

Insurance

Editor: John R. Birds

LT Change of circumstances; Fire insurance; Fire precautions; Insurance contracts; Risk

Material changes in risk, or the importance of functioning sprinklers: *Ansari v New India Assurance Ltd*

This article discusses the Court of Appeal's recent judgment in *Ansari v New India Assurance Ltd (Ansari)*,¹ holding that property insurers were discharged from liability following the deactivation of a building's automatic sprinkler system, by application of a clause in the policy. It discusses the common law rule on post-contractual material change of circumstances under insurance policies, and the assimilation of certain policy clauses to the common law position, and highlights the different meanings of "materiality" in insurance law in the pre- and post-contractual context. *Ansari* not only raises interesting issues for insurance lawyers, it also stands as a warning to a wide category of assureds: if their automatic protective systems are not functioning properly, their insurance cover may be ineffective.

Background to the dispute and the judgment of the Court of Appeal

The assured under a policy of commercial property insurance was the owner of a building which was damaged by fire. In response to a question in the proposal form—"Are the premises protected by an automatic sprinkler system?"—the assured had answered: "Yes". The building did have an automatic sprinkler system. However, the judge at first instance found that the automatic sprinkler system had, to the assured's knowledge, been intentionally turned off—"with a view to its remaining in that condition for an indefinite period"²—at a time after inception of cover but prior to the fire.

The policy contained a clause (the material change clause) which read:

"This insurance shall cease to be in force if there is any material alteration to the Premises or Business or any material change in the facts stated in the Proposal Form or other facts supplied to the Insurer unless the Insurer agrees in writing to continue the insurance."

The insurer rejected the assured's claim and cancelled the policy; the assured issued proceedings. The judge at first instance dismissed the claim.

In upholding the decision at first instance, the Court of Appeal³ held that:

¹ *Ansari v New India Assurance Ltd* [2009] EWCA Civ 93.

² *Ansari* [2009] EWCA Civ 93 at [36].

³ Moore-Bick L.J. giving the only reasoned judgment, with which Waller and Thomas L.JJ. agreed.

- An automatic sprinkler system must be “properly functioning”, that is “constantly ready to operate in the event of a fire without the need for human intervention”, in order for it to be said that the premises were fitted with or, in the words of the proposal form, “protected by” an automatic sprinkler system.⁴ This was by way of contrast with an intruder alarm,⁵ which only operates once armed, as it would not be reasonable to interpret a warranty that premises are fitted with an intruder alarm as leading to a loss of cover merely as a result of negligence in failing to set the alarm.
- Turning off the sprinkler system for a short time for legitimate reasons, such as maintenance or repairs, would not mean that the premises ceased to be “protected” by a functioning system. However, turning off the system indefinitely, for whatever reason, was different⁶: the latter amounted to a change in the facts set out in the proposal form.
- “Material”, in the context of the material change clause, did not have the same meaning as it does in the context of pre-contractual negotiations leading to the issue of cover.⁷ The clause was held to cancel cover if there were:

“alterations or changes in facts of a kind that take the risk outside that which was in the reasonable contemplation of the parties at the time the policy was issued”.
- On issuing the policy, the insurer would have had in mind that the sprinkler system might be turned off temporarily from time to time, but would not have contemplated that the system might be turned off indefinitely. The turning off of the system for an indefinite period altered “the nature of the subject matter of the insurance”. The insurers were consequently held not liable.

The effect at common law of changes in the nature of the insured “risk”

At common law, in the absence of contractual provisions to the contrary,⁸ a sufficiently significant change in the nature of the risk relieves the insurer from liability. This “undoubted principle of the law of insurance”,⁹ which Warrington J. had explained early in the last century, was reaffirmed by Moore-Bick L.J. in the following terms:

“If circumstances have altered so as to take the risk outside that which was within the contemplation of the parties when the contract was made, [the insurer] ceases to be liable.”¹⁰

⁴ *Ansari* [2009] EWCA Civ 93 at [24]–[28].

⁵ The Court thus distinguished *Hussain v Brown* [1996] 1 Lloyd’s Rep. 627 CA (Civ Div).

⁶ *Ansari* [2009] EWCA Civ 93 at [34]–[36].

⁷ *Ansari* [2009] EWCA Civ 93 at [41].

⁸ A “held-covered clause”, for example.

⁹ *Law Guarantee Trust and Accident Society v Munich Re-insurance Company* [1912] 1 Ch. 138 Ch D at 153–154.

¹⁰ *Ansari* [2009] EWCA Civ 93 at [45].

In marine insurance, in the context of voyage policies, this common law rule finds its expression in the well-known rules on change of voyage and deviation.¹¹ From the moment the assured manifests a firm intention to change the vessel's destination, the insurer is discharged prospectively.¹² Likewise, from the moment the vessel actually deviates from the contractual course or fails to pursue it with reasonable dispatch, though exception is made for deviations which are involuntary or otherwise justified.¹³

The analogy between these marine insurance doctrines and the more general rule expressed in *Ansari* is clear. Subject to an exception for justifiable and temporary deactivation, the turning off of a sprinkler system represented a change in the nature of the insured adventure, resulting in the prospective discharge of cover.¹⁴ It is submitted that it would push the analogy with the change of voyage rule too far, however, to contend that an insured would lose the benefit of cover simply by manifesting an intention to turn off a protective system if that intention is, in the event, not carried out. In cases like *Ansari*, it is likely that the intention must be accompanied by the change itself. In the case of changes of voyage, the intention alone is sufficient to discharge cover, it is submitted, because marine voyages are by their very nature defined by the intention of the assured to reach a certain destination.

Clauses assimilated to the common law rule

The narrow basis for the decision in *Ansari* was the construction of the material change clause, rather than the application of the common law rule. The judgment, however, is of more general importance because the clause was construed as having the same scope and effect as the common law rule. This is in line with earlier authorities dealing with other, similar, clauses.

In *Exchange Theatre Ltd v Iron Trades Mutual Insurance Co Ltd (Exchange Theatre)*,¹⁵ a fire policy included a clause which stipulated:

“This policy shall be avoided with respect to any item thereof in regard to which there be any alteration after the commencement of this insurance . . . whereby the risk of destructional damage is increased. . .”

When the insured premises were destroyed by a petrol fire and explosion, insurers sought to avoid liability by arguing that the introduction of a petrol generator and containers of petrol to the premises had altered the risk so as to discharge

¹¹ Marine Insurance Act 1906 ss. 45, 46 and 48. See Lloyd J. in *Hadenfayre Ltd v British National Insurance Society Ltd* [1984] 2 Lloyd's Rep. 393 QBD at 398, highlighting the equivalence between the rules on change of voyage and the common law rule.

¹² See Gilman et al., *Arnould's Law of Marine Insurance and Average*, 17th edn (London: 2008), para.14–07 (*Arnould*); *Tasker v Cunninghame* (1819) 1 Bli. 87 HL at 100 and 102; 4 E.R. 32 at 36 and 37, per Lord Eldon.

¹³ Marine Insurance Act 1906 s.49.

¹⁴ *Ansari* [2009] EWCA Civ 93 at [18], quoting the first instance judge's [93].

¹⁵ *Exchange Theatre Ltd v Iron Trades Mutual Insurance Co Ltd* [1984] 1 Lloyd's Rep. 149 CA (Civ Div).

cover under the clause. In rejecting this argument, Eveleigh L.J. held that the clause concerned alterations to “the subject-matter of the insurance”.¹⁶ In his view, the introduction of the new items had merely increased the danger that the risks insured might materialise, without changing the nature of the risks themselves. Eveleigh L.J. further stated that he would have been prepared to hold that the introduction of the new elements into the premises was a matter within the contemplation of the parties, leading to the same result in application of the common law rule, though insurers had not advanced their case on that basis.¹⁷

In *Kausar v Eagle Star Insurance Co Ltd*,¹⁸ the Court of Appeal dealt with a similar clause, which read:

“You must tell us of any change of circumstances after the start of the insurance which increases the risk of injury or damage. You will not be insured under the policy until we have agreed in writing to accept the increased risk. . .”

Saville L.J. explained the effect of that clause as follows:

“... [A]ll that this condition does is to state the position as it would exist anyway as a matter of common law, namely that without the further agreement of the insurer, there would be no cover where the circumstances had so changed that it could properly be said by insurers that the new situation was something which, on the true construction of the policy, they had not agreed to cover. The mere fact that the chances of an insured peril operating increase during the period of the cover would not, save possibly in the most extreme of circumstances, enable the insurers to properly say this, since the insurance bargain is one where, in return for the premium, they take upon themselves the risk that an insured peril will operate.”

Ansari represents further confirmation that the courts will continue to assimilate the effect of clauses such as these to that of the common law rule. Given the need for greatest possible clarity and certainty in insurance law, such confirmation is welcome.

The different meanings of “risk”

A further issue highlighted by *Ansari* and the authorities discussed above is that there are at least two meanings of the word “risk” in insurance law. According to a first, “risk” means “the adventure or subject matter insured”, while a second is “the chance that a casualty will occur”. Though the two meanings are obviously related, the law requires that a distinction be drawn between them: for, in the

¹⁶ *Exchange Theatre* [1984] 1 Lloyd’s Rep 149 at 151–152.

¹⁷ *Exchange Theatre* [1984] 1 Lloyd’s Rep 149 at 152.

¹⁸ *Kausar v Eagle Star Insurance Co Ltd* [2000] Lloyd’s Rep. I.R. 154 CA (Civ Div).

post-contractual context, it is only changes to “risk” in the first sense which will act to discharge cover.¹⁹

Determining whether there has been a change in the subject matter insured, however, can be a matter of delicate judgment. In *Ansari*, the physical change undergone by the property was very slight—the sprinkler system could probably have been easily reactivated—and the decision of the Court of Appeal was not a foregone conclusion. *Hadenfayre*²⁰ was another difficult case. In it, the defendants insured the sellers of a property against the risk of default by the purchasers. The insurers were informed by the sellers that the purchase price would be paid in instalments of £6,000 per week. However, the sellers and purchasers later agreed to reduced instalments of £3,000. Upon the purchasers’ default, the insurers contended that they were entitled to avoid liability on the grounds that the reduction in the instalments was a material variation in the risk. Lloyd J. agreed with this contention,²¹ stating:

“... [A]ny alteration in the rate of instalments did indeed affect a material alteration in the risk, not in the sense, as I have already indicated, that a claim would be more likely to occur... but in the sense that the amount for which the defendant might become liable at any point of time would be greater... ‘Risk’ is an elusive word in the law of insurance. But in the present context, where one is concerned with an increase or variation in the risk, it must include not only the greater likelihood of a claim but also the likelihood of a greater claim.”

As the very language employed by Lloyd J. illustrates, the distinction between an increase in “the likelihood of a greater claim” and “the greater likelihood of a claim” is a subtle one at best; considered at an abstract level, it is far from clear that an increase in “the likelihood of a greater claim” is a sufficient indicator that there has been a material change in the nature of the insured subject matter. The change in the amount of the instalments had, on one view, altered the insured subject matter very little. Indeed, Lloyd J.’s view was that the amount of the instalments was not a parameter which insurers had considered at all in issuing the policy and setting the premium, and thus arguably was not a matter they had deemed relevant to the definition of the adventure insured.²² *Hadenfayre* illustrates the difficult determinations that the common law rule—and clauses assimilated thereto—sometimes require.

¹⁹ In *Baxendale v Harvey* (1859) 4 Hurl. & N. 445 at 449 and 452; 157 E.R. 913 at 915 and 916, Pollock C.B., in memorable style, stated (during argument) “If a person who insures his life goes up in a balloon, that does not vitiate his policy”; and later (giving judgment):

“A person who insures may light as many candles as he please in his house, though each additional candle increases the danger of setting the house on fire.”

²⁰ *Hadenfayre* [1984] 2 Lloyd’s Rep. 393.

²¹ *Hadenfayre* [1984] 2 Lloyd’s Rep. 393 at 400. Insurers failed on other grounds.

²² *Hadenfayre* [1984] 2 Lloyd’s Rep. 393 at 400. The judge, in the end, appears not to have taken pre-contractual considerations into account in considering whether the risk had materially changed. He was correct not to do so, as the concept of materiality differs considerably as between the pre- and post-contractual contexts: see the following section.

“Materiality” in the pre- and post-contractual contexts

The Court of Appeal’s judgment in *Ansari* is also a reminder that, in insurance law, the concept of materiality in the pre-contractual context is different from that which applies post-contract, and provides clarification as to meaning of “material” under the common law rule and assimilated clauses.

In insurance, as is well known, insurers may avoid a policy ab initio if a “material circumstance” was not disclosed or was misrepresented before the inception of cover. Circumstances in this context are “material” if they would “influence” the prudent insurer in fixing the premium or determining whether to take on the risk.²³ “Materiality” in the pre-contractual context thus presents only a low hurdle to an insurer seeking to avoid liability.

In contrast, in the post-contractual context, the concept of a “material change” in the risk requires something more substantial: a change in the nature of the adventure or subject matter insured itself. A new fact which increases the risk of a claim being brought, without changing the nature of the subject matter insured, will not discharge insurers: even though, had the same fact emerged, but not been disclosed, in the pre-contractual period it would give insurers grounds to avoid the policy. The timing at which changes in circumstances occur is thus crucial to determining whether insurers may escape liability. In *Ansari*, Moore-Bick L.J. explained the reasons for this as follows:

“If ‘material’ were to bear the same meaning [in the material change clause] as that which it bears in the context of pre-contractual negotiations, the policy would automatically lapse on the occurrence of any new circumstances which would influence to any extent the judgment of a prudent insurer in deciding on what terms he would be prepared to accept the risk, whether or not those circumstances were such as would actually lead him to alter his terms in any way. That would be highly detrimental to the position of the insured, who might well not be aware that a particular change of circumstances would be viewed in that way, and render his position precarious. Moreover, it would, in effect, give New India the right to renew the underwriting exercise every time it was notified any minor alteration of the premises or any minor change in the facts stated in the proposal regardless of whether there was any significant change in the risk. That is not, in my view, how a reasonable insured, or for that matter a reasonable insurer, would read this clause.”²⁴

The different meanings of “material” in the pre- and post-contractual contexts have not always been well understood. In *Hadenfayre*, there was a dispute as to whether cover had incepted before or after the reduction in the instalments, and insurers had thus argued that the reduction amounted to a material pre-contract non-disclosure, and in the alternative that it had represented a material change in

²³ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501; [1994] 2 Lloyd’s Rep. 427 HL.

²⁴ *Ansari* [2009] EWCA Civ 93 at [41].

the risk post-contract. Counsel for the assured sellers had conceded,²⁵ in relation to the first argument, that the change in the amount of the instalment was a material fact which should have been disclosed. In response to the insurer's second argument, however, the assured's submission was that there had been no material change in the risk. In the judge's view, these two positions were fundamentally inconsistent.²⁶ This was clearly a slip in the judge's reasoning: though, in the end, Lloyd J. appears to have applied the correct test in determining that there had been a material change in the nature of the risk insured. Nevertheless, the judgment in *Ansari* provides a clear and welcome warning to future courts against conflating pre- and post-contractual concepts of "materiality".²⁷

A warning to assureds

As the levels of performance required from, and complexity of and potential dangers posed by, equipment used in many areas of human activity have increased, the incorporation of automatic safety systems into that equipment has also expanded. Buildings incorporate sprinkler systems, smoke detectors and fire alarms. Seagoing vessels often have automatic identification systems—in many cases required by law—which are relied upon in avoiding collisions and in search and rescue situations. Many trains are equipped with automatic warning systems which trigger the brakes in certain circumstances to avoid collisions. In each of these cases, and in many others, the automatic systems in question are meant to function without human intervention.

Thus, aside from its interesting theoretical aspects, the judgment in *Ansari* represents an important warning to all of those whose insured property incorporates automatic safety systems: they should regularly look to ensure that those systems are activated and properly functioning as, depending on the wording of their insurance policies, the effectiveness of their cover may be at stake.

Jeffrey Thomson*

²⁵ *Hadenfayre* [1984] 2 Lloyd's Rep. 393 at 396.

²⁶ *Hadenfayre* [1984] 2 Lloyd's Rep. 393 at 398:

"If [the change in instalments] was a material fact to be disclosed *before* the contract of insurance, on the ground that it would have influenced the judgment of a prudent insurer in deciding whether to accept the risk and, if so, at what premium, then it seems to me to follow that it must have constituted a material variation *after* the contract of insurance was concluded" [emphasis in the original].

²⁷ *Arnould* (2008), para.18–13:

"... [T]he concept of materiality, as it exists in the pre-contractual context, is meaningless in the post-contractual period. The insurer has already decided to write the risk and at what premium."

* Barrister of the Inner Temple; Maîtrise en droit (Univ. Paris 1, Panthéon-Sorbonne). Thanks to Ben Osborne, Clotilde Lemarié, Christopher Kelly and David Pliener for their comments. All errors are the author's own; jeffrey.thomson@hardwicke.co.uk.