets, resolve disputes and manage mergers. We have advised on insolvencies for both insurers and corporate buyers.

Our network

Our London offices are complemented in the UK by our Manchester office, which has a strong commercial insurance team. Our Madrid office is widely recognised as Spain's leading insurance law specialists. The success of our work in Spain led to the opening of an office in Mexico City in 2003, which is dedicated to providing services to the London, European, Latin American and US insurance markets.

For further details, please visit our website www.dac.co.uk.

key contacts



David Bear

Partner

Office: London (Bouverie Street)

Tel: +44 20 7293 4195

Email: dbear@dac.co.uk



Martin Butterworth

Partner

Office: London (Bouverie Street)

Tel: +44 20 7293 4556

Email: mbutterworth@dac.co.uk



Michael Edwards

Associate Partner

Office: London (Gracechurch Street)

Tel: +44 20 7293 4258

Email: medwards@dac.co.uk



Francisco Fernandez G Fletes

Abogado

Office: Mexico City

Tel: +52 551 107 6056

Email: ffletes@dacmexico.com



Ricardo Garrido

Partner

Office: Madrid

Tel: +34 91 781 6300

Email: rgarrido@dacsain.com



Stephen Gorman

Managing Partner, Manchester

Office: Manchester

Tel: +44 161 955 3865

Email: sgorman@dac.co.uk



Danny Gowan

Senior Partner

Office: London (Bouverie Street)

Tel: +44 20 7293 4083

Email: dgowan@dac.co.uk



Mark Shaya

Associate Partner

Office: London (Bouverie Street)

Tel: +44 20 7293 4410

Email: mshaya@dac.co.uk



Ken Silk

Senior Associate

Office: London (Gracechurch Street)

Tel: +44 20 7293 4168

Email: ksilk@dac.co.uk



Nick Young

Partner

Office: London (Gracechurch Street)

Tel: +44 20 7293 4278

Email: nyoung@dac.co.uk

LONDON

6-8 Bouverie Street
London EC4Y 8DD
T +44 20 7936 2222
F +44 20 7936 2020
DX 172 London
E daclon@dac.co.uk

LONDON MARKET

85 Gracechurch Street
London EC3V 0AA
T +44 20 7936 2222
F +44 20 7293 4888
E daclon@dac.co.uk

MANCHESTER

60 Fountain Street
Manchester M2 2FE
T +44 161 839 8396
F +44 161 839 8309
DX 14363 Manchester
E dacman@dac.co.uk

MADRID

New address as of March 2007

C/Serrano 37
1a - 2a Planta
28001 Madrid
T +34 91 781 6300
F +34 91 576 8669
E dacmadrid@dacspain.com

MEXICO CITY

Av. Insurgentes 950-9
Colonia del Valle
Delegación Benito Juárez
Codigo Postal 03100
México D.F.
T +52 551 107 6056
F +52 555 687 6849
E info@dacmexico.com

www.dac.co.uk