



# **INSURANCE INTERMEDIARIES** **KEY PRACTICAL ISSUES**

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*From an initially wide ranging practice, covering all areas of Chambers work he has come to specialise in professional negligence and commercial law, especially insurance related matters. He also carries out construction and personal injury work, and has experience in company and insolvency law.*

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## **Introduction**

1. The aim of this paper is not to provide a comprehensive account, or even a complete overview, of the law relating to insurance intermediaries. Rather, the aim is to discuss a few areas in connection with the liability of insurance intermediaries, both brokers and IFAs, which give rise to problems or issues in everyday practice in this area.

## **Whose Agent Is He Anyway?**

2. An issue frequently litigated concerns the precise role of the insurance broker as agent. This issue frequently arises when a breakdown in the flow of information between insured and insurer (and vice versa) can be identified.

3. The general rule is that the broker is the agent of the insured and not the insurer: see **Searle v Hales & Co** [1996] QB 68, **Anglo African v Bayley** [1970] 1 QB 311, **Winter v Irish Life** [1995] 2 LI Rep 274, and **Re Great Western** [1999] LI Rep 377.
4. It follows that where full disclosure is made to the broker, but the broker fails to pass on the relevant information to the insurer, the insured fails against the insurer, and is thrown back on his remedy against the broker. This principle has been criticised by the Court of Appeal (in **Roberts v Plaisted** [1989] 2 LI Rep 341 (at 345 per Purchas LJ)), but it remains good law.
5. Further, the broker is agent for the insured to agree the terms of the policy: **Zurich v Rowbery** [1954] 2 LI Rep 55. The insured will accordingly be bound by the terms agreed by the broker as his agent. See further paragraphs 29 & 30 below for the problems which can ensue.
6. The broker can be the agent of the insurer, however, for certain limited purposes. Thus for example, where he operates under a binding authority granted by underwriters, the broker will have the authority to grant cover to the insured (see **Stockton v Mason** [1978] 2 LI Rep 430). Note however that a placing broker employed to seek business on the part of a coverholder who has been granted a binding authority by underwriters does not generally owe contractual or tortious duties to those underwriters, notwithstanding that his remuneration is derived from them. Such a broker's duties are owed to the coverholder only: **Pryke v Gibbs Hartley Cooper Ltd** [1991] 1 LI Rep 602.
7. Moreover, in relation to issues of non disclosure, if the insurer knows the full facts because they have come to the attention of the broker operating under a binding authority, he is fixed with that knowledge, and the insured has no duty to disclose those facts. This is so, even if the insured does not know that those facts are known to the broker: **Woolcott v Excess** [1979] 1 LI Rep 231.
8. Further, appropriate policy terms could constitute the broker as the agent of the insured for the purposes of receiving notice of claims (although generally the broker is not the agent of the insurer for this purpose).

## What Does He Do For His Money?

### 1. Getting a Grip

9. There is now a tendency to view the broker as having a duty to manage his client's insurance affairs in a focused and organised manner. The days of the broker being a conduit for information ("merely a post box") are over: **Alexander Forbes v SJB** [2003] LI Rep PN 137. In that case, the Claimant were concerned that its activities in the field of pensions advice (specifically, advising clients to "opt out" of state or occupational pensions) had left it vulnerable to professional indemnity claims. One such client made a claim, and the relevant correspondence was passed by the Claimant to the Defendant broker, with instructions to notify the relevant professional indemnity underwriters. The Defendants made a notification to underwriters subscribing to one policy (a group policy) which might potentially have responded to provide cover, but failed to make a notification under a policy specific to the Claimant company. It was held that the group policy did not respond whereas the specific policy would have done.
  
10. The Judge held that a focussed and deliberate approach should be required of the broker:  
*"Brokers owe duties going beyond those of a post box. It was for the brokers to get a grip on the proposed notification, to appraise it and to ensure that the information was relayed to the right place, in the correct form. As the expert put it, they needed a strategy for handling claims..."*
  
11. See also **Etter v Commercial Union** (1998) 166 NSR 2d 299, in which the client purchased a property including a derelict barn. He intended to renovate the barn and so advised his broker. The broker failed to advise insurers of those intentions. The renovations took place and the new property was then damaged in a storm. Insurers denied liability and the broker was held liable on the basis that he should have kept himself up to date with the insured's operations on the property and advised insurers appropriately about the fact and progress of the works.
  
12. The writer's recent experience has been that any expert witness worth his salt will agree that the broker needs to "get a grip" on his client's affairs and have a strategy, in precisely this sense. It is frequently pointed out that a broker can expect, in some cases, considerable remuneration in relation to large accounts. It has been said to follow that the broker needs to get to know his client; to understand his business; and to give advice and guidance as to how his client can best obtain insurance cover which is both comprehensive and cost effective. It is also the broker's duty

to act as representative and advocate for his client in terms of a claim or (more pertinently) notifiable circumstances (see **Alexander Forbes** above), where the insurer is taking a tough line. The broker cannot simply pass on correspondence from the insured to the underwriters. Compare the duties of an IFA under the FSMA, requiring him to know his client etc.

## 2. Asking the Right Questions, in the Right Way

13. The broker has always had a duty to enquire of his client so as to secure relevant information: **McNealy v Pennine** [1978] 2 LI Rep 18, **The Moonacre** [1992] 2 LI Rep 501.
14. In the **McNealy** case, the Claimant had motor insurance with the Pennine under a particular scheme. This scheme excluded various categories of persons<sup>1</sup>, including full or part time musicians. The Claimant was principally a “property repairer”, but from time to time he played the guitar in a band on board cruise ships. He was thus a part time musician and excluded from the categories of person to whom insurers were prepared to offer cover. He had an accident when returning from one of his “gigs” on board a ship, and insurers, learning of his part time occupation, avoided the policy for misrepresentation of a material fact. The Claimant successfully sued his brokers.
15. Note that this case has certain special features which make it clear that the broker ought to have made specific enquiries: (i) he knew that there was a list of excluded occupations; (ii) he knew that the premium was particularly low because of the restricted availability of the insurance cover. This was accordingly something of a special policy and it is submitted that the Court of Appeal’s decision to hold the broker liable was plainly correct. Note that although the list of excluded occupations was reasonably lengthy it was held that the list should have been read out to the Claimant so that he could advise if he followed any such occupation.
16. On the other hand, the broker is entitled to expect the insured to show some common sense in understanding what has to be disclosed, and is not required to cross examine his client: see for example **Fanhaven Pty Ltd v Bain Dawes Northern Pty Ltd** [1982] 2 NSWLR 57 (where the insured was an apparently reputable company the brokers were not negligent for failing to

discover that the directors had criminal records) and **Lyons v JW Bentley Limited** (1944) 77 LI R 335, where the Claimant failed to disclose previous claims on other policies.

17. In **The Moonacre** (above), the broker failed to take proper instructions because he paraphrased a question on the proposal form, during the course of interviewing the insured to complete the proposal form on his behalf. The policy concerned a sea going motor yacht, belonging to a wealthy retired businessman who lived in Spain. The yacht was laid up every winter. A question on the proposal form asked if it were to be used as a houseboat.
18. The broker asked the insured if he was intending to live on the boat during the winter. The insured answered “no”; but did not reveal that he had engaged a person to sleep on the boat while she was laid up, for security reasons. Consequently, when the boat was damaged by fire, and the insurers successfully relied on a misrepresentation as to use as a houseboat, the brokers were liable to the insured. It was held that the broker should have put the precise question on the proposal form to the insured, rather than engaging in his own paraphrase.
19. The broker also has a duty to check his own records to ensure that material matters are passed on to insurers: **Dunbar v A & B Painters** [1985] 2 LI Rep 616 (the point was not pursued on appeal). In practice this can be important: insured persons sometimes rely on insurers or brokers keeping full records. The answer “see your records” is sometimes given on proposal forms in relation to questions about previous insurance claims. It is submitted that, if there is a previous relationship between insured and broker, such an answer would give rise to a duty on the broker to call for and consider his records, and (probably) to check with the insured that the records were accurate and complete.

### 3. Other Areas of Expertise

20. The broker is not a valuer: but he must advise as to the need to take careful steps properly to value the sum insured, and he must ensure that his client understands the importance of making a

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<sup>1</sup> There is no attempt in the judgment to analyse the sociological significance of those occupations which were excluded. Amongst the list were bookmakers, jockeys, students, service personnel and journalists, as well as musicians!

proper declaration of the value of property to be insured. See **TW Bollom v Byas Moseley** [1999] LI Rep PN 598.

21. Hence, it follows that the broker is not required to step outside his sphere of expertise to give advice as to the proper sums insured in relation to land or property. However, it is submitted that clearly the broker must consider the steps that his client has taken properly to estimate the relevant values. He should ensure that the valuations are current. If he knows that the valuation has been made on a basis which is unsound he should point this out (e.g. suppose that his client acquires a site for re-development and subsequent to the acquisition he secures planning permission. The broker would come under a duty to check that his client had a valuation which took into account the existence of such a planning permission).
22. Note that in the same way a broker is required to have a working knowledge of insurance law, and to know when he is out of his depth on a legal point so that he should advise that more specialist advice should be taken: **Sarginson Bros v Keith Moulton & Co** (1942) 73 LI Rep 104.

#### 4. Knowing the Market

23. The broker must also be aware of the market and the nature of the product being purchased by his client. See for example **Bates v Burrow** [1995] 1 LI Rep 680, **Osman v J Ralph Moss** [1970] 1 LI Rep 313. In the **Bates** case, placing brokers effected reinsurance which was illegal owing to the reinsurer not being properly registered to carry on business in the UK pursuant to the Insurance Companies Acts. It was held that in effecting that reinsurance the brokers were in breach of their duty of care, albeit that that breach had caused no loss to the Claimant reinsured because the contract was enforceable against insurers pursuant to section 132 of the Financial Services Act 1986.
24. In **Osman** the brokers advised the Claimant to take out a motor policy with a company whose *“shaky financial foundation was ...well known in insurance circles at that time”*. It was held that the recommendation was negligent and indeed this point was conceded in the Court of Appeal.

25. See also **Seymour v Ockwell** [2005] PNLR 39. Here an IFA failed to make a proper appraisal of an investment presented (and aggressively marketed to her), and consequently was held to have mis-sold it to her clients. The IFA failed to note:
- (1) that the investment involved investing in a fund based in the Bahamas;
  - (2) that the prospectus presented in relation to that investment was or might have been misleading;
  - (3) that the safeguards allegedly present to preserve the investment were not as failsafe as was implied by the promotional material;
  - (4) that the proposition was dubious applying business common sense: the product promised guaranteed returns of 15% per annum at a time when base rate was 5%. The Judge held that the IFA ought to have seen that the investment was, so to speak, too good to be true.
- Accordingly the IFA was held to be negligent for having recommended the product to her client.

#### 5. The Need for Caution

26. The broker should not take unnecessary risks. He can be liable for exposing his client unnecessarily to legal proceedings: **FNCB v Devanney** [1999] LI Rep IR 619 (where the broker was held liable for failing to obtain specific protection in the form of additional clauses tailored to ensuring the protection of the bank as mortgagee; in the event those clauses were not made part of the policy and the bank was thrown back on a more difficult argument for indemnity, on the terms of the policy as they stood, and raising an uncertain point of law as to whether the misrepresentations of the mortgagor to insurers affected the position of the mortgagee). This is consistent with the rules applying to other professions. Generally, if a professional has 2 possible means of giving effect to his client's instructions, one safe and the other doubtful, it is negligent to take the doubtful course and expose the client to the risk of litigation: see **Dixey v Parsons** (1964) 192 EG 197 (solicitor's negligence).
27. He can be liable for taking a risk as to whether a fact was material: if in doubt, he should disclose it: **Aiken v Stewart Wrightson** [1995] 1 WLR 1281. Note that he should also seek the views of insurers if he is in doubt as to the proper construction of a term in the policy (or, perhaps more importantly, the view which insurers would take in particular circumstances): see e.g. **Melik v Norwich Union** [1980] 1 LI Rep 523.

## 6. Read and Advise on the Small Print

28. He should advise about unusual or onerous terms: **Bollom v Byas Moseley** (above), **Baker v LFC** [2000] 1 PNLR 21 and **Harvest v Davies** [1991] 2 LI Rep 638 at 643, where Judge Diamond QC (sitting as a deputy High Court Judge) said this:

*“...if the only insurance which the intermediary is able to obtain contains unusual, limiting or exempting provisions which, if they are not brought to the notice of the insured, may result in the policy not conforming to the client’s reasonable and known requirements, the duty falling on the agent...may... entail that the intermediary should bring the existence of the limiting or exempting provisions to the express notice of the client, discuss the nature of the problem with him, and take reasonable steps either to obtain alternative insurance, if any is available, or alternatively to advise the client as to the best way of acting so that his business procedures conform to any requirements laid down by the policy...”*

29. This duty is potentially of high significance given that the Unfair Contract Terms Act 1977 is of course inapplicable to insurance contracts. Therefore the insured cannot seek the assistance of the Act if he perceives later that the terms of his policy are unduly onerous. Note that the broker is not under any relevant duty in relation to standard insurance terms: **Nsubuga v Commercial Union** [1988] 2 LI Rep 863. As MacGillivray comments (page 103 note 31), citing the **Nsubuga** case, “there is no need to bring the insurers’ standard terms to the notice of the applicant [insured] unless any of them are for any reason unusual and not to be expected in that class of insurance”. It is submitted that what is required to engage a duty to advise is a term whose *provisions* are unusual: the fact that the *effect* of a standard term is potentially draconian does not require it to be explained in detail.
30. Moreover, whilst as a matter of general contract law, very onerous standard terms are not incorporated into the contract at all in the absence of their having been specifically drawn to the attention of the other party<sup>2</sup>, in an insurance context there is a hidden trap. This is that the broker is deemed to have contracted (as agent for his client) on insurers’ usual terms. See **Clarke, The Law of Insurance Contracts**, at para 11-1A3 (c) and the reference to **Parker v SE Railway** (1877) 2 CPD 416 at 422, and **MacGillivray on Insurance Law** at para 2-10 (“it will readily be

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<sup>2</sup> Thornton v Shoe Lane Parking [1971] 2 QB 163; Interfoto v Stiletto [1989] QB 433.

assumed that, when an applicant seeks insurance cover from particular insurers, he impliedly offers to take insurance on the insurers' usual or standard terms of cover").

### Timing Issues

#### How long does the duty last?

31. It has recently been held that certain of a broker's duties are continuing duties: see **GNER v JLT Corporate Risks** [2006] PNLR 34 (Cresswell J). In that case, the Claimant railway company instructed its brokers to obtain cover which did not contain a particularly restrictive exclusion previously applicable. Negligently the brokers failed to do so, but misinformed the Claimant that they had obtained cover which contained a more favourable exclusion in relation to the same matter<sup>3</sup>.
32. Cresswell J held that it was arguable<sup>4</sup> that the brokers were under a continuing duty to review the insurance which had been obtained and to advise the Claimant if and to the extent that it did not conform to the instructions given.
33. Note that, as recorded in his judgment, Cresswell J's conclusion was in line with a considerable weight of academic opinion.

#### How long does the client have to complain?

34. Limitation in relation to claims against brokers is usually straightforward, but there have been recent developments which should be carefully noted.
35. The easy case concerns the broker whose negligence results in the Claimant insured obtaining a voidable policy. In that event, the Claimant suffers damage as soon as the policy is taken out. He does not acquire what he paid for. He paid for a valid policy; owing to the broker's negligence he has a policy of dubious or no validity. The rights which he acquires are of lesser value than the rights which he thought he was acquiring and ought to have acquired. See **Knapp v Ecclesiastical Insurance** [1998] PNLR 172, approved in **Law Society v Sephton & Co** [2006] 3 AER 401.

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<sup>3</sup> The policy excluded liability for all accidents arising from defective maintenance work whereas the insured had sought a policy which excluded only defective work carried out by its own personnel.

36. However, in **Gaughan v McDonagh** [2005] PNLR 36, Gloster J held that a different view was possible on certain facts. In that case, the Claimant owned a number of hotels and sought cover for his entire portfolio of property. He paid a premium to the brokers which included a sum in respect of a particular hotel; that hotel was, however, omitted from the schedule of properties produced by the insurers, who went on cover in April 1998. Noticing the omission, the Defendant corresponded (in November 1998) with insurers about it, and arranged for the hotel to be included in the cover. Later, however, following a disastrous fire at the hotel, the insurers sought to avoid the policy for misrepresentation, complaining about statements made in the correspondence in November. The Court held that it was highly arguable that the limitation period ran from November 1998, when the misrepresentation was made, and not April 1998. Even if there had been a breach of duty on inception, resulting in the hotel being wrongly omitted from cover, this was not a relevant breach. The loss arose from the misrepresentation made by the broker in November, and time ran from that point.
37. See also the **GNER** case, where Creswell J followed the same approach. Again, it is submitted that this approach must be correct if the broker is under a continuing duty.
38. Thus, it is submitted that in a case where the negligence of the broker did not make the policy voidable but had the effect, for instance, of meaning that the insured did not take steps to comply with a warranty, the cause of action would occur when the loss was sustained. This is because until a loss occurred, the position might still have been remedied. Once the loss occurs in circumstances where the insurer has a defence of breach of warranty, the position cannot be saved. Note the remarks of HHJ Diamond QC in **Harvest v Davies** (above) as to the duty of a broker in a case where the policy contains onerous terms which require the insured to adjust his business practices in order to obtain the benefit of the cover.

#### Excuses for the Broker

#### Who Owned the Property?

39. If the insured in fact had no insurable interest in the subject matter of the insurance, he cannot obtain damages if the broker by his negligence has failed to secure a valid policy, because he

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<sup>4</sup> Given the nature of the proceedings, which comprised a Part 24 application, he did not need to go further.

would have recovered nothing on the policy even if it had not been void: see **Newby v Reliance** [1994] 1 LI Rep 83.

40. This is an important point in relation to small companies, because the rule is that a director has no insurable interest in property owned by his company: **Macaura v Northern Ass Co** [1925] AC 619.
41. In that case, the claimant owned all the shares in the company, and was the creditor of the company to a significant extent. The company owned a large amount of cut timber. The claimant insured the timber in his own name with the Defendant insurer. The timber was damaged by fire, an insured peril. The Defendant refused to pay on the policy, arguing that the claimant had no insurable interest in it, because it was not his property, but that of the company.
42. This defence was upheld by the House of Lords. The Lords held that it is necessary for a claimant to establish some legal or equitable relation to property before he has a sufficient interest in it to be able validly to insure it.
43. The issue of insurable interest is a frequent trap for High Street brokers dealing with one man companies. In such companies there is frequently a “blurring” of the distinction between the director and his company, when it comes to the name in which the property is owned. Suppose a case in which the broker failed to ascertain that the property was owned by the director personally and took out the insurance was in the name of the company. In such a case the rule in **Macaura** would prevent recovery under the policy. It is submitted that the broker would usually be held to be negligent in those circumstances for failing to ensure that the correct insured (that is to say, a person with an insurable interest) was named on the policy (unless the insured had positively given inaccurate information to him on the point). What the broker knew about the manner in which the client held the property (or other properties) is potentially highly material. In a case where the broker deals with the property portfolio of the director, and knows that some properties are held personally and others via the company, it would be very difficult to defend a negligence claim. For an example of a case where a broker was negligent for failing to discover and deal with an insurable interest problem, see the New Zealand authority of **Cee Bee Marine v Lombard** [1990] 2 NZLR 1 (broker has 2 clients seeking insurance on goods; client 1 has no insurable

interest, client 2 does, but the insurance is taken in the name of client 1 alone: held, the broker was negligent).

“They wouldn’t have paid anyway”

44. Another good ground for escaping liability, if it can be proved on the facts, is that the insurer (a) had alternative grounds for avoiding the policy, and (b) would have avoided on those grounds. See **Gunns v Par** [1997] 1 LI Rep 173 (where the defence succeeded, the learned Judge having formed a very unfavourable view of the plaintiff’s conduct), **Fraser v Furman** [1967] 1 WLR 898, **Everett v Hogg Robinson** [1973] 2 LI Rep 217.
45. Note the nature of the defence, which is best explained by the **Fraser** case (especially per Diplock LJ at page 11). There are 2 questions. First, what is the chance that the insurer would have taken the point? A contemporary Court may, depending on the nature of the case, require rather less in the way of evidence to show that the point would have been taken than was needed in a more gentlemanly age. The fact that insurers have been willing to deny the claim upon the ground arising out of the broker’s negligence is generally a good indicator that they would have taken other points, if available (although it is important to look to see whether the point was known to insurers and not taken by them, and if not, why not). The second question is, what would the practical consequence have been?
46. The defence only arises, however, in the event that the broker has been found to be in breach of his duty. It is, therefore, a defence founded on the proposition that there is no loss caused by a breach: conversely, the insured generally puts his claim on the basis that he seeks the value of the chance that insurers would have paid out.
47. Thus the Claimant would be entitled to nominal damages by way of a claim in contract, even if the defence were established. More importantly, if there is merely a chance that the insurer would have taken the point successfully, or if it is held that the insurers might have taken the point but would have settled without pressing the matter to trial, the insured will recover a suitable percentage of his damages. In other words, the damages represent a full recovery under the policy, discounted by a percentage designed to reflect the size of the chance that the insurer



would have taken the point, and the judge's view as to what settlement value the argument would have had alternatively its prospects of success at trial.

48. The defence is usually unpopular and difficult to run (compare the defence for a negligent litigation solicitor that the cause of action, lost through his negligence, was worthless in any event).

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