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Big Read Book volume 14 – Contractual Insurance Warranties

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Dearest Reader

Welcome to Volume 14 of Norton Rose Fulbright's The Big Read Series on Contractual Insurance Warranties.

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Introduction

Contractual insurance warranties feature regularly in coverage disputes between insurers and insureds. The following questions usually require consideration: What does the warranty mean? Has it been breached? Did the loss occur because of the breach? Does it matter? What are the consequences of the breach?

What are insurance warranties?

An insurance contract warranty is a method used by an insurer to control the risk to which the insured (and in turn the insurer) is exposed.

An insurer can do this in two ways:

1. Firstly, by having the insured warrant (usually at the time that the insurance contract is concluded) the truth of its representations regarding a past or present fact, its opinion or knowledge. This is called an affirmative warranty. For example, the insured could warrant that there are burglar bars on all opening windows at the property to be insured.
2. Secondly, by having the insured promise that a certain situation will exist in the future, or that the insured will conduct itself in a certain way. This is called a promissory (or continuing) warranty. For example, the insured could promise to activate their house alarm when the premises are unattended.

An insurance warranty can be drafted in such a way that it has both affirmative and promissory elements. For example, an insured could warrant that their home is equipped with a security system which will be activated it when the premises are unattended.

Insurance warranties are effective in controlling the insurer's risk because, provided all necessary requirements are met, the insurer is entitled to cancel the insurance contract from the time that the insurance warranty was breached. That may be at the inception of the insurance contract or at some later date. This entitlement operates as a matter of law and even if there is no cancellation clause in the insurance contract. A related consequence is that the insurer doesn't have to pay the claim in regard to which the breach of the insurance warranty may have been discovered. These usual consequences can be – and often are – contractually altered.

Interpretation of insurance warranties

The usual principles of contractual interpretation, and of insurance contracts in particular, apply to the interpretation of insurance warranties.

The approach is summarised as follows in *Centriq Insurance Company Ltd v Oosthuizen and Another* 2019 (3) SA 387 (SCA):

"Insurance contracts are contracts like any other and must be construed by having regard to their language, context and purpose in what is a unitary exercise. A commercially sensible meaning is to be adopted instead of one that is insensible or at odds with the purpose of the contract. The analysis is objective and is aimed at establishing what the parties must be taken to have intended, having regard to the words they used in the light of the document as a whole and of the factual matrix within which they concluded the contract."

The court in *Kliptown Clothing Industries (Pty) Ltd v Marine and Trade Insurance Co of SA Ltd* 1961 (1) SA 103 (A) adopted the following principle from English law which the court in *Guardrisk Insurance Company Limited v Café Chameleon CC* [2020] ZASCA 173 described as "instructive":

"No rule, in the interpretation of a policy, is more firmly established, or more imperative and controlling, than that, in all cases, it must be liberally construed in favour of the insured, so as not to defeat without a plain necessity the claim to the indemnity, which in making the insurance, it was the insured's object to secure. When the words are, without violence, susceptible of two interpretations, that which will sustain the claim and cover the loss, must in preference be adopted."

From our experience and in light of the above, care should be taken by insurers to:

- Make plain that the insurance warranty is in fact an insurance warranty. It may seem self-evident, but including the verb "warrants" is recommended, even though it is not an absolute requirement.
- Ensure that standard insurance warranties used by an insurer in its policies are revised in relation to each policy wording. There is a risk that an insurance warranty was drafted with reference to a particular policy wording and utilises definitions specific to that policy wording unsuited to the new wording. A copy and paste approach from a different wording with different definitions is always perilous. The wording of insurance warranties must be fit for purpose.
- Check that the wording of the insurance warranty is clear. Are there any terms in it which could possibly have different meanings, or a special meaning in the context? Is it free from ambiguity?
- Make it clear to which sections of the insurance contract specific insurance warranties apply, if not all of them.

Type one: affirmative warranties

Content and creation

- Affirmative warranties relate to a state of affairs or accuracy of representations at a particular point in time – usually at the time of conclusion, material amendment, or renewal of the insurance contract.
- The answers to questions in a proposal form are usually stated in the insurance contract to be the basis of the contract, with the result that they become terms of the insurance contract. In this way, pre-contractual representations are converted to insurance warranties and are contractually enforceable.
- Affirmative warranties can be warranties of fact, knowledge or opinion. Consider the following examples:
  - The insured warrants that they do not have any previous convictions for driving offences. This describes a factual situation.
  - The insured warrants that, to the best of their knowledge, approved plans exist in relation to the premises. This describes the extent of the insured's knowledge.
  - The insured warrants that they are of good health to the best of their opinion. This describes the insured's opinion.
- An affirmative warranty can be absolute or relative. An absolute warranty leaves no doubt as to what is required (as in the first example) whereas a relative warranty entails an element of reasonableness (third example).

Test for breach

- Whether an affirmative warranty of **fact** has been breached is tested objectively. The insured's knowledge or opinion is irrelevant to the assessment.
- Whether an affirmative warranty of **knowledge** has been breached is tested with reference to what the insured subjectively knew. There may still be a breach if the professed knowledge or absence of it was unreasonable in the circumstances.
- Whether an affirmative warranty of **opinion** has been breached is tested with reference to the insured's state of mind. If the opinion was unreasonable in the surrounding circumstances, the opinion warranty might still be contravened.
- The onus is on the insurer to prove a breach on a balance of probabilities.

Materiality

- To rely on the breach of an affirmative warranty, an insurer must prove materiality.
- In the non-life insurance context, section 53(1) of the Short-term Insurance Act, 1998 explains what materiality means. That section is usually understood to deal with misrepresentation and non-disclosure as evidenced by its title, but it also addresses affirmative insurance warranties. It states:

  "Misrepresentation and failure to disclose material information"

  1. Notwithstanding anything to the contrary contained in a short-term policy, whether entered into before or after the commencement of this Act, but subject to subsection:

     — the policy shall not be invalidated;

     — the obligation of the short-term insurer thereunder shall not be excluded or limited; and

     — the obligations of the policyholder shall not be increased,

     on account of any **representation** made to the insurer **which is not true, or failure to disclose information, whether or not the representation or disclosure has been warranted to be true and correct**, unless that representation or non-disclosure is such as to be **likely to have materially affected the assessment of the risk** under the policy concerned at the time of its issue or at the time of any renewal or variation thereof.

  2. The representation or non-disclosure shall be **regarded as material** if a reasonable, prudent person would consider that the particular information constituting the representation or which was not disclosed, as the case may be, should have been correctly disclosed to the short-term insurer so that the insurer could form its own view as to the effect of such information on the assessment of the relevant risk." (own emphasis)
- Subsection (2) deals with the consequences of an incorrectly stated age in relation to an accident and health policy, and adjusts the policy benefits.
- In a life insurance context, a similarly worded provision appears in Rule 21 of the Policyholder Protection Rules (Long-term Insurance), 2017.
- Affirmative warranties entail representations warranted in the insurance contract to be true, which is the subject of section 53(1) and Rule 21, and that is why the sections and rules are applicable to them (in the non-life or life insurance context, respectively).

Causation

- Assuming a material affirmative warranty has been breached, does an insurer need to prove a causal link between its breach and the loss?
- As the case law stands, the position is that no causal link is required, according to *SA Eagle Insurance Co Ltd v Norman Welthagen Investments (Pty)* Ltd 1994 2 SA 122 (A).
- However, the Supreme Court of Appeal in *Viking Inshore Fishing (Pty) Ltd v Mutual and Federal Insurance Co Ltd* 2016 (6) SA 335 (SCA) remarked, without deciding, that warranties are "not lightly to be construed as invalidating cover on grounds unrelated to the loss". This suggests that causation between the breach of the insurance warranty and the loss should be established before the insurer can rely upon it. A court considering an insurance warranty-related dispute in future may well be persuaded by the Supreme Court of Appeal's non-binding observation. This is a risk factor for any insurer seeking to rely on the breach of an insurance warranty which does not relate to the cause of the loss.
- To ameliorate an insured's position, insurers may restrict their remedies contractually, by expressly providing that they will only rely on the breach of an insurance warranty if it caused or contributed to the loss or its extent.

Consequences

- The breach of a material affirmative warranty is equivalent to the breach of a material term of the contract. This requires an election by the insurer whether or not to cancel the insurance contract from the time of the breach. If it chooses to uphold the insurance contract, it can still resist payment if the insurance contract permits this.
- The insurer does not need to provide for a period of notice in relation to the cancellation of an insurance contract based on the breach of an insurance warranty.
- Notice of cancellation naturally still needs to be given in the stated or a reasonable time, and this can take place in any form (unless the insurance contract has specific requirements).
- The position in insurance law regarding when the cancellation of the insurance contract is effective from (retrospectively from the time of the breach of the insurance warranty) is not aligned with the general principles of the law of contract, which is that the cancellation is only effective when the guilty party is notified of the cancellation. See *LAWSA* vol 12(2) at para 50.
- Practically, cancellation of the insurance contract would require restitution (in the form of a refund of the premium). Insurers may simply reject the relevant claim while keeping the insurance contract alive, if the insurance contract allows this.
- A claim for damages by the insurer against the insured for breaching a warranty is theoretically possible but unusual to see in practice.

Type two: promissory warranties

Content and creation

- Promissory warranties can arise from the answers to questions in a proposal for insurance warranted in the contract but are more often inserted directly into the insurance contract.
- Just like affirmative warranties, promissory warranties can also be absolute or relative. Here are two examples:
  - Absolute: The insured warrants that jewellery with a value above R25 000 will be stored in a locked safe when not worn. There is no doubt what is required.
  - Relative: The insured warrants that it will maintain the vehicle in a roadworthy condition under the road traffic laws. An element of reasonableness is required in assessing whether a warranty worded in these relative terms has been breached.

Burden of proof

- The insurer must prove the breach on a balance of probabilities.

Materiality

- Unlike affirmative warranties, materiality in the sense of a link between the warranty and the risk does not need to be established to rely on the breach of a promissory warranty. This is because our courts have held that such warranties do not involve representations (which is what brings affirmative warranties within the scope of section 53 of the Short-term Insurance Act, 1998 and Rule 21 of the Policyholder Protection Rules (Long-term Insurance), 2017). Rather, they are contractual undertakings. See again *South African Eagle Insurance Company Ltd v Norman Welthagen Investments (Pty) Ltd* 1994 (2) SA 122 (AD).
- However, and in line with general contractual principles, an insurance contract can only be cancelled if the insured's breach is sufficiently serious. See *LAWSA* volume 9 at para 407.

Causation

- Under English law, a causal link between the breach of a promissory warranty and the loss is not required, but there is contrasting Roman-Dutch authority such that it has been questioned whether the English law position is equitable and should be followed in South Africa.
- As already mentioned, the non-binding observation made in *Viking Inshore Fishing* that insurance warranties are "not lightly to be construed as invalidating cover on grounds unrelated to the loss" may be persuasive to courts considering insurance warranty-related disputes in future.
- A causation requirement may be imposed contractually.

Consequences

- Promissory warranties are not available to an insurer to claim specific performance if a promissory warranty has been breached.
- The breach of a promissory warranty entitles the insurer to cancel the insurance contract from the time of the breach. The insurer can also claim damages but this is not a remedy insurers often resort to, if at all.
- From an insurer's perspective, proving when the breach occurred and with effect from when the insurance contract should be cancelled can be difficult. The insured may have initially complied with the insurance warranty but breached it during the course of the insurance contract. An insurer's investigations should therefore not only focus on the breach but also the time of the breach. This will determine, for example, the period for which premiums will need to be returned (and whether any claims paid before the breach of the insurance warranty was discovered will need to be repaid by the insured). If the promissory warranty was only breached immediately before the risk materialised, a refund of premiums and repayment of prior claims is not practically relevant.

Defences available to insureds

Disputes around the application or otherwise of insurance warranties usually centre around their interpretation, or the question of causation.

Waiver arguments can also feature in insurance warranty-related disputes. Take the example of a promissory stacking heights warranty. The insured initially complied. The insurer later arranged a survey and it was evident that the stacking heights warranty was breached, but the policy was neither cancelled nor endorsed. The insured then sustained a loss. An inference of waiver may be made when the right to cancel a contract was not exercised within a reasonable time after the breach was known. See *Mahabeer v Sharma NO and Another* [1983] 2 All SA 377 (D). An insurer may also be found to have waived its right to cancel an insurance contract if it unconditionally accepts payment of the premium knowing that the insurance contract has been breached by the insured. See *LAWSA* volume 12(2) at para 161.

If the insurer became aware of a breach of an insurance warranty in relation to an earlier claim and did not rely upon it then, but seeks to rely upon it in a subsequent (larger) claim, this is also likely to give rise to a waiver argument.

It could also happen that an insurer becomes aware of the breach of an insurance warranty and provides the insured with a timeframe within which to "rectify" the breach, receives no feedback, does not follow up and a claim subsequently arises at which point it transpires that the insured had not rectified the breach. The insurer is likely to successfully argue that it had no liability nor duty to follow up and evade a waiver finding if it had clearly expressed its intention regarding the consequences of the insured not rectifying the breach timeously.

Estoppel sometimes features in the alternative to a waiver argument, to counter an insurer's defence based on the breach of an insurance warranty. To successfully counter the insurer's defence, the insured would need to establish the requirements for estoppel, namely the:

- insurer's representation to the insured by words or conduct that the breach is condoned;
- insured acting upon the representation, believing its truth;
- prejudice would be suffered by the insured if the insurer is allowed to deny the truth of the representation.

For example, the insurer in the previous example, after providing the insured with a time within which to rectify the breach of an insurance warranty, might receive no feedback and when following up may telephonically indicate to the insured that compliance with the insurance warranty is not vital. In those circumstances, the insured may be inclined not to take any remedial measures. When a claim subsequently arises and the insurer seeks to cancel the policy on account of a breach of the insurance warranty, the insured would be justified in raising estoppel to counter that defence.

It is possible to provide in the insurance contract that previous acceptance of a situation may not be relied on as a waiver for estoppel against enforcement of a warranty.

There are many possibilities and not always easy answers.

More practical tips for insurers

In addition to our drafting-related tips under the interpretation section, it is important for insurers to:

- Secure the necessary evidence (documentary, factual witnesses and/or expert witnesses) upfront, before a breach of an insurance warranty is relied upon to cancel the insurance contract/reject a claim;
- Not delay a decision to cancel a policy or reject a claim unless the right to do so is reserved while investigations proceed or to act inconsistently (eg renew the policy when evidence of a breach of warranty is known); and
- Consider the forum in which any insurance warranty-related dispute is being adjudicated. Considerations of equity are important before the insurance ombuds. An absence of causation may be fatal to an insurer's defence if an insurance warranty-related dispute is being adjudicated by the ombuds.

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