Are Successful Denials for Unreported Material Changes in Risk a Thing of the Past?

Maybe So, According to Some Recent Case Law, Unless Insurers/Brokers Radically Change Their Practices

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Introduction

Statutory Condition 4 has long been a feature of property insurance in BC and elsewhere. As a result of recent changes to the *Insurance Act* in BC, an insured's failure to provide prompt notice of material changes in risk may now result in liability insurance being voided as well.

Some recent decisions appear to have narrowed the ability of underwriters to void coverage if an insured fails to report changes material to the risk which occur during the policy period. This case law places a new emphasis on the obligation of insurers (and consequently their brokers) to ensure the concept of material change in risk is fully and properly explained to insureds upon inception of coverage and its renewal. Failure to do so might result in coverage under the policy for circumstances beyond underwriters' anticipation.

1. Statutory Condition 4: The New Regime in BC

BC's *Insurance Act*, SBC 2012, c.37 was substantially revised effective July 1, 2012. As a result of these revisions:

- The former Fire Insurance part of the Act was deleted entirely;
- Part 2 of the Act ("General Insurance Provisions") now applies to virtually every form of property and liability policy issued in the province (s.8);
- The former Fire Insurance Part statutory conditions were transferred into the new Part 2 of the Act;
- All fourteen of the statutory conditions apply to and are deemed to be part of all property policies issued in BC;
- However, five of the statutory conditions, including SC4 re "material change in risk", apply to all liability policies issued in BC; and
- All P&C policies in BC are now subject to the "unjust contract provisions" section of the revised Act (s.32).

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The statutory conditions which now apply to liability policies in BC include:

- SC2 – Property of Others;
- SC3 – Change of Interest;
- SC4 – Material Change in Risk;
- SC5 – Termination of Insurance
- SC14 – Notice

There is no obvious rationale for making these statutory conditions applicable to liability insurance and exempting the other statutory conditions from such policies. It remains to be seen what the court will make of this and how it will apply the conditions, particularly insofar as "material change in risk" is concerned. However, recent case law suggests that, whether it be property or liability insurance, it may become increasingly difficult for insurers to successfully deny coverage for unreported material changes in risk unless communication practices with insureds are radically amended.

Three cases are examined below which highlight the new trend. The wording of Statutory Condition 4 has not changed in the new Act but has been reformatted grammatically as follows:

Material change in risk

4. (1) The insured must promptly give notice in writing to the insurer or its agent of a change that is

(a) material to the risk, and
(b) within the control and knowledge of the insured.

(2) If an insurer or its agent is not promptly notified of a change under subparagraph (1) of this condition, the contract is void as to the part affected by the change.

(3) If an insurer or its agent is notified of a change under subparagraph (1) of this condition, the insurer may

(a) terminate the contract in accordance with Statutory Condition 5, or
(b) notify the insured in writing that, if the insured desires the contract to continue in force, the insured must, within 15 days after receipt of the notice, pay to the insurer an additional premium specified in the notice.

(4) If the insured fails to pay an additional premium when required to do so under subparagraph (3) (b) of this condition, the contract is terminated at that time and Statutory Condition 5 (2) (a) applies in respect of the unearned portion of the premium.

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2. Marche v. Halifax Ins. Co., 2005 SCC 6

The facts of the case are relatively simple:

- Ms. Marche and Mr. Fitzgerald purchased the latter's family home on Cape Breton Island in Nova Scotia and converted it into two apartments;
- They then moved to British Columbia to find work, leaving the two apartments vacant;
- The property was insured with Halifax Insurance but the couple did not inform Halifax Ins. that the property was vacant and that they were looking for tenants for both flats;
- The property remained vacant for several months until early December 1998, when Mr. Fitzgerald's brother Danny moved in;
- Danny failed to pay rent and in an effort to make him move out, Ms. Marche had the water to the property disconnected in mid-January 1999 and, when that didn't work, the electrical power boxes removed at the end of that same month;
- The property was destroyed by fire on February 7, 1999, while Danny and his possessions were still in the house.

Statutory Condition 4, which formed part of the homeowner's policy, provided as follows:

> "4. Material Change – any change material to the risk and within the control and knowledge of the insured shall avoid the contract as to the part affected thereby, unless the change is promptly notified in writing to the insurer or its local agent; and the insurer when so notified may return the unearned portion, if any, of the premium paid and cancel the contract, or may notify the insured in writing that, if he desires the contract to continue in force, he must, within 15 days of the receipt of the notice, pay to the insurer an additional premium; and in default of such payment the contract shall no longer be in force and the insurer shall return the unearned portion if any, of the premium paid."

The Supreme Court of Canada had no difficulty accepting that "vacancy can be a change material to the risk" and, indeed, that "this is reflected in the common and accepted practice of including 30-day vacancy exclusion clauses in insurance policies". That, however, was not really the issue in the case.

Halifax Insurance argued as follows:

- The statutory condition expressly provides that failure to report material change in risk renders the contract "void";
- Once the contract is "void", neither it nor any coverage under the contract exists any longer;
- Because the contract was void following the initial months' vacancy, it remained void as of the time of the loss and therefore no coverage was in force when the fire occurred.

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In reply the insureds argued that:

- There may have been a "technical" breach as a result of the vacancy but that breach had been "cured" when the brother in law moved into the premises;
- The premises had not been vacant for a two month period prior to the loss; and
- In such circumstances it was appropriate to grant relief and enforce coverage by virtue of the "unjust contract provisions" section of the *Insurance Act* which provided:

> "171. Where a contract…
>
> (b) contains any stipulation, condition or warranty that is or may be material to the risk including, but not restricted to, a provision in respect to the use, condition, location or maintenance of the insured property,
>
> the exclusion, stipulation, condition or warranty shall not be binding upon the insured if it is held to be unjust or unreasonable by the court before which a question relating thereto is tried."

The insurer's position was that, since the statutory conditions were prescribed by the legislature, by definition they could not possibly be "unjust or unreasonable". However, the Supreme Court of Canada held that the relief provision applied not just when an insurance condition was unreasonable or unjust on its face, but also when, on the facts in any particular case, it was unjust or unreasonable to apply the condition in the circumstances.

The court held that because "Statutory Condition 4 is not a model of clarity" and because the vacancy breach had been cured at the time of the loss, it would be an unjust or unreasonable result for the statutory condition to be applied to void coverage in this case. Coverage was therefore enforced and the insureds were able to recover the policy proceeds.

The same "unjust contract provisions" is now found in section 32 of the revised *Insurance Act* of BC and reads as follows:

> Unjust contract provisions
>
> 32. If a contract contains any term or condition, other than an exclusion prescribed by regulation for the purposes of section 33 (1) or established by section 34 (2) or (3), that is or may be material to the risk, including, but not restricted to, a provision in respect of the use, condition, location or maintenance of the insured property, the term or condition is not binding on the insured if it is held to be unjust or unreasonable by the court before which a question relating to it is tried.

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One abbreviated way of reading this clause might be:

> "if a [liability or property policy] contains any term…that is or may be material to the risk…the term is not binding…if it is held to be unjust or unreasonable."

This may have exceedingly broad application. The door may now be open to invoke this section of the Act to overcome denials of coverage on virtually any ground (depending on how broadly the court interprets the concept of "material to the risk"). It will almost certainly give rise to much litigation involving creative and imaginative grounds to circumvent denials.

3. Jackson v. CNS, 2010 BCSC 1532

This case arose out of a fire which destroyed the plaintiff's barn and greenhouse on his hobby farm in Coldstream, BC in November 2005. The insured was a practicing physician who also had a love of horticulture and an avocation in construction. The construction of the principal residence and outbuildings was supposedly "a labour of love". However, the heating system originally installed in the outbuildings resulted in uneven and expensive fluctuations. Dr. Jackson therefore decided to install some auxiliary heating comprising of a wood-fired furnace. The inevitable happened and, not very long after its installation, the furnace caused a fire which destroyed the barn.

The property was insured with Canadian Northern Shield Insurance. CNS denied coverage on the basis that a woodstove installation constituted a material change in risk which had voided the policy because there had been no prompt notice given to the insurer (as per Statutory Condition 4). The court held the denial of coverage was "unassailable and the plaintiff's claim must be dismissed".

What is instructive about this case, however, is the extent to which the insured had been advised of his obligation to report material changes and had even been provided with an explanation as to what a "material change" might be. In that regard the Court noted:

- While the application for insurance signed by the plaintiff did not disclose the use of a wood burning or solid-fuel heating unit or, indeed, any heating unit at all in the outbuildings, the "coverage summary" contained the following statement:

  > "this insurance is provided and the premium is calculated in accordance with the above information and the dwelling details represented by the insured. If any of the information or dwelling details change during the currency of this insurance, the insured is required to notify the broker within 60 days of such change." (emphasis added)

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- In addition, the broker had sent to the insured an invoice, a cover letter and an attachment entitled "Some Coverage Notes and Recommendations". These included the following;

  "4. Let us know about any changes!

  If a "Material Change" arises during the policy period, this must be reported to our office immediately. Failure to do so may result in a voiding of the Insurance Policy involved. A "material change" is something important enough to change the original agreement between the insurance company and the policy holder;

  Some example of "material changes" which would require you to notify your insurer would include:

  - …
  - …
  - Using an auxiliary wood heat source without the insurers knowledge;
  - …"

The court had no difficulty in concluding that the plaintiffs had been advised of and clearly understood the existence of an obligation to notify the insurer of a change, such as the installation of a wood burning stove. Their failure to comply with a statutory condition in such circumstances meant that coverage was void.

Jackson v. CNS is an excellent example of how an insurer and its broker can combine to inform and warn insureds about their obligation to provide notice of material changes in risk. Unfortunately, it is not a very common occurrence.

4. Thomas v. Aviva Ins., 2011 NBCA 96

This case also involved a fire caused by a supplementary woodstove which had been installed by the insured following inception of coverage. Here, however, the insured was an elderly gentleman with very limited formal education who had no idea that he had any obligation to report any material changes, let alone any appreciation as of what a "material change" might be. He was provided with no explanations by the underwriter or broker and the New Brunswick Court of Appeal had little difficulty enforcing coverage.

Interestingly, the insurance broker (and Aviva agent) who had sold the policy to Mr. Thomas testified on the insured's behalf. He advised the court that he (the broker) had never been told by Aviva before the fire that it considered the installation of a woodstove to be a change

material to the risk. He also testified that he had never provided advice to that effect to the insured or, for that matter, to any other insured under Aviva policies.

Mr. Thomas completed a "habitational insurance application" form upon inception of coverage in April 2000 at the request of the broker. At the time, Mr. Thomas truthfully reported that the home's primary heating source was electrical. The question on the form pertaining to the presence of a "solid fuel heating unit" in the home was left blank and indeed the agent drew a diagonal line across the section pertaining to auxiliary heating sources (the wood stove was not installed on the back porch to supplement the electric heating until a year and a half after inception).

Each year Aviva sent a "renewal policy notice" to Mr. Thomas. It listed the original underwriting information provided by Mr. Thomas, including the notation "primary heat: electric heat". It asked the insured to "ensure all information is accurate, as your coverage and premium are based upon the information you provided". None of the renewal notices asked questions about changes or about the installation of other heating sources. None of the notices informed Mr. Thomas of any requirement to report any significant changes in risk or any explanation as to what those might be. Mr. Thomas simply renewed his insurance year after year without any understanding of any obligation to disclose the presence of the woodstove as an auxiliary heating source.

The New Brunswick Court of Appeal concluded:

- Under the *Insurance Act*, the question of materiality is a question of fact to be determined by the court (as it is in BC also);
- The onus was on the insurer to establish that any change was material to the risk;
- In this case, the insurer failed to prove the installation of a woodstove was in fact a "material change in risk";
- This was because of (1) Aviva's failure (through its agent) to ask questions of the insured about non-electrical heating sources, (2) their "trivialisation" of that issue by drawing a diagonal line across the relevant section of the application form, (3) the failure of Aviva to seek answers to those questions either at inception or upon subsequent renewals and (4) the declaration in the renewal documents that coverage depended upon the accuracy of the information earlier provided (that earlier information had indeed been accurate);
- The "informational deficiencies" in Aviva's renewal documents were highlighted by their comparison to the caution provided to the insured in *Jackson v. CNS* (with the *Jackson* warning being set out in detail in the court's reasons for judgment);

The Court further stated (or recited from other case law) the following observations/principles:

- "Where an insurer fails to ask about a matter, the court may draw an inference that the insurer does not consider that matter relevant";
- An insured may be "released from his obligation to disclose material facts" if the information "could have been discovered by the insurer by making enquiry at the time of renewal;
- "An insurer's failure to ask questions may be evidence that the particular insurer does not consider the issue to be material, even if, objectively, the information would have been regarded as relevant by a prudent insurer";
- "If it regarded these facts as material, why did [the insurer] not ask about them?"

The New Brunswick Court of Appeal then endorsed the following "good faith" propositions, which may have far reaching effect if widely adopted:

- "It runs contrary to the good faith obligation that the insurer owes to the insured for the insurer to agree to insure risk…when it knows or should know that there is information relevant to the risk that it does not have and that it did not even enquire into or that is incomplete, and then to raise the lack of information as a defence to a claim under the policy"; and insofar as material change is concerned,
- "If the event in question truly constituted, in [the insurer's] eyes, a change material to the risk, its duty of good faith to the insured required that he be so advised in plain language. Having failed to offer the advice it was duty bound to give, [the insurer] cannot benefit from Statutory Condition 4".

The above conclusions were sufficient to dispose of the Appeal. However, the court went on to make further comments and observations about the interpretation of Statutory Condition 4. It appeared receptive to arguments that Statutory Condition 4 can be reasonably interpreted as requiring knowledge of materiality on the part of the insured, because:

- The plain language of the material change condition makes relevant the insured's knowledge of any change material to the risk, not just his or her knowledge of any change;
- The condition's wording requires <u>both</u> "control" and "knowledge" by the insured;
- Logically, "control" relates only to the occurrence of the change; and

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- "Control" necessarily implies "knowledge"…for one to "control" a material change, one must therefore be aware the change is material. Otherwise to interpret "knowledge" as relating only to the occurrence of the change would create a redundancy.

Lastly, the New Brunswick Court of Appeal held that, had it found an enforceable breach of Statutory Condition 4 voiding coverage, then it would have referred back to the trial judge the issue of "relief from forfeiture" under the "unjust or unreasonable condition" section of the *Insurance Act*. It expressly referred to the *Marche v. Halifax Insurance* case as holding that "relief against forfeiture is available into the Act to determine whether application of a statutory condition would produce an unjust or unreasonable result". Clearly, the New Brunswick Court of Appeal was of the view that the circumstances in the *Thomas v. Aviva* case would trigger the relief provision.

5. Lessons for Brokers and Underwriters

It is apparent from all of the above that the courts may be reluctant to enforce Statutory Condition 4 unless brokers and underwriters have been very diligent in seeking relevant information both at inception and at renewal, and have also expressly informed the insured of their obligation to report material changes in risk.

In order to preserve any right that may exist to deny coverage for failing to report a material change during the policy period, it would be sensible/prudent practice for brokers and underwriters to do the following:

- ensure application forms are used in respect of the initial assessment of risk and application for coverage;
- ensure all key questions material to the risk are set out in that document and that the insured's information regarding each question is actually obtained;
- set out on the policy declaration pages, in plain and visible language, the statement that coverage has been issued in reliance upon the information provided by the insured and that any/all changes to that information must be immediately notified to the insurer to keep coverage in force;
- provide to the insured upon each renewal an explanation written in plain English of what is (1) "a material change" and (2) emphasize the obligation to immediately report same.

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The documentation and the practices employed in the *Jackson v. CNS* case are an excellent example of how insurers can protect their interests. The *Thomas v. Aviva* case demonstrates how the courts will not hesitate to use the "*Jackson* procedures" to contrast perceived "informational deficiencies" of any given insurer's underwriting/renewal processes so as to avoid denials of coverage.

There are lessons to be learned here. It remains to be seen whether underwriters or brokers will actually abide by them.

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