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POLICY CONDITIONS: LEGAL CLASSIFICATION AND CONSEQUENCES OF BREACH

On at least three occasions last year the Court of Appeal considered the issue of the interpretation and status of conditions where insurers were seeking to rely upon terms to obtain a declaration of non liability for a particular claim. In any policy, determining the status of a contractual term is vital to establishing the insurer's rights upon breach of that term. Depending upon its status the remedies can range from a right to terminate the policy, refuse a claim or simply seek damages. The normal area for debate is whether or not a "condition" has been unambiguously expressed in the policy to be a condition precedent.

Breach of a condition precedent

If a condition is found to be a condition precedent as to the validity of the policy or the attachment of risk, then breach of that condition by an assured will allow the insurer to refuse to indemnify for any loss arising under the policy before that condition has been satisfied.

If a term is stated to be a condition precedent as to liability, then breach of that condition will nearly always give rise to the insurer being able to refuse a claim. Claims procedure



conditions are often stated to be conditions precedent to an insurer's liability, for example conditions providing for notification of a claim within a specified period. Unlike the conditions precedent as to the validity of the policy and attachment of risk, breach of a condition precedent as to liability does not mean that the insurer can reject all other past and future claims.

Breach of a condition

Conditions not expressly stated to be condition precedents generally deal with the conduct of the assured during the lifetime of a policy. Whether or not a breach of such a condition gives the insurer the right to set aside the policy in its entirety, refuse to indemnify an insured with regard to a single claim or simply seek damages for any loss incurred as a consequence of the breach, will be influenced by whether the policy specified the effect of breach of that term or not. In the absence of any express term outlining the effect of breach, the question will be whether a breach of the term in question can be said to go to the heart of the contract and is in effect fundamental to the entire risk, or whether it is clear that the term is of a minor nature and will not affect the existence of the policy. In the former case the insurer will cease to be liable for any losses arising under the policy after the date of the breach, whilst in the latter insurers will remain responsible for losses accruing after the date of the breach, and will only have a right to seek damages if the breach of that condition has resulted in any actual loss.

Breach of an innominate term

It is possible that the status of the condition cannot actually be established at the outset of the policy, and in such cases it will be treated as an "innominate" condition. As such it is necessary to look at the consequences of the breach of that condition before determining whether or not the insurer can set aside the policy or seek damages. It is evident, however, following *Alfred McAlpine plc v BAI (Run Off) Ltd.* ([2000] Lloyds Report IR 352) that the Court of Appeal (obiter) has established a third possible remedy for insurers, namely that if an insurer can show that in linking the condition to the particular claim the breach was of such a serious nature that it in effect repudiated that claim, then the insurer can reject that claim, whilst the policy and risk in respect of other claims remain unaffected.



Recent cases

In light of the severe consequences to an assured of a breach of a condition precedent, issues as to the identification and status of these terms are often raised in Court. The following cases highlighted how difficulties can arise, and in turn demonstrate the Court of Appeal's reiteration of the well established principle that whilst it is open to insurers to express a term to be a condition precedent to liability or to risk, in doing so they should ensure that the condition so expressed is drafted in clear and unambiguous language because if there is any ambiguity, the condition will be interpreted in favour of the assured.

In *George Hunt Cranes v Scottish Boiler and General Insurance Co Ltd* ([2002] Lloyds Rep IR 178) the defendant insurer agreed to indemnify an engineering company against all sums for which it would become legally liable to pay under any contract of hire for compensation in respect of loss and damage to plant hired to it. The claimant's crane had been hired to the company and suffered damage whilst in its possession. The company subsequently went into voluntary liquidation and the claimant obtained judgment in default for the amount of its claim for damages. The company had, however, failed to notify the insurer of the claim in accordance with the policy, which provided that there should be delivery of a claim in writing within 30 days or such time as granted by the insurer and that no claim under the policy would be payable "unless the terms of this condition have been complied with".

The rights under the policy transferred to the claimant in accordance with the Third Parties (Rights Against Insurers) Act 1930. The claimant sought to enforce the judgment against the defendant. The defendant argued that it had not received notification of the claim in accordance with the policy which expressly stated that unless the terms of the condition had been complied with, no liability would attach, thereby making it a condition precedent to liability. The claimant in turn argued that the clause was not a condition precedent to liability because, unlike an earlier clause (dealing with the notification to the police of malicious damage or theft), it was not expressly stated to be such. The argument was that the insurers in having expressly stated one clause to be a condition precedent could have, and it if had been its intention should have, expressed the other aspect to be conditions precedent.



The Court of Appeal held that irrespective of the fact that the words 'condition precedent' had not been used, there was no ambiguity and the intention of the parties was clear because of the words "No claim under this policy shall be payable unless the terms of this condition have been complied with."

The Court accepted that this clause could be said to be an innominate term, however, considered it to have been appropriately designed as a condition precedent and, therefore, the insurer was entitled to reject the claim upon breach of the term.

In reaching this decision the Court noted that there is a tendency to use the label of 'condition precedent' or 'condition of liability' somewhat indiscriminately and when it is not always appropriate to do so. It is clear that whilst the Court was willing to consider the label attributed to a term, that label would not necessarily be decisive as to its status.

In the case of *Cornhill Insurance v DE Stamp Felt Roofing Contractors* ([2003] Lloyds Rep IR 648) the Court of Appeal reiterated the need for tight drafting when imposing conditions precedent to liability. The claimant roofing contractor had been contacted by a school to lay a felt roof on a new building. The process involved the application of three layers of roofing felt to the new roof. The director of the claimant company visited the site prior to works commencing to check what had to be done and resolve any difficulties. The works commenced and involved the use of a blowtorch to soften the bitumen on the back of the first felt layer that was to be adhered to the plywood roofing deck. The first layer was applied and, without any substantial break, work began on the second layer. The workmen, however, ran out of materials and they left the roof in order to collect what they needed to continue the work. While they were away the roof was seen to be smouldering in the area where the new roof adjoined the old building and there was subsequently extensive fire damage to the school. The expert evidence confirmed that the use of a blowtorch when applying the first layer had ignited a smouldering fire in a small area partially hidden from view by the structure of the roof wherein easily ignitable loose debris, such as dust and small leaves could have collected.

The defendant insurers refused to indemnify the claimant relying upon condition 3 of the policy which provided under the heading "Fire Conditions":



"It is a condition precedent to any liability of Cornhill that the insured shall have arranged for the following precaution to have been taken whenever carrying out any work involving the application of heat

- A When blow torches blow lamps or electric oxy-acetylene or other welding or flame cutting equipment are to be used:
- i) a thorough examination of the immediate vicinity of the work (including the area on the other side of any wall or partition) shall be made to see whether any combustible material (other than the material to be worked on) is in danger of ignition either directly or by conduction of heat
 - ii) all movable and/or combustible materials shall be moved from the immediate vicinity of the work (to a distance of not less than fifteen metres from the point of application of heat when welding or flame cutting equipment is used)
 - iii) all combustible materials which cannot be moved shall be covered and fully protected by overlapping sheets or screens of non-combustible material
- B For one hour after completion of each period of work involving the application of heat the site shall not be left unattended and a thorough inspection of the area surrounding the work (including that described in paragraph A(i) above) shall be made at frequent intervals up to the end of the period of one hour to ensure that nothing is smouldering and there is no risk of fire.

At first instance the Judge found that there had been a breach of 3A(ii) and 3B and there had not, therefore, been compliance with the condition precedent as set out in condition 3. The Court of Appeal disagreed, finding the condition precedent to liability being limited to the obligation to ensure that arrangements for the precautions to be taken were in place, and not that they should also, as a matter of fact, be effected. It was evident that should it have been the intention of the insurer to make it a condition precedent to liability that each stage of the arranged precautions were actually undertaken, then they



should have stated this clearly in the policy. The Court, however, noted that whilst it would be reasonable for an insurer to require an arrangement to be in place, it would be far less reasonable to require a guarantee that the arrangements were undertaken because failure to do so would probably be a result of an employee's negligence for which the cover was required.

In the final case, *Glencore International v Ryan 'The Beursgracht'* ([2002] 1 Lloyd's Rep IR 335) the Court of Appeal rejected an argument for a condition precedent as to the attachment of risk. Underwriters had provided open cover in respect of all vessels chartered by the assured for and during a 12 month period between 1 November 1986 and 31 October 1987. The open cover provided that the assured should notify the underwriters of new risks by way of a monthly declaration. A charter-party for a risk relating to the Beursgracht was entered into on 13 October 1987. During the loading of this vessel an accident occurred in which a stevedore was injured and subsequently died. In 1991 the owners notified the assured that proceedings had been issued in respect of the accident and the assured sought indemnification under the policy. It transpired that no declaration for the Beursgracht could be traced, and the assured subsequently declared it in 1993.

The defendant contended that no contract of liability insurance in relation to the vessel came into existence because no declaration had been made or indeed accepted by underwriters. The defendants also sought to imply a term that open cover declarations should be made within a reasonable period of time. At first instance the Court found for

the claimant, and the defendant appealed on the basis that it was a condition precedent as to risk that there be a timely declaration. The Court of Appeal found that nowhere in the policy did it provide that the underwriters should not be bound unless and until they received a declaration, and that whilst the declaration was an essential part of the contract it was not linked in the working in any way to the attachment of risk. Further it was found that if the underwriters had considered the commercial consideration regarding timely declarations sufficiently important then they could have made it a condition of cover that declarations be made within a specified time. It was accepted that there was an implied term that the declaration should be made within a reasonable time, and in turn that the claimant had breached this, however, the Court found this to be an innominate term and that the breach was not sufficiently serious so as to entitle the underwriters to avoid liability.



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