

## Property Insurance Update

January 2010

### A.C.Ward & Son Ltd v Catlin (Five) Ltd & Others: Implications for Property Insurers

#### *A.C.Ward & Son Ltd v Catlin (Five) Ltd & Others* [2009] EWHC 3122

RPC successfully defended a coverage dispute on behalf of various insurers, which concerned the theft of a large quantity of cigarettes and tobacco from a warehouse in March 2007. Whilst the insurance market will be re-assured by the judge's comments on misrepresentation and non-disclosure, the judgment also has implications for market practice in relation to warranties in property insurance policies. We look at the background to the case and its implications in this Update.

#### Factual background

The insured was the owner and operator of a wholesale distribution warehouse in Essex. Insurers provided cover to the insured under a coverholders bespoke wording. On a weekend in March 2007, whilst the warehouse was unoccupied, thieves broke in and stole £432,940 worth of cigarettes and tobacco from a storage area on the mezzanine level.

Risk surveyors appointed by insurers had attended the warehouse midway through 2006 and made Risk Improvement Requirements (RIR) which included an upgrading of security in the mezzanine area. The key RIR (all applicable to the mezzanine level) obliged the insured to (i) construct a metal cage for cigarette and tobacco stock (ii) install additional movement detectors and (iii) install vibration detectors around all four walls of the metal cage.

In light of the survey, insurers varied cover so that theft cover was excluded in respect of cigarette and tobacco stock stored on the mezzanine level outside of business hours until the RIR had been completed in full (Endorsement 6). In February 2007, the insured (via its brokers) confirmed that the relevant RIR had been implemented and, as a result, insurers removed the exclusion and re-instated full theft cover.



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#### Any comments or queries?

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During the theft, the warehouse's security protections, including guardwire on the external walls and movement detectors on the mezzanine level, did not respond as they should have done. In addition, the remotely monitored CCTV system failed to operate properly or at all throughout the period of the theft, and for a time beforehand due to an intermittent fault. It was not until one of the movement detectors eventually activated that the thieves finally fled.

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### **The Issues and Outcome**

Insurers primarily resisted liability on the grounds that (1) the re-instatement of full theft cover in February 2007 (referred to above) could be avoided for material non-disclosure or misrepresentation with the effect that the exclusion (Endorsement 6) remained in place and (2) before the loss had occurred the claimant was already in breach of both the Protection Maintenance Warranty (PMW) and the Burglar Alarm Maintenance Warranty (BAW), so that insurers had been discharged from liability from the date of the breach of warranty.

Insurers succeeded on point (1), entitling them to avoid or rescind the re-instatement of full cover in February 2007 with the result that there was no theft cover in place for the cigarette and tobacco stock at the time of the theft. The insured's claim for an indemnity under the policy therefore failed. The judge (Mr Justice Flaux) did not, however, agree with insurers' arguments on the strict construction of the warranties.

### **Misrepresentation / Material Non-Disclosure**

Having reviewed the evidence thoroughly and on the basis of detailed findings of fact, the judge accepted that, at the time of re-instating full theft cover, representations had been made by the insured / its broker, that the key RIR had been complied with in full. The judge held that the statements made in relation to (i) the installation of additional movement detectors on the mezzanine floor and (ii) the extension of the guardwire around all four walls of the storage area on the mezzanine floor were, in fact, misrepresentations or alternatively non-disclosures.

The judge then went on to consider the issues of materiality and inducement in accordance with the two-stage test laid down in *Pan Atlantic Insurance Co v Pine Top Insurance* [1994] 1 AC 501, namely whether the fact misrepresented or not disclosed would affect the judgment of a reasonably prudent underwriter in exercising his underwriting judgment as to whether to write the risk or here to extend cover, and whether the underwriter who agreed the risk or variation was induced to agree it by the fact misrepresented or not disclosed.

On the issue of materiality, the insured's expert witness accepted that, if the key RIR had not been complied with in full, this would be an important factor in the decision making process for a reasonably prudent underwriter who would at least want to know what was outstanding and how long it would take to complete. This amounted to an acceptance of materiality by the claimant but the judge did,

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however, make it clear that he had reached the same conclusion on his own view of the issues.

On inducement, the judge accepted on the basis of all the evidence before him that the underwriter, had certainly not been indifferent to the security in place at the warehouse or to compliance with the RIR and he held that he had been induced by the material misrepresentations or non-disclosure identified above to make the variation and lift the exclusion on full theft cover.

The judge decided that if the true position had been made known to insurers then either the variation to cover would have remained in place until the key RIR had been complied with in full or there would have been a further discussion between insurers and their risk surveyor in order to decide what further action was necessary; either way, insurers were entitled to rescind or avoid the re-instatement of cover.

### **Breach of warranty**

The first hurdle for insurers to overcome was to establish that the BAW and PMW had some 'content' in relation to the policy. The insured's case was that, as there had been no proposal form applicable to the warehouse, no 'protections' had been identified for the purpose of the PMW. Furthermore, no burglar alarm system had been identified in the policy schedule, and thus the BAW could not 'bite'. The judge did not accept these submissions, which he judged to be far too literal a construction.

The judge did, however, accept that the 'protections' that came within the policy were only those that existed at the premises at the time of inception (*Pratt v Aigjaon Insurance SA (The Resolute)* [2008] EWCA Civ 1314, 2009 2 All ER (Comm) 387). On this basis, neither the extension to the guardwire carried out following the RIR in 2006 nor the CCTV monitoring link (installed in September 2006) came within the remit of the PMW. He also held that the policy should be construed so as to apply to the burglar alarm system that was in place at the warehouse at the time of inception.

On insurers' case, on the wording of the warranties there could still be a breach of warranty even where the insured did not have knowledge of the facts underlying the breach. This was because the wording of the warranties required the protections and alarm to 'be' in full and effective operation rather than 'kept' – the word 'be' effectively imputing a strict liability for the insured to comply with the provision. In support of this approach, insurers relied on the judgment of Mr Justice Woolf in the case of *Melik & Co v Norwich Union Fire Insurance Society* [1980] 1 Lloyd's Rep 523.

The insured argued that the wording "*all defects occurring in any protections must be promptly remedied*", present at the end of both the PMW and BAW, implied that knowledge was required in order to establish a breach, ie that the insured is only in breach if it is aware of the defect but fails to take prompt action to remedy the position, and that therefore the obligations in each of the warranties were qualified.

The judge found for the insured on this construction issue, deciding that to do otherwise would not give effect to commercial sense. The judge, like the insured, decided that the 'promptly remedied' wording at the end of each warranty was there for a reason and was not merely surplusage, as insurers had argued. Having found that knowledge was necessary, the judge took the view that the insured

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had not been aware of the deficiencies in the security protections at the site at the time of the theft and that, accordingly, the insured was not in breach of either the BAW or the PMW. This, of course, did not affect the overall result given the judge's finding in favour of insurers on misrepresentation/non disclosure.

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### Implications for insurers

The judgment does have implications for insurers, particularly property insurers and their coverholders:

- Given the court's approach to the construction of warranties in this case, insurers should be wary of creating warranties, particularly those which apply to the whole policy
- Conditions precedent to liability (as opposed to warranties) are a preferable and more proportionate tool which the courts are less likely to find fault with
- Clear and concise wording in plain English is required so that the requirement on the insured and the consequences of any breach are absolutely clear to all
- If insurers wish an obligation to have effect, regardless of whether or not the insured is aware or should be aware of the defect, then this should be spelt out in very clear language
- Insurers should avoid using words such as "*All defects .. must be remedied promptly*" at the same time as imposing what appear to be absolute obligations on the insured