

Paper C1 2004

The Principles of Insurance

Examiners General Comments

After last years paper I reviewed my approach to how I set Questions and as to the level of detailed expertise that I expected from Candidates. As a result this year I took a deliberate decision that the paper should be, for want of a better analogy, a “Ronseal Exam”. That is the paper should reflect fully both the spirit and the physical content of the syllabus, nothing more or less. This year I therefore endeavoured to set a paper that did not look to test the knowledge of the candidates on any of the more obscure elements within the syllabus, trying to restrict questioning to what I perceived to be the core of the subject, that is, “The Principles of Insurance”.

Pleasingly this meant that only a very few of the exam papers I reviewed were of a very poor standard, however conversely no single candidate produced a paper that I would have considered exceptional or worthy of a distinction. What no one seemed to grasp was that as I was asking straightforward and precise questions, that I wanted direct and precise answers. There were no occasions where a “near enough” answer would have garnered the points required to get a pass.

Many of the questions could have been adequately dealt with and received full marks for answers that would have been no more than a short paragraph or a number of bullet points. I was not looking for reams of case law (for the majority of questions one or two well chosen cases would have gained full marks and saved the candidate time for other questions), neither was I looking for complex or convoluted reasoning.

To those of you who were looking for the trick questions, there were none, I was looking for you to show me that you understood the core of this subject, I was not looking to show everybody how clever I was by setting a fiendishly tricky paper.

For future papers I would suggest that candidates make sure that they:

- Do thoroughly understand the principles of insurance (with one or two good cases for each element), that is Insurable interest, Proximate Cause, Indemnity , Subrogation and Contribution.
- Understand Contract
- Know the Standard Fire Policy inside out, particularly the claims conditions
- Understand all the various forms of average, and the Reinstatement Memorandum

Best of luck

Paper C1

The Principles of Insurance

Answer points

1.

a) Johnson Brothers v BW Developments [2003]

Fire started in property belonging to BW , which they had had renovated. During the course of the work alterations had been carried out to a fire place and the firebricks had been removed .This exposed timber-work in the party wall with JB. A sub-contractor working on site a set a fire in the fire place , this spread to the timber in the party wall and then through to Johnsons premises causing £200k damage.

Salient points here are that this case actual provides a clarification to the defence under the Fire Prevention Metropolis Act for fire “accidentally begun”. In this instance it was considered that the contractor who had removed the firebricks had been negligent and therefore that for the purposes of the act that the fire was not accidentally begun. The other main point of interest in this judgement is that the act was viewed as being so hazardous that BW could not divert the claim from themselves by claiming that they could not be held responsible for the actions of an independent contractor, (as in Alcock v Wraith) (nb if you got the first part you got full marks)

b) Commercial Union Assurance Co V Hayden [1977]

This is a liability case that sets a precedent for the independent liabilities method being the usual method of apportionment between two policies of insurance.

The P/h had two liability policies , one with Lloyds of London with a LOI of £10,000, and one with the CU for a LOI of £100,000. The contractor caused damage that was agreed with the third party at the figure of £4425.45 , the claim being settled by agreement between the two insurers by CU. Both sides agreed that there should be contribution , but they disagreed as to the method. Lloyds wanted to agree the contribution based on the maximum liability (sums insured) method, whilst the CU preferred the Independent Liabilities method. The court considered the latter most appropriate , based on academic studies , and also on the general principle of the correlation between the level of respective premium to likely level of loss.

c) Mitchell V Ealing Borough Council [1978]

Ealing Borough Council evicted Mitchell from one of their properties on 16 December. Mitchell was a squatter in a council property. The council offered to store her furniture (rather than leave it on the pavement), to which offer Mitchell consented. The council stored Mitchell's furniture in a lock up garage. On 19 December, Mitchell's partner arrived at the lock up by prior appointment to collect the furniture. The council official failed to turn up and so no access was gained to the garage. Subsequent arrangements were made and on 15 January when the furniture was to be collected, it was found that the lock up garage was empty, the furniture having been stolen.

The court held that having failed to deliver up the bailed goods on demand to the bailor on 19 December, the goods were held illegally thereafter and de-facto that the council would be held to be the insurers of the goods. Irrespective of whether or not the council had complied with their duty of care in storing the goods in a lock up garage, the court decided that the council could not prove when the theft occurred. The inference of this being that had the loss been proved to have occurred prior to the pre-arranged collection time on 19 December, the council would not have been liable, provided they had complied with the duty of care.

d) TSB V Botham [1995]

This case helped clarify what items were to be viewed as fixtures. The court decided in this case that the principle test was one of the degree of annexation.

The case concerns a mortgage repossession where Botham sought to recover those improvements to the property that he had had carried out , stating that they were not part of the buildings and that LTSB had no charge on them. The areas of dispute included items such as fitted carpets , curtains , blinds , tap fittings and shower heads, mirrors attached to walls , fitted kitchen units and integral appliances . The court of first reference had decided that these were all buildings items and that LTSB was able to retain the proceeds from their sale.

However on appeal Jacob.J stated that the “test of whether an item is or is not a fixture depends primarily on the degree of annexation”. However equally

important was the purpose of annexation, as in some case this can render an item a chattel in law that is nonetheless attached to land. If an item is attached to land merely to enable the owner to enjoy the chattel, rather than to effect a permanent improvement to the land, it would still be viewed as a chattel.

e) Blyth v Birmingham Waterworks Co [1856]

This is a case made famous for its succinct definition of what negligence was. The court held that negligence “ was he omission to do something which a reasonable person guided by those considerations which ordinarily regulate the conduct of human affairs, would do, or something which a prudent and reasonable person would not do”

f) Regina Fur Company Ltd V Bossom [1958]

This case concerns the onus of proof with regards to Insurance claims and reaffirms the principle that Insurers are entitled to put the policyholder to strict proof both with regards to the existence of a loss, with regards to its cause and finally with regards to its amount .. The famous passage which is usually quoted is that given by Lord Evershed “ I think that the defendant _whether he is a underwriter , or any other kind of defendant – is entitled to say , by the way of a defence, I require this case to be strictly proved and admit nothing.. the onus remains throughout upon the plaintiffs to establish the case that they are alleging”

2.

a) The six elements necessary are:

Intention to form such a legally enforceable agreement

Legality

Capacity to enter into a contract

Unqualified offer

Unqualified acceptance

Valuable Consideration

Finally the really smart amongst you will have noticed that I missed the seventh element off, that is absence of fraud. One candidate picked up on this in addition to the other 6 and got the appropriate bonus mark.....

b) Ubberimae Fides is the concept of utmost good faith.

This requires that all parties engaged in the negotiation regarding the establishing of an insurance contract must disclose all relevant information (material facts) to all the other parties. Instead of parties only having to give information that they are directly asked about, as would be the normal case, in this instance there is a positive duty of disclosure where the parties must volunteer the information even if not asked. This is important in that in the majority of cases, when accepting a risk , an insurer will only know that which the policyholder chooses to tell him. The principle has arisen to counteract this unequal position.

The principle case is that of *Carter V Boehm* (1766), quoting Lord Mansfield:

“The special facts.....lie most commonly in the knowledge of the Insured only : the underwriter trust to his representation and proceeds upon confidence that he does not keep back any circumstance in his knowledge to misled the underwriter ...and to induce him to estimate the risk, as if it did not exist”

c)

i. “Contra Preferentum”

This is one of the rules governing the interpretation of contracts. It states that if there is any ambiguity in the way that the wording of a contract can be interpreted, that this will be interpreted in the way that best suits the party that did not draft the contract.

Quoted case is that of *W & J Lane V Spratt* (1970)

This is a case involving the theft of a lorry load of goods by an employee of the Insured for whom they had not taken up references. The Underwriters tried to interpret this as a lack of reasonable care on the policyholders behalf , as the policy did not contain any more express condition regarding the matter of pre –employment checks. The court held that when interpreted in context that the reasonable care conditions related to physical security , and that if the underwriters had wanted to extend it to include checks on staff then they should have expressly worded the policy so.

ii. “Ultra Vires

Ultra Vires is the principle that when someone is entrusted to do something for another party that they are only allowed to do things within the limits of the powers delegated to them. If someone goes beyond these limits they will be held to have acted ultra vires and the anything they have then done is unenforceable.

iii. “Ejusdem Generis”

This is otherwise referred to as the “rule of context”. When interpreting contract wordings , if the meaning of a word is not immediately apparent , or it can be interpreted a number of ways , it will be first interpreted utilising the words immediately around it in the contract to see if its intention and meaning then become clear.

Cases to quote include *King V Travellers Insurance Association Lt* (1930)

This claim involved the loss of a persian lamb fur coat. TIA tried to exclude the item saying that it was a valuable article within the terms of their policy that excluded

“ jewellery , watches , glasses , cameras and other fragile or specially valuable articles unless separately declared and valued. . In the context of those items specifically defined as valuable under the contract it was held that the coat was a “common place article of dress in the case of very woman of any sort of comfortable means”

3.

a) The basic positions are as follows:

Common Law

If a loss is covered under two or more policies and in the absence of any specific contract conditions concerning the matter , the policyholder may submit his claim in the first instance to whichever of the Insurers that he should so chose. He must declare the existence of the other policies to that Insurer , but they must settle the claim within the terms of their policy before then seeking a contribution from the other Insurers.

As Modified under the Standard fire policy

Under the standard fire policy Contribution is claim condition five. The condition states that the liability of the Insure will be limited to its rateable proportion Therefore unlike the common law position, the Insurer of first reference does not have to satisfy the claim to his limit of indemnity under his policy , he is able to say to the policyholder , that I will only pay ,my part of the loss and you will need to seek to recover the balance under the other policies of insurance.

The condition also imports the application of average to its policy , in the circumstance that one of the other contributing policies may be subject to its application and the Insureds policy not.

b) I was of course hoping and expecting that the definition in the case of Pawsey Scottish Union and National [1908] would be used , that is :

“The active efficient cause that sets in motion a chain of events which brings about a result without the intervention of any force working actively forma a new and independent source”

c) The ABI Theft/Impact Agreement covers contribution between Buildings Insurance under a material damage policy and the tenants liability sections of

the tenants contents Insurers in cases of impact damage to buildings caused by Ram Raids or attempted Ram raids:

The provisions are as follows:

The contents policy will meet the loss in its entirety up to the policy limit of indemnity or £25,000, whichever ever is the lower. Above this figure the loss will be paid by the material damage Insurer.

The expenses of settlement will be split in proportion to the insurers respective contributions.

The agreement only covers those Insurers who are signatories to it.

4.

a) In the event of damage the Insured shall:

- Notify the Insurer immediately
 - Notify the police immediately if it becomes evident that any damage has been caused by malicious persons
 - Carry and permit to be taken any action which may be reasonably practicable to prevent further damage
 - Deliver to the Insurer at the insureds expense
1. Full information in writing of the property lost damaged or destroyed and of the amount of Damage
 2. Details of any other Insurances on any property hereby Insured

Within 30 days after such damage or such further time as the Insurer may allow

3. All such proofs and information relating to the claim as may reasonably be required
4. If demanded a statutory declaration of the truth of the claim and of any matters connected with it.

No claim under this policy shall be payable unless the terms of this condition have been complied with.

b) Quoting relevant case law describe what the courts would presently consider to be storm under a specified perils policy

Original case is that of *Oddy V Phoenix*. This is a case dating back to 1966, and concerns the collapse of a twelve feet high retaining wall on to Mrs Oddys bungalow. The collapse was principally caused by the inadequate design and construction of the wall, but the straw that broke the camels back was a build up of run off water behind the wall, which exerted sufficient pressure to bring matters to a head. The policy specifically excluded land-slip cover and Mrs

Oddy attempted to claim for the damage on the basis that the run off water had resulted from storm. The court found in insurers favour and the principle part of the judgement states :

“Storm means storm and to me it denotes some sort of violent wind usually accompanied by rain , hail or snow . Storm does not mean persistent bad weather , nor does it mean heavy rain or persistent rain by itself”

Others include Glasgow Training Group Ltd V Lombard Continental PLC (1989). This is a case concerning collapse of a roof due the weight of standing snow . The judge quoted from the shorter oxford Dictionary stating that storm was:

“ A violent disturbance of the atmosphere.....sometimes applied to a heavy fall of rain, hail or now or to a violent outbreak of thunder and lightning unaccompanied by strong winds”

You could also quote from Anderson V Norwich Union [1977] or from S & M Hotels Ltd L Legal and General Assurance Society Ltd {1971}. These are really however only clarifications of the Oddy judgement

5. a) Insurable interest is defined simply as the insureds financial interest in the subject matter of Insurance”

In the case of material damage insurance the three essential elements to establish insurable interest are:

There must be a physical object capable of being destroyed lost or damaged

The physical object must be the subject matter of the insurance

The Insured must have some legal relationship to the subject matter of the insurance that they would benefit from the preservation of the property or be prejudiced by its destruction.

b) Insurable Interest must exist at the time of the loss. It is immaterial if the interest existed at the time of the formulation of the contract if it does not exist at the time of the loss.

c) The vendor continues to have an insurable interest in the property being sold after the date of exchange of contracts up and until the point of completion of the sale. Conversely the purchaser will also have an interest in the property after the date of exchange. As such both parties could legitimately insure the premises as they both have a financial interest in the subject matter of the Insurance. On this basis if the subject matter was damaged or destroyed , both could legitimately claim , however as the policy would be covering separate interest. Previous Common Law practice and section 47 of the Law of

Property Act 1925, made the purchaser responsible for payment of the premium of Insurance from the point of exchange and thus responsible for Insuring the property.

Section 5.1 of the Law Society Standard Conditions of Sale 1990 modifies the former position that made the buyer responsible for Insuring the property after the signing of the contract (I.e. from the point of exchange. However to be frank the conditions are not as clear as they should be and it would still be wise for the purchaser to insure the premises for this period.

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a) Under the standard ABI policy of insurance the wording states that “ if the sum (insured) shall be at the commencement of any damage less than the value of the property covered within such sum insured , the amount payable by the insurer in respect of any such damage shall be proportionately reduced. No leeway is allowed under the strict wording. As such if the sum insured represents 95% of the value at risk, the policyholder will only recover 95% of the admitted value of the loss.

The special condition of average states that unless the sum insured is less than 75% of the value at risk that there will be no application of average. However once the sum insured represents less than 75% of the value at risk , then average applies in full. This condition is usually found on policies covering agricultural produce and the 25% margin of error is allowed to reflect the difficulties that exist in valuing the stock in advance at the start of an insurance year due to potential market fluctuations of value for the stock.

Under the reinstatement memorandum providing the sum insured represents more than 85% of the value at risk , no penalty will apply in respect of under-insurance. However as with the special condition of average , once the sum insured represents less than 85% of the value at risk average applies in full.

b)

The three options provided for under the settlement provisions of the ABI Standard Fire Policy are that the Insurer will pay to the insured the value of the property at the time of its loss or destruction. 2 pay the amount of the damage. 3 at its option re-instate or replace such property or any part of it.

The case of *Brown v Royal Insurance* [1859] concerns the option to reinstate or repair . In this instance the Royal elected to reinstate the fire damaged building belonging to Brown, however they did not proceed with Care , as a result of which they were required by the Commission of the Sewers of the City of London to dismantle the remains of the structure , which the Commission adjudged to be in a dangerous state. The Royal now tried to argue

that they should be released from their contractual obligation to reinstate as reinstatement had, in their opinion, become impossible. The court had no sympathy with this argument, stating that even if performance of their contractual duty was now impossible that they would be liable in damages for the non-performance to Brown. The court believed that the real problem was not that reinstatement had become impossible but that it had become impossibly expensive, and in the court's opinion even if this meant that the policy sum insured would be exceeded that Royal would still have to pay the cost. To summarise if an insurer opts to reinstate, they are bound by that decision regardless of the cost. As such the option to reinstate must be used with extreme care.