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THE INSURER'S REMEDIES ON FIRST PARTY PROPERTY LOSSES: MISREPRESENTATION, WARRANTIES, AND MISSING TERMS

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THE INSURER'S REMEDIES ON FIRST PARTY PROPERTY LOSSES: MISREPRESENTATION, WARRANTIES, MISSING TERMS AND LIMITATION PERIODS

I. INTRODUCTION

The purpose of this paper is to identify emerging trends in the law relating to misrepresentation, warranties, missing terms and limitation periods in the context of first party property losses, so as to assist insurers in identifying what, if any, remedies may be available in the event of a claim.

The law regarding misrepresentation has changed over time so that now, if an insurer seeks to void a policy, it must be able to show that the misrepresentation was with respect to a material fact, was not trivial, and actually induced the issuance of the policy.

Similarly, the law regarding warranties has changed to now require the insurer to prove that the term in question is actually a "warranty" the breach of which caused or increased the risk of loss, and that it would not be unjust to enforce the warranty against the insured. This paper analyzes CGU's warranty wordings in light of recent developments in the law surrounding warranties.

This paper also reviews the issue of "missing terms" in a policy, and suggests some steps insurers should take in delivering policies to insureds, in light of the current state of the law.

Lastly, this paper discusses two recent decisions of the British Columbia Court of Appeal dealing with limitation periods on suits commenced by insureds for coverage on their property loss claims and the broader impact of the decisions on the legality of incorporating Statutory Conditions into contracts of insurance.

II. MISREPRESENTATION

The insured is under a duty to disclose all material facts relating to the insurance coverage. In the discharge of this duty, the insured is required to state accurately all the facts to which the duty applies, whether they are material in themselves, or whether they are shown by the asking of questions to be considered material. Accuracy is required because statements from the insured are often an inducement to the insurer to enter into a contract of insurance.

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This section of the paper will address recent developments in the law surrounding materiality of statements and inducements into contract. A recent case handled by our office will also be reviewed in the context of materiality and inducement. Finally, we will set out strategic considerations for property insurers in the proactive defence or cases involving misrepresentation.

A. MATERIALITY AND INDUCEMENT

Though litigated for well over 200 years courts continue to grapple with issues of materiality and inducement in respect of contracts of insurance. Below we set out a recent case from the House of Lords, the highest Court in the United Kingdom, which presently settles the law in this area. We also set out a recent case from the Supreme Court of British Columbia which affords a sound practical example of the application of law set by the House of Lords.

1. *Pan Atlantic Insurance Co. Ltd. v. Pine Top Insurance Co.*

The case of *Pan Atlantic Insurance Co. Ltd. and others v. Pine Top Insurance Co.*,[1] involved a dispute between an insurer (Pan Atlantic) and its reinsurer (Pine Top). Pine Top sought to void its reinsurance contract on the basis of non-disclosure, relating to the presentation that had been made by Pan Atlantic's broker to Pine Top's underwriter of the loss record for the previous years. Pan Atlantic had disclosed losses of US $235,768 for the underwriting year 1981 when its true losses for that year were US $468,168. Pan Atlantic conceded that it had information about the additional losses available before the slip by which Pine Top was bound to the risk was signed on January 13, 1982.

In determining the case the House of Lords first considered the question of materiality. The Court queried whether it had to be shown by the party seeking to avoid the contract that full and accurate disclosure would have led a prudent underwriter to a different decision on accepting or rating the risk or was a lesser standard of impact on the underwriter's mind sufficient, and, if so, what was that lesser standard?

Secondly, the Court considered whether the establishment of a material misrepresentation or non-disclosure was sufficient to enable the underwriter to void the policy, or was it also necessary that the misrepresentation or non-disclosure had induced the making of the policy, either at all, or, on the terms on which it had been made?

Pan Atlantic argued that the language in the *Marine Insurance Act 1906* called for the disclosure only of such circumstances as would, if disclosed to the hypothetical prudent

[1] [1994] H.L.J. No. 29

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underwriter, have caused him to decline the risk or charge an increased premium. Sections 17 and 18 of the Act read as follows:

> *"17. A contract of insurance is a contract based on the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.*
> *18(1) …the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured…If the assured fails to make such disclosure, the insurer may avoid the contract.*
> *18(2) Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk…"*

The Court rejected that argument, since the wording of the Act did not say "decisively influence" or "conclusively influence".

The Court went on to consider the effect of an underwriter having an invariable right to void the contract once a material misrepresentation or non-disclosure had been established. In order to avoid the prospect of underwriters escaping liability even if the misrepresentation had no effect on the underwriter's decision-making, the court implied into the Act a requirement that neither a material misrepresentation or a wrongful non-disclosure would entitle the underwriter to void the policy unless it had induced the making of the contract on those terms.

Accordingly, a party seeking to avoid a contract of insurance for misrepresentation or non-disclosure must ask itself two separate but closely related questions:

1) Did the misrepresentation or non-disclosure induce the insurer to enter into the contract on those terms?
2) Would the prudent insurer have entered into the contract on the same terms if he had known of the misrepresentation or non-disclosure immediately before the contract was concluded?

Ultimately, the Court concluded that Pan Atlantic's misrepresentation had been material, and had induced the making of the contract, so that Pine Top was entitled to void the policy.

The effect of this decision is to make it more difficult to void an insurance policy for misrepresentation. The misrepresentation must be material *and* it must have induced the insurer to enter into the insurance contract on those terms when otherwise it would not have done so.

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2. *Lafarge Canada Inc. v. Little Mountain Excavating Ltd.*

A recent British Columbia example of the application of the requirements set out in *Pan Pacific* occurs in *Lafarge Canada Inc. v. Little Mountain Excavating Ltd.*[2] In that case the insured obtained a comprehensive general liability policy. In the course of applying for the policy, the insured represented the type of work it performed as "*land clearing, site preparation type contractor … installs driveways, clears lots, digs septic fields. Since last summer his equipment has been at a local gravel site (operated by Lafarge Concrete) where he works at an hourly rate (but not as an employee) loading sand and gravel onto trucks*". The insured also specifically represented that it performed no welding.

In fact, two employees of the insured used welding torches to cut through metal bolts in the course of their work at the Lafarge plant and caused a fire.

The insurer, AXA, elected to void the policy on the basis that the insured had misrepresented the nature of its business operations. AXA argued that if it had been made aware of the true nature of the business operations, it would have declined the risk or required a higher premium based on the fact that:

a) the insured worked on equipment owned by Lafarge giving rise to a significant risk of damage to the equipment;
b) the insured used cutting torches and welding equipment on parts of the Lafarge plant giving rise to a significant fire risk;
c) the expertise of all but one of the insured's employees was gained on the job and individuals who did not have welding tickets were called upon to perform tasks using welding equipment;
d) there was risk that the insured's employees would perform work beyond their expertise because it was called on to do work that was miscellaneous and varied; and
e) the insured's employees were working under the direction of Lafarge employees so they had no ability to refuse work that was assigned to them.

The Court concluded that the activities not revealed by the insured were material to the risk and that AXA, or any prudent insurer would be reluctant, if not unwilling, to provide coverage because of the significant risk and lack of predictability necessarily occasioned by the insured's work. The insured's action for coverage was dismissed.

[2] [2001] B.C.J. No. 732 (B.C.S.C.)

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3. Materiality and Timing

The relevant time for assessing materiality is the time at which the application for insurance is completed because that is when the underwriter must assess the risk, determine the coverage and set the premium.[3] This requirement recently impacted upon an insurer's decision to afford coverage it otherwise likely would have denied.

On a recent claim an insured suffered a theft of jewelry. Earlier, in applying for insurance, the insured had answered certain questions on the insurance application form as follows:

> *"Are showcases kept locked with keys removed during business hours?* ***Yes***"
> "*Is a business week library of tapes in place?* ***Yes***"

The answer to the first question was untrue as the showcases were unlocked for some minutes at both store opening and closing. The answer to the second question was also untrue as, instead of a business week of videotapes being available, the store had one videotape which it continuously recycled over the days of the week.

Though the misrepresentations were material to the loss and a reasonably prudent insurer would likely not have entered the contract of insurance on the same terms if the questions had been answered accurately, the insurer in this case afforded coverage on the policy for the following reasons:

a) the facts disclosed that prior to submitting the application the insured had submitted an earlier Proposal for Insurance form on which the insured had indicated that the showcases were kept unlocked during store opening and closing. The insurer could not now legitimately maintain that it had been misled by the misrepresentations on the second application, itself not having made further inquiries in this regard; and

b) the insurer had bound to the risk on the basis of the earlier Proposal for Insurance which did not elicit whether and to what extent the insured maintained videotapes. The insurer could not now realistically argue that this was a material representation on which it had relied in entering into the contract of insurance.

This claim, apart from exemplifying the effects of timing, highlights the importance of obtaining representations from an insured through the use of questions. As will be seen

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[3] *Maryn v. Unum Life Insurance Co. of America*, [1999] B.C.J. No. 829 (Q.L.)(S.C.)

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in the remainder of this section, questions and statements of materiality can be used advantageously by insurers in respect of the defense or prosecution of cases.

B. STRATEGIC CONSIDERATIONS

1. Matters of Proof

For the purpose of strategic considerations in respect of misrepresentations the distinction between misrepresentations and pure omissions is critically important. Statutory Condition 1, which governs the formation of the policy, is generally included as a contractual term. It reads:

> *"1. If any person applying for insurance falsely describes the property to the prejudice of the insurer, or misrepresents or **fraudulently** omits to communicate any circumstance which is material to be made known to the insurer in order to enable it to judge of the risk to be undertaken, the contract is void as to any property in relation to which the misrepresentation or omission is material*. (emphasis added)

In most forms of insurance, any non-disclosure of a material fact will render the contract void whether the non-disclosure was deliberate or accidental. No distinction is drawn between a false statement and an omission to disclose a material fact. The situation is made different by Statutory Condition 1 whereby there is a distinction between a false statement and an omission to provide information. False statements will void the insurance policy, but pure omissions will not, unless the insurer can prove that the omission was fraudulent.

As a result, in defending claims made on policies to which this Statutory Condition applies, it is important for an insurer to be able to characterize any non-disclosure as a misrepresentation. In that way, the insurer is not required to establish fraud. Further, it is much easier to characterize non-disclosure as a misrepresentation if it is based upon a false answer contained in a questionnaire. Such false answers which amount to misrepresentations do not have to be accompanied by a fraudulent intent in order for the insurer to avoid liability on the basis of non-disclosure of a material fact.

2. Questions: A Method of Proof

Usually, during negotiations, the insurer asks the insured questions as to matters on which it requires information. This is frequently done by way of printed questions in an application form. A non-disclosure or misrepresentation of a material fact on an application form may entitle the insurer to avoid the contract. Below we provide some general principles concerning questions and answers:

a) The questions show what facts are regarded by the insurer as material. If an insurer doesn't ask a question about a particular fact, the Court may conclude that the fact is immaterial. For example, where an insurer asks about motoring convictions, non-motoring convictions were considered immaterial (*Revell v. London General Assurance)*[4]

b) Answers relate solely to the state of affairs at the time the application is completed, and not to future circumstances *(Kirkbride v. Donner*).[5]

c) The statement must be considered as a whole and a trivial misstatement does not render the entire statement inaccurate. For example, where an insured stated that there was no building within 100 feet, and in fact there was a small outhouse 46 feet away, this was considered an omission of an "immaterial detail" *(Strong v. Crown Fire Insurance Co.*)[6]

d) A fair and reasonable construction must be adopted. For example, if a question asks "Have you had any other illness, local disease or personal injury?", a reasonable construction would assume that the question related to serious illness only (*Connecticut Mutual Life Insurance Co. of Hartford v. Moore*).[7]

e) The whole truth must be told. Where a proposal asks "Has proponent ever been a claimant on a fire insurance company in respect of the property now proposed, or any other property?", one could technically answer truthfully "Yes. 1917. Ocean Insurance" but if the insured had also made other claims, the answer would be interpreted as inaccurate (*Condogianis v. Guardian Assurance Co. Ltd.*)[8]

f) One must take into account other information in the possession of the insurer. An answer, which when taken by itself is insufficient, may not be inaccurate when read with other answers in the application (*Dear v. Western Assurance Co.*)[9]

g) Inconsistent or unsatisfactory answers may give rise to an obligation on the insurer to investigate further. As the court said in *Thomson v. Weems*, "[i]f his answer is hesitating or unsatisfactory, the insurers are put upon their guard, and have the option of

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[4] (1934) 50 L1.LR. 114
[5] [1974] 1 Lloyds Rep 549
[6] (1913) 23 OWR 701
[7] (1881) 6 App Cas 644, PC
[8] [1921] 2 AC 125
[9] (1877) 41 UCR 553

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declining the assurance, or seeking information from other sources, or of charging a higher premium".[10] An example of inconsistent answers is where the insured's date of birth does not correspond with his age as indicated in separate portions of an insurance application.

h) Where a question is left unanswered the court may conclude that the answer is negative *(Roberts v. Avon Insurance Co. Ltd.)*[11]

Various approaches taken by different insurers with respect to questions on application forms are set out below:

For example, the questions posed in CGU's form "Proposal For Jewellers Block" consist of:

"Nature of business based on sales (Must add to 100%)
Retail ___%
Wholesale ___%
Manufacturing ___%
Pawnbroking ___%
Repair ___%
Other ___%
Number of years in the jewellery business
Number of years at this location
List all previous trade names
Number of employees?
What is the least number of employees, officers or owners on your premises at any time during business hours? or when opening or closing business?
Premises Protection:

a) Burglar Alarm System
is alarm service to central station? Yes No
or monitoring station Yes No
Name of the protection company
Extent of protection (1,2,3,or 4) Line security level

b) Holdup Alarm System
Number of holdup buttons, if any fixed movable
Do entrances have single door buzz-in, buzz-out locking system?
Do entrances have a two-door mantrap?
Do premises have other protection which would deter loss?

[10] (1884) 9 App Cas 671
[11] [1956] 2 Lloyds Rep 240

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c) Surveillance System
What type of camera system, if any, protects the premises?
If there is a VCR[s], where is it located?
Which area of the premises does the camera survey?
Is a business week library of tape[s] in place?"

In contrast, the questions that are included in certain Lloyds' Employment Practices Insurance applications include the following:

"Other Material Facts

A. Please declare any Material Facts on a separate sheet:

None ___ See attached ___

A Material Fact is one likely to influence the assessment of this risk, the premium charged and the terms and conditions imposed by Underwriters. If you are in any doubt as to whether a fact would be considered material you should declare it. All the information requested in this proposal is material.

The Applicant warrants after full investigation and inquiry that the statements set forth herein are true and include all material information".

It is noteworthy that the second application, for EPL insurance, contains a "catch-all" provision that prevents an insured from contending that it had no duty to disclose material facts which were not expressly raised by the insurer.

In our view, there is good reason to include a "catch-all" question in light of earlier Court decisions that suggest if an insurer does not ask a question about a specific topic, the topic may be considered "immaterial". For example, if a jewellery store had a "single door buzz-in, buzz-out locking system", the insured could answer the specific CGU question in the affirmative even though the system had been disconnected. A catch-all question would put a positive duty on the insured to disclose this latter fact.

An appropriate question to include at the end of CGU's "Proposal for Jewellers' Block" might be:

"Other Material Facts

Please declare any other material facts relating to employees, previous insurance or applications for insurance, inventory, premises, security, record-keeping or anything else which is likely to influence assessment of this risk, the premium charged and the terms and conditions imposed by the Underwriters on a separate sheet. If you are in any doubt whether a fact is material you should declare it. All of the information requested in this Proposal is material".

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An alternative approach is to ask whether the applicant is aware of any facts which give rise to a future claim, and specifically exclude any such claim. For example:

> *"Is the undersigned or any person proposed for insurance aware of any fact, circumstance or situation which could reasonably be expected to result in any future claim being made against them? Yes ____ No ____*
>
> *If yes, please give full details:*
>
> *It is agreed that if any facts, circumstances or situations exist, any claim or action arising from them is excluded from this proposed coverage".*

III. WARRANTIES

In addition to voiding a policy for misrepresentation, an insurer can insert clauses in its policies called "warranties", by which the right of the insured to recover is made dependent upon the existence of a given fact or state of things defined in the clause.

This section of the paper will illustrate how the historically strict interpretation of warranties has been relaxed over time, and how relief from forfeiture may be obtained with respect to warranties, in some circumstances. This section will also summarize the current state of the law with respect to enforcement of warranties, and apply current principles to CGU's warranty wordings.

A. THE TRADITIONAL LAW OF WARRANTIES

Warranties were initially developed as a device by which an insurer could grant a policy without troubling to make inquiries about certain matters. For instance, if an insurer was prepared to insure a vessel, but only on the condition that a watchman was stationed aboard the vessel at all times, the insurer would insert that specific term as a condition or "warranty" in the contract of insurance.

By means of a warranty, an insured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or affirms or negatives the existence of a particular state of facts. A warranty must be exactly complied with, whether it is material to the risk or not for coverage to afford.

Traditionally, Canadian courts have taken a strict approach to warranties. For example, in *New Forty Four Mines Ltd. v. St. Paul Fire & Marine Insurance Co.*,[12] a fire insurance policy which insured a gold mine contained the following clause:

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[12] [1984] 34 Alta. L.R. (2d) 28 (Q.B.)

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"Watchman Warranty
It is hereby warranted by the Insured that one man shall be on duty at all times at the Insured's premises".

In actual fact, there was only a full-time caretaker who attended at the site at staggered hours. A major portion of the mill buildings burned to the ground and the property insurer denied coverage on the basis that the warranty had been breached.

The Court discharged the insurer from liability, even though the insured's broker had acted carelessly in offering a warranty without the consent or knowledge of the insured. The Court confirmed that

> *"**the essential characteristic of a warranty is that it must be exactly complied with, whether it be material to the risk or not. If it be not complied with, then, subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach**" (emphasis added).*

Until recently, Courts have insisted that warranties be strictly complied with, and it made no difference whether the risk was increased by the breach of the warranty. An insurer was entitled to void the policy irrespective of the materiality of the breach. This is unlike a misrepresentation, which in order to void, must not only be untrue but material.

Another example of the Court enforcing a warranty (and thereby relieving the insurer from indemnity) occurred in *Bell v. Tinmouth*.[13] In that case, a valuable art collection was stolen from an art gallery. The insured had warranted to its property insurer, the following:

a) there was always someone on the premises;
b) all the windows were sealed;
c) there was a watchdog on the premises; and
d) the Vancouver City Police provided particular surveillance to the premises because of a friendship with the gallery's proprietors.

In actual fact, the home in which the gallery was located was left unoccupied at the time of the theft, the windows were not barred in any effective way and the "watchdog" turned out to be a cocker spaniel pup.

The Court concluded that the breach of warranty entitled Lloyds to void the policy.

[13] (1987), 39 D.L.R. (4th) 595 (B.C.S.C.)

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B. RELAXATION OF THE STRICT RULES OF WARRANTY INTERPRETATION

In some cases, Courts appear to have stretched themselves to avoid discharging the insurer in circumstances where the Court concluded that finding a breach of warranty would work an injustice. Recently, the law in Canada respecting warranties has changed and it has become more difficult for insurers to avoid indemnity on the basis of breach of warranty.

In *Case Existological Laboratories Ltd. v. Century Insurance Co. of Canada*,[14] Case's vessel, a converted barge that was partially open to the sea on her bottom and kept afloat by an airtight deck, sank when a member of her crew intentionally opened the deck valves to let out the air trapped in the hull so the stern would settle, and then negligently failed to close the valves again.

Case sought indemnity for the loss pursuant to its policy of property insurance. The insurers raised a number of defences, including breach of warranty. The clause that was said to be a warranty appeared under the heading "Special Conditions" and read as follows:

> *"WARRANTED that a watchman is stationed on board the BAMCELL II each night from 2200 hours to 0600 hours with instructions for shutting down all equipment in an emergency".*

In fact, no night watchman was stationed on board the ship once the insurance came into effect. However, the opening of the deck valves occurred early in the afternoon and the sinking occurred shortly thereafter, long before 2200 hours. So the clause bore no relationship to the occurrence that caused the loss.

The Court acceded to the argument that the parties could not have intended that if the night watchman was late one night, or even missed a night, then the insurers would be discharged from liability for the remainder of the term of the policy.

Even though the word "warranted" appeared in the term, the Court concluded that the term in question was actually a "suspensive condition" (a term which is descriptive of the risk), and not a true warranty. In the result, the insurer was not discharged from liability.

Canadian Courts have continued to follow the approach set out in *Case.* In *Shearwater Marine Ltd. v. Guardian Insurance Co. of Canada*,[15] the insured vessel took on water and

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[14] (1982), 133 D.L.R. (3d) 727 (B.C.C.A.)
[15] (1997), 29 B.C.L.R. (3d) 13 (S.C.)

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sank while moored against a log boom breakwater. A provision which formed part of the property policy reads as follows:

> *"WARRANTED:*
> *Item 1b) Vessel inspected daily basis and pumped as necessary"*

The insurer argued that the provision was a warranty, had not been complied with, and so the policy was void. However, the Court concluded that the term was not a true warranty and granted judgment for the insured. It quoted with approval a portion of the earlier judgment in *F.B.D.B. v. Commonwealth Insurance*:[16]

> *"…in contracts of insurance the word "warranty" [or warranted] does not necessarily mean a condition or promise the breach of which will avoid the policy…the clause, "warranted no St. Lawrence between October 1 and April 1"… is an example of a so-called warranty which merely defines the risk insured against. [Thus if] the vessel was in the St. Lawrence on October 2, but emerged without a loss, and during the … policy [term] a loss happens in July, the underwriters cannot avoid payment on the ground that the vessel was in the St. Lawrence between October 1 and April 1".*

Notwithstanding the "relaxation" in the interpretation of warranties which has occurred recently, Courts continue to enforce warranties where there is a clear relationship between the breach of warranty and the contracted risk. This is illustrated in *Elkhorn Developments Ltd. v. Sovereign General Insurance Co.*,[17] a recent decision of the British Columbia Court of Appeal.

Elkhorn purchased a forty-year-old wood barge to be used as a floating camp for its employees. After considerable trying, Elkhorn succeeded in obtaining insurance coverage for the barge. The coverage was subject to two express warranties:

1. *Warranted vessel laid up permanently at Pearce Bay, B.C.; and*
2. *Warranted any movements of this vessel to be subject to underwriter prior approval of such tow.*

The property coverage was renewed several times and each time a cover note was delivered with a letter reiterating that the policy was subject to "No moves without prior approval".

On an unknown date, the barge was towed some miles to another bay. The insurers were not advised of the move. The barge was then towed a second time, this time a

[16] (1983), 2 C.C.L.I. 200 (B.C.S.C.)
[17] (2001), 87 B.C.L.R. (3d) 290 (C.A.)

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distance of 100 miles, where it was moored. The insurers were again not advised of the move.

The barge was left unattended for five days after the second move, and sank. The insurer argued that there had been a breach of warranty which voided the policy. The insured, not surprisingly, argued that the term was a "suspensive condition" the breach of which did not void the policy.

The Court concluded that the moving of the barge posed a risk of damage which may or may not have resulted in the sinking. The Court determined that the term was indeed a warranty, the breach of which discharged the insurer from liability. The Court said:

> *"…it is not necessary in this case to show that the loss incurred was as a result of the breach of the warranty not to move the Barge.* ***The fact that moving the Barge bore a clear relationship to the risk contracted for by both parties is sufficient to distinguish this case from cases involving suspensive conditions****"(emphasis added).*

Accordingly, it is only the breach of those warranties which bear a "clear relationship to the risk contracted for" which will entitle the insurer to void the policy.

If a warranty wording is capable of bearing two meanings, Courts will interpret the term in the manner most favourable to the insured. For example, in *Andreas Pizza Mill Ltd. (c.o.b. Portofino Restaurant and Pizzeria) v. Sovereign General Insurance Co.*[18] the restaurant owner's son forgot his keys. Afraid that he would activate the alarm upon exiting, he decided to leave the alarm unarmed overnight. The business premises suffered a loss by fire, which started less than two hours after the son's departure.

The property policy contained an alarm warranty in the following words:

> *"In consideration of the premium charged it is agreed that during the policy period the burglar alarm system installed at the insured's premises will be maintained in proper working order and connected at all times when the premises are not open for business".*

Sovereign General contended that "connected" meant "activated", "armed" or "turned on", and as the alarm system was none of those things at the time of the loss, the insured was in breach of the warranty, and therefore not entitled to coverage.

The insured, on the other hand, argued that "connected" should be given its ordinary meaning, and as the alarm system was connected both to an electrical power source and to an external alarm monitoring system, it had complied with the warranty and was entitled to coverage.

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[18] (1997), 33 B.C.L.R. (3d) 372 (C.A.)

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The Court of Appeal said:

> *"In deciding which of the two meanings would promote, or give effect, to the parties' intentions, the court will endeavour to find the most reasonable one, and one which promotes a sensible commercial result.* ***If both interpretations are reasonable, then the language will be interpreted in the way most favourable to the insured, and against the insurer, as the author of the language, or at least the person in control of the contract's content****" (emphasis added).*

In the end, the Court opined that to require the alarm system (which included motion sensors) to be activated at all times when the premises were not open for business would effectively eliminate the possibility of employees working in the premises before or after business hours. Such a result could not have been intended, the Court said, in a business in which preparation and cleanup work must, of necessity, be done before and after business hours. For that reason, the Court allowed the insured's claim.

C. RELIEF FROM FORFEITURE

In some cases, where the Court is convinced that it would be unjust to relieve the insurer from liability on the basis of the insured's "imperfect" compliance with the insurance contract, it may excuse the breach through a process called "relief from forfeiture". Section 10 of the *Insurance Act*, R.S.B.C. 1996, c. 226 says:

> *"If there has been imperfect compliance with a statutory condition as to the proof of loss to be given by the insured* ***or other matter or thing required to be done or omitted by the insured with respect to the loss****…the court may, on terms it deems just, relieve against the forfeiture…" (emphasis added)*

An example of the Court granting relief from forfeiture occurred in *312630 British Columbia Ltd. v. Alta Surety Co.*[19] In that case, an aggregate supplier sought payment from a surety under two Labour and Material Payment Bonds. A clause in the bonds required that notice of a claim be given within 120 days, however, the insured had been late in affording written notice.

The case is instructive in that it is one of the few decided cases in which the doctrine of relief from forfeiture was used to reduce the insured's claim by a monetary amount that was caused or attributable to the breach of condition; in this case late notice. The Court permitted the insured to recover $100,000 of the $170,000 claimed on the bonds on the premise that any amounts in excess of $100,000 arose from the bonding company's inability to properly manage the risk had notice in writing been provided on a timely basis. In reducing the insured's recovery in a monetary manner the Court addressed

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[19] [1995] B.C.J. No. 1600 (Q.L.)(C.A.)

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various factors to be considered in deciding whether to grant relief from forfeiture including the degree and type of prejudice to the surety, the insured's knowledge and awareness of the contractual requirement, the experience and knowledge of the insured and the insured's degree of delay in affording written notice. The Court stated:

> *"I agree that those are all relevant factors in relation to the discretion **but by far the most important factor is the factor of whether the surety has suffered prejudice. ...In my opinion, the question is whether the surety has suffered actual prejudice**" (emphasis added).*

This decision illustrates how the Court will use the doctrine of relief from forfeiture to provide a solution when there has been a breach of condition, however, concurrently ensuring that the insurer does not pay a monetary sum in excess of what would otherwise have been paid had there been no breach of a condition.

Similarly, the *Law and Equity Act*, R.S.B.C. 1996, c. 253 contains a general provision which permits the Court to relieve against the requirement for strict compliance with contractual terms if to enforce the terms would cause unfair hardship. Section 4 of the Act says:

> *"If a plaintiff or petitioner claims to be entitled…to relief on an equitable ground against a deed, instrument or contract, or against any right, title or claim asserted by a defendant or respondent in a cause or matter, … the court,…must give the plaintiff or petitioner the relief that ought to have been given by the court in a suit or proceeding in equity for the same or similar purpose properly commenced before April 29, 1879".*

Is there an equitable right to relief from forfeiture in the case of a breach of warranty? The answer is unclear. In *Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*[20] the Court confirmed that the provision in the *Law and Equity Act*, R.S.B.C. 1996, c. 253, applied to insurance contracts, but did not rule specifically on whether relief from forfeiture is available in the event of a breach of warranty. The Court did, however, set out the factors to be considered on an application for relief from forfeiture. It said:

> *"The power to grant relief against forfeiture is an equitable remedy and is purely discretionary. The factors to be considered by the court in the exercise of its discretion are **the conduct of the applicant, the gravity of the breaches and the disparity between the value of the property forfeited and the damage caused by the breach**".*

D. SUMMARY OF THE CURRENT STATE OF THE LAW

The current state of the law with respect to warranties might be summarized as follows:

[20] [1994] 2 S.C.R. 490

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1. For a breach of "warranty" to entitle the insurer to avoid the policy, there must be a causal connection between the breach and the loss;
2. There must be some temporal link between the breach and the loss;
3. However, if the breach of warranty increases the risk of loss, the insurer will be entitled to void the policy;
4. If two reasonable meanings can be ascribed to a warranty, the meaning most favourable to the insured will be given effect;
5. The fact that a clause contains the word "warranty" or "warranted" does not necessarily mean that it will be interpreted as a warranty; and
6. The Court may be able to excuse a breach of warranty where to.

E. APPLICATION OF CURRENT PRINCIPLES TO CGU'S WARRANTY WORDINGS

Now using the principles set out above, one can examine how a Court might approach some of CGU's frequently used warranties:

1. WELDING, CUTTING AND OPEN FLAME WARRANTY

The following is added to COMMERCIAL GENERAL LIABILITY CONDITIONS (SECTION IV):

Welding or Cutting Warranty.

You warrant that the following precautions will be taken while performing welding, torch cutting or other operations involving the application of open flame.

- a. *The entire area within 8 metres shall be swept clean and kept clean before and during such operations and all combustible materials shall be removed;*
- b. *The immediate area in which such operations are performed will be hosed down with water before and after such operations, unless the use of water would cause property damage;*
- c. *A fire-watcher will be present during all such operations, and will remain at the location of such operations for at least 30 minutes after the completion of such operations;*
- d. *The fire-watcher will be properly equipped and able to perform fire prevention and protection duties during such operations;*
- e. *You will maintain at least one multi-purpose fire extinguisher of an approved type, and in proper working order within 8 metres of such operations.*

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A breach of this warranty will not necessarily permit the insurer to void the policy in the event of an electrical fire. For example, if the insured failed to hose down the immediate area before and after working with an open flame, but a fire started in an electrical box and had no causal connection with the insured's failure to hose down the area, the court would probably not permit the insurer to void the policy.

On the other hand, if the insured failed to maintain a functioning fire extinguisher within 8 metres of the operations area, then whether or not the fire was started electrically, there would be a causal connection between the breach and the loss, and the insurer would be permitted to void the policy.

Note that warranty "b" uses the phrases "the immediate area" and "before and after such operations". Those phrases can bear a variety of interpretations unlike say, "the area within 30 feet" and "within 10 minutes before and after". In a case where the interpretation is in doubt, the Court will ascribe the meaning most favourable to the insured.

2. ROOFING CONTRACTOR WARRANTY:

(ROOFING WITH THE APPLICATION OF HEAT)

It is warranted that during all roofing operations described under declaration of this policy, the following precautions will be taken:

1. *Before and after all heat applications, the immediate area will be hosed down, where practical.*
2. *During any heat application a proper fire extinguisher will be in close proximity.*
3. *A guard or watchman will be on hand during all heat application operations to watch for and extinguish any sparks or over heated areas and for one-half hour after the operations are completed.*

Violation of the conditions set forth herein shall render coverage provided by this policy null and void.

In the event that the insured failed to hose down the immediate area after applying roof material with heat, but the premises were damaged not by fire but by flood, the insurer would not be permitted to void the policy because there would be no causal connection between the breach and the loss.

Similarly, in the event that the watchman did not remain at the scene for one-half hour and thereby breached the warranty, but it could be shown that a fire started, say, a full two hours after completion of operations and would not have been discernible within

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30 minutes of completion of operations, the court would probably not permit the insurer to void the policy on the basis of the breach, since there would be no temporal or causal connection between the breach and the loss.

If, however, the guard left within 10 minutes of completion of operations and it could be shown that the fire started shortly thereafter, the insurer would be permitted to void the policy.

3. ALARM SYSTEM WARRANTY ENDORSEMENT

> 1. *IT IS A WARRANTY OF THIS POLICY THAT the Insured will maintain in proper working order and connected both electrically and physically at all times and activated when there is no authorized person(s) physically present on the premises, an alarm system which is of the closed circuit electrical type as described in the Burglar Alarm Systems Details Endorsement.*
> 2. *The warranty in Paragraph 1 above includes the obligation of the Insured to ensure that the alarm system described herein will correctly read, recognize, process, distinguish, interpret and accept any encoded, abbreviated or encrypted date, time or combined date/time data or data field.*
> 3. *Notwithstanding the provisions of any section of, part of, or endorsement to this policy, including the "Misinterpretation of Date Exclusion Endorsement", the Insured will not be insured against the peril of "burglary" or "theft" if the alarm system described herein is not maintained and activated as required and warranted in 1 and 2 above.*

In the event that the insured failed to keep the burglar alarm physically connected but the inventory was lost by fire (which the burglar alarm would not have detected even if it had been connected), the insurer will probably not be permitted to void the policy since there would be no causal connection between the breach of warranty and the loss.

If the owner of the premises chose to sleep overnight at the store and did not activate the alarm, and the inventory of the store was stolen during the night, the insurer would be obliged to afford coverage. The warranty requires the alarm to be activated only "*when there is no authorized person(s) physically present on the premises*".

The Court would probably permit an insurer to void the policy in the event of a theft during a time when the alarm was either disconnected or not activated, since the wording of this warranty is precise and any breach would significantly increase the risk of loss.

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4. PREMISES AND PROPERTY PROTECTION WARRANTY

PART 1 OF 2

It is hereby understood and agreed that with respect to the Jewellers Block Form, it is warranted that:

A. *The Insured will maintain in proper working order during the life of this policy, alarms and protective devices including video cameras and video recorders (VCR's) described in his or their proposal form and in endorsements attached hereto. Upon the Insured becoming aware of any interruption of the alarm service or of any protective devices as described in his or their proposal and in endorsements attached hereto, the Insured shall immediately notify their Insurance Brokers.*

It is further understood and agreed that the Insured shall take all reasonable steps immediately to restore the alarm service or protective devices including video cameras and video recorders (VCR's) or otherwise secure the property insured hereunder.

B. *The Insured further agrees to provide notification to the Insurer within twenty four (24) hours of receipt of any advice from any police authority of suspension of response by their members. Failure to provide notification as stipulated above will render the coverage provided under this policy null and void as of the date of notification of suspension of response by the police authority.*

C. ***Upon Opening:*** *All entrances and exits shall be kept locked, except to admit authorized personnel, while the premises are being prepared for the usual daily display of stock.*

D. ***Upon Closing:*** *All entrances and exits shall be locked at the close of each business day prior to the removal of stock from show windows, showcases, counters and or wall cases and are to remain locked until all stock usually deposited in the safe(s) and/or vault(s) is deposited therein and all protective devices are set.*

IT IS UNDERSTOOD AND AGREED THAT NON-COMPLIANCE WITH ALL OR ANY OF THE ABOVE WARRANTIES SHALL RENDER ***VOID ALL COVERAGE UNDER THIS POLICY***

Again, in the event that the insured failed to "maintain in proper working order" a burglar alarm and the inventory was lost by fire, the insurer would not be permitted to void the policy because there would be no causal link between the breach and the loss.

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Note that this warranty contains no positive obligation on the part of the insured to keep alarms "activated" during certain hours or when no authorized persons are on the premises.

In circumstances where the alarm system was interrupted and then subsequently repaired without notice to the insurer, (a breach of warranty) and a theft occurred after the alarm system had been restored, a Court may not permit the insurer to void the policy since there is no temporal link between the breach and the loss.

Likewise, if it could be shown that the store entrance was not kept locked on a particular day while the premises were being prepared for the usual display of stock (without incident), and a "smash and grab" theft occurred say, two months later, the Court would probably not permit the insurer to void the policy. There would be no temporal link between the breach of warranty and the loss.

PREMISES & PROPERTY PROTECTION WARRANTIES PART 2 OF 2

I. INVENTORY

A) A detailed and itemized inventory record of the insured property shall be maintained and physical inventory shall be taken at intervals of not more than 12 (twelve) months.

B) Detailed record books showing a complete record of business transacted, including all purchases and sales for cash and credit.

C) Detailed records of (i) the property of others in the Insured's custody and control (ii) all travellers' stocks and (iii) property sent to others for any purpose.

D) You must at all times keep and produce these records for us in a manner that will allow us to accurately determine and verify the existence of the property covered and the amount of the loss.

II. BURGLAR ALARM

It is warranted that the following described burglary alarm system will be in proper working order and will be operational and activated at all times when the Insured's premises are closed and vacated by all authorized personnel.

III. SURVEILLANCE SYSTEM

It is warranted that the following described Surveillance System will be in proper working order, and the video recorder (VCR) must be kept hidden from public view. The described Surveillance System must be operational

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and activated at all times when there are authorized personnel in the Insured's premises. It is further warranted that the Insured must maintain a weekly library of individual video tapes recording all the daily activities, of the entire business day. All video tapes must be kept hidden from public view.

IV. HOLDUP PROTECTION

It is warranted that the following described holdup protection will be in proper working order and will be operational and activated at all times when there are authorized personnel in the Insured's premises.

V. SAFES AND VAULTS

It is warranted that the total value of the following described property left out of the following described locked safes and vaults when the premises are closed and vacated by all authorized personnel shall not exceed ________________________.

Described Property:

i) set and unset diamonds, precious gems, semi-precious stones and cultured pearls;
ii) karat gold, gold bullion and platinum;
iii) watches having a cost price in excess of $________________________

Described safes and vaults:

VI. KEYS

It is warranted that all keys and duplicate keys capable of operating the alarm(s) or opening the safe(s) or vault(s), described herein, are removed from the Insured's premises when the said premises are closed and vacated by all authorized personnel.

IT IS UNDERSTOOD AND AGREED THAT NON-COMPLIANCE WITH ALL OR ANY OF THE ABOVE WARRANTIES SHALL RENDER VOID ALL COVERAGE UNDER THIS POLICY

In the event that the insured failed to keep detailed transaction records for one day in June, but otherwise kept detailed records that related to all items claimed as lost, the Court would probably not permit the insurer to void the policy since there would be no causal connection between the breach of warranty and the loss.

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If a theft occurred while the shop was closed and the alarm not activated, but a salesman remained on the premises at the time, the insurer would not be permitted to void the policy. The obligation to activate the alarm only occurs when the premises are "vacated by all authorized personnel".

In the event that the insured failed to remove "all keys capable of operating the alarm(s) or opening the safe(s) or vault(s)" while the premises were closed and vacated, but the loss occurred by fire, the insurer would probably not be permitted to void the policy. There would be no causal connection between the breach and the loss.

In the event of a theft during a time when the property left out of the locked safes exceeded the warranted amount, the court would probably permit the insurer to void the policy since the breach increased the risk of loss (by creating an "attraction" for thieves). However, using the relief from forfeiture provisions, the insured may be able to argue that the insurer was obliged to indemnify the insured, but only to the extent of the warranted amount:

5. PROPERTY IN CUSTODY OF PERSONNEL/AGENTS AWAY FROM PREMISES WARRANTY

> …
>
> 3. *It is hereby understood and agreed that in addition to the provisions contained in Clause 7(D), the Insurer will not be liable for loss or damage to property by theft from any unattended vehicle, unless the following two conditions are fully complied with:*
>
> *Condition 1):*
>
> *The vehicle where the property is contained must be equipped with an alarm covering all openings of the vehicle. The alarm system for the vehicle must have all of the following requirements:*
>
> *A) Alarm contacts on all doors.*
> *B) Alarm contact on the hood.*
> *C) Alarm contact on the trunk.*
> *D) Alarm must operate from its own dedicated battery.*
> *E) All wiring must be concealed.*
>
> *Condition 2):*
>
> *The property insured must be contained within the trunk compartment of the vehicle. A chain and padlock must be attached to the interior of the*

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rear trunk and property secured. The chain and padlock must be locked together and secured in a manner that does not allow for easy removal of the property from the trunk. The doors and the trunk of vehicle must be locked and the alarm must be operational and activated.

IT IS UNDERSTOOD AND AGREED THAT NON-COMPLIANCE WITH ALL OR ANY OF THE ABOVE WARRANTIES SHALL RENDER VOID ALL COVERAGE UNDER THIS POLICY"

In the event of a theft when the trunk was not secured in the manner prescribed, the Court would likely permit the insurer to void the policy, since the wording of the warranty is clear and there is a clear connection between a breach of the warranty and an increased risk of loss.

However, if the insured failed to keep the trunk locked but the contents of the vehicle were lost by fire, the insurer would not be permitted to void the policy since there would be no connection between the breach of warranty and the risk of loss.

6. LOCKED VEHICLE WARRANTY ENDORSEMENT

IT IS HEREBY AGREED THAT:

THIS CLAUSE DOES NOT APPLY TO PROPERTY UNDER THE CONTROL OF A COMMON CARRIER

Warranted by the insured that any vehicle in which the property insured is carried is equipped with a fully enclosed metal body or compartment, and the Insurer shall be liable in case of loss by theft from an unattended vehicle only as a direct result of forcible entry (of which there shall be visible evidence) into such body or compartment, the doors and windows of which shall have been securely locked.

In the event that the vehicle was left unlocked (a breach of warranty), but the loss of property occurred by fire, the insurer would not be permitted to void the policy because there would not be a causal connection between the breach of warranty and the loss.

However, if the contents were stolen from a locked fiberglass trailer, the insurer would be permitted to void the policy. There would arguably be an increased risk of loss because the trailer is made of fiberglass and not metal.

Likewise, if the contents were stolen from an open convertible the insurer would be permitted to void the policy.

IV. MISSING TERMS

A problem associated with modern underwriting practices arises from the evidentiary difficulty in proving that an insured actually received the policy wording. Typically, when an insured arranges for insurance, the broker provides a cover note or binder to the insured, without the policy wording being issued until a later date. If an insurer later seeks to rely on certain policy wording, it must be able to satisfy the court that the full policy wording was actually delivered to the insured.

In the unreported case of *Reierson et al v. Commercial Union Insurance Company of Canada* (B.C.S.C.), the insured claimed for a fire loss. The property insurer sought to rely on certain terms and statutory conditions contained in the policy in denying coverage. At issue was whether the insured had ever received the policy wording. In support of its defence, the insurer adduced affidavit evidence from the broker and underwriter concerning the office procedures and practices to demonstrate how the process that is followed once an application for insurance is received, through to the actual forwarding of the policy wording by the insurance company to the customer.

Insurers seeking to rely on such evidence face difficulties, since the evidence is open to criticism that it does not amount to personal knowledge and only indicates what "probably" happened with respect to delivery of the policy. Still further, if the insured can satisfy the court that on other occasions the "invariable practice" was not followed, the evidence will be of little value.

In *Hwang v. AXA Pacific Insurance Co.*[21] the insured sought to take advantage of not having received the liability wording from the insurer. The British Columbia Court of Appeal considered whether an insurer is entitled to deny coverage on the basis of exclusions or conditions contained in a policy booklet which was not received by the insured.

The insured, Hwang, was sued by a neighbouring property owner as a result of allegations of causing a landslide on to the neighbour's property. Hwang settled the case and sought indemnification from his insurer. The insurer denied coverage on the basis that the policy did not cover intentional acts and that Hwang had failed to give timely notice. Hwang had received the Declarations page of the policy but <u>not</u> the policy wording booklet including the exclusions.

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[21] 91 B.C.L.R. (3d) 34 (C.A.)

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Section 12 of the *Insurance Act*, R.S.B.C., 1996, c. 226, reads as follows:

> *"(1) A term or condition of a contract which is not set out in full in the policy or in a document in writing attached to it, when issued, is not valid or admissible in evidence to the prejudice of the insured or the beneficiary.*
> *(2) This section does not apply to an alteration of the contract agreed on in writing between the insurer and the insured after the issue of the policy."*

At trial, the Court opined that the Declarations page and the policy wording booklet were intended to form the whole contract of insurance, and since the policy wording booklet had not been delivered to Hwang, the liability insurer could not deny coverage on the basis of exclusions or conditions which were not in fact received by the insured.

On appeal, the British Columbia Court of Appeal noted that there was not a word in the Declarations page as to the meaning of "Select Homeowners Comprehensive Form", or, any obligation to defend. The obligation to defend was contained in the policy booklet, so the insured would have to prove the grant of coverage by means of the policy booklet in order to succeed in his claim. The Court said:

> *"It is in my opinion, a fundamental principle of the common law of general application that one may not take the benefit of an instrument without also taking its burden."*

The Court also quoted with approval an extract from *Macdonald v. The Law Union Fire and Life Insurance Company*:[22]

> *"…the Plaintiff cannot sue upon the contract which contains that proviso without being bound by it, and that he must take the contract with the proviso, and not reject it."*

Ultimately, the Court determined that Hwang had to assume the whole of the policy booklet or none of it, and since the Declaration page alone contained no words defining the insurer's obligations, the insurer was not liable to indemnify Hwang.

In practical terms, the *Hwang* and *McDonald* cases illustrate that while an insured cannot take advantage of not having received a policy, it is beneficial to have internal processes in place for the delivery of the full policy wording which are consistent and ideally, which allow for the "tracking" of delivery to individual insureds.

V. CONCLUSION

There are remedies available for insurers confronted with first party property losses in the event of a misrepresentation or breach of warranty on the party of the insured.

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[22] (1874) L.R. 9 Q.B. 328

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In order for an insurer to successfully void a policy for misrepresentation, the insurer must be able to prove that on a fair and reasonable construction, the misrepresentation was with respect to a material fact, was not a trivial misstatement, and induced the making of the contract.

In order for an insurer to successfully void a policy for a breach of warranty, the insurer must be able to convince the court that the term in question is an actual "warranty", that there was a causal connection between the breach and the loss or at least an increased risk of loss as a result of the breach, and that it would not be unjust to enforce the warranty.

If an insurer seeks to rely on specific policy wording to avoid liability under the policy, the insurer must be able to prove that the wording was actually issued to the insured or, at a minimum, provide convincing evidence that its office procedures are such that it is reasonable to conclude that the wording was delivered to the insured.

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