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ISSUE 022: November 2011 **Craig Langstone, Partner**
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Insurance Brokers' Negligence—More Bad News?

The English decision in *Jones v Environcom Ltd* [2010] EWHC 759 (Comm) looked at the extent to which a broker was required to explain disclosure obligations and elicit material information from an insured.

The recent appeal from this decision, reported at [2011] EWCA Civ 1152, considered the extent to which it could be said that certain losses were in fact caused by a broker failing to meet those requirements.

The Facts

Environcom was a recycler of electrical equipment such as refrigerators. Environcom had developed a practice of using hot plasma cutters to remove the bolts securing fridge compressors. Using plasma cutters was inherently dangerous because the tools reached temperatures of over 15,000 degrees Celsius while in operation. This danger was further enhanced by the fact that the refrigerators often contained inflammable pentane gas.

The inevitable happened and a catastrophic fire completely destroyed Environcom's premises. The total losses to Environcom were in the region of £6 million. The insurer disputed liability on the basis that the use of plasma cutters, and a history of fires, had not been disclosed. Eventually the insurer settled for less than £1 million.

Environcom sought to recover the balance from its insurance broker on the basis that the broker was negligent in failing to properly explain the disclosure obligations owed to the insurer.

Explaining Disclosure Obligations

Environcom, as with all insureds, owed its insurer an extensive duty to disclose all facts that might influence the insurer's decision to provide cover. The failure to disclose the use of plasma cutters, and a history of fires, was held to be a breach of Environcom's disclosure obligations.

The question to be determined was whether the broker had taken sufficient steps to inform Environcom of its disclosure obligations. The UK High Court held that standard form written explanations and warnings annexed to proposals or policy documents did not provide a sufficient explanation, and said that the broker must instead satisfy himself that the disclosure obligations are understood by the insured.

This will usually require the broker to engage in oral discussions or written correspondence with the insured on the topic of disclosure obligations. There was no evidence of any such correspondence or discussions and therefore the broker was held to be in breach of his duty to Environcom.

Eliciting Material Information

The extent to which a broker is required to elicit material information from the insured was also considered. The Court held that the broker was not required to specifically ask whether Environcom used plasma cutters.

The broker was, however, possibly required to ask more general questions about whether Environcom used "heat" or any "hazardous processes" at its premises. The Court noted that, even if the broker had asked these general questions, Environcom would probably not have disclosed the use of plasma cutters probably because Environcom considered their use to be trivial and non-hazardous.

The broker was also required to specifically ask whether there had been any fires at the premises in the past. The broker should have made it "absolutely clear" that any previous fires were material matters which should have been disclosed. The Court held that, if the broker had met this requirement, Environcom would have disclosed the historic fires and in doing so the use of plasma cutters would have become apparent. So the broker was negligent and in breach of the duty of care owed to Environcom.



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Uninsurability and Causation

Even though the broker was negligent, Environcom was ultimately unsuccessful. This was because the broker's negligence did not cause the loss of "unimpeachable" insurance. The reasoning for this conclusion was that if Environcom had disclosed the historic fires, and therefore also the use of the plasma cutters, Environcom would not have been able to obtain insurance (at least, not on acceptable terms and with acceptable premiums).

Environcom argued that steps would have been taken to reduce the fire risk so that insurance cover could have been obtained. The Court rejected this argument, stating that the evidence did not support a conclusion that Environcom would have taken a pro-active approach to reducing the fire risks.

The Appeal—Causation

Environcom appealed the decision. On appeal, it argued that if the broker had complied with his obligations, the fire would never have occurred at all. This was taking the causation argument one step further. In other words, Environcom argued that had the broker asked about fires in the past and learnt the truth, Environcom would have changed its work practices (so as to get insurance) and the fire would have never happened.

The Court drew a distinction between negligence which caused loss of unimpeachable insurance cover for a fire loss, and negligence which caused a fire loss. The former related to the broker's duties to explain the disclosure obligations and elicit material information. The latter related to a wider duty to advise Environcom on how to eliminate risks from its business practices.

It was held that in order for Environcom to argue that the broker's negligence actually caused the fire loss, and not just loss of unimpeachable cover, an amendment to the duty of care pleaded was necessary. The Court refused to grant permission to amend the pleading and the appeal was dismissed. Whilst the appeal was decided on a pleadings point, clearly the Court of Appeal had little time for the "broker's negligence actually caused the fire" argument.

Comment

Whilst the broker ultimately succeeded, insurance brokers will no doubt feel a chill down the spine regarding their obligations to elicit material information from insureds and to fully explain the insured's disclosure obligations. Quite how far does this go? How exactly is an insurance broker to elicit disadvantageous information an insured wants to hide? Who really knows. But watch out – as a result of this case insurance brokers are not able to merely "process" information provided to them so as to obtain insurance for an insured. Their duty of care is much more extensive and so is their liability exposure.

For further information about this case, please contact either:

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Jones Fee is happy to forward a full copy of the appeal decision (free of charge) to anyone interested.

