EXPLAINING THE DUTY OF DISCLOSURE TO CLIENTS – THERE'S NO SMOKE WITHOUT FIRE

Two recent High Court decisions focus on the extent to which insurance brokers must ensure clients understand their duty of disclosure to underwriters.

Avondale Exhibitions Ltd v. Arthur J. Gallagher Insurance Brokers Ltd [2018]

The broker placed a Commercial Combined Insurance policy on behalf of Avondale, a manufacturer of exhibition stands. Avondale was owned and run by a Mr and Mrs Watkins. In August 2012, there was a fire at Avondale's premises. Avondale's claim was declined by the insurer, which sought to avoid the policy on the basis that Avondale had not disclosed two previous criminal convictions of Mr Watkins.

Avondale then claimed against its broker, arguing that the broker had been told about the convictions, but had failed to disclose the information to the insurer. Alternatively, Avondale argued that, even if it hadn't told the broker about the convictions, the broker was at fault for failing to advise Avondale of the need to disclose them and/or for failing to elicit the information that needed to be disclosed to the insurer.

The Judge found, as a matter of fact, that Avondale had *not* told its broker about the convictions. Therefore, the issue that needed to be considered was the extent of the broker's duty to advise its client in relation to the duty of disclosure. The Judge summarised an insurance broker's duty as follows:

- to advise the client of the duty to disclose all material circumstances;
- to explain the consequences of failing to do so;
- to take reasonable care to ensure that the client understands the duty, and the consequences of failing to discharge it;
- to indicate the type of matters that are likely to be material, and therefore ought to be disclosed;
- to take reasonable care to elicit matters which ought to be disclosed, but which the client might not think it necessary to mention; and
- to take reasonable care to disclose matters of which the broker is aware and not to make material representations to underwriters which it knows are untrue.

In its defence, the broker relied on written duty of disclosure warnings that it had issued to Avondale. The Judge therefore had to decide whether those written warnings were sufficient to discharge the duty as set out above. Whilst the Judge commented that the documentation issued by the brokers was *"both complex and bulky"*, he concluded that the written warnings were complete and clear, and that they had properly drawn Avondale's attention to the duty that needed to be discharged.

The Judge went on to consider the necessity for specific oral advice to be given by the broker. Affirming the existing law on this point, he concluded that the need for oral advice will depend on the particular circumstances of the case. As such, whilst there is no general obligation to give oral advice or ask specific questions, brokers should always consider whether this is necessary in order to discharge their duty to advise clients on the duty of disclosure.

In the circumstances, on the specific facts of the case, the Judge held that the broker was not in breach of its duty to Avondale.

Dalamd Ltd v. Butterworth Spengler Commercial Ltd [2018]

The broker placed various policies for the operator of a waste recycling plant. In October 2012, there was a fire at the plant, which destroyed all of the buildings on the premises. Cover for the loss was rejected on the following bases:

- non-disclosure/misrepresentation of the fact that the insured had ceased trading and had gone into insolvency, and the fact that the business had been transferred to a new/"phoenix" company;
- non-disclosure/misrepresentation of the fact that, following a previous claim for storm damage and a build-up of waste at the plant, an Environment Agency / HSE investigation had determined that the insured had breached its EA licence and the previous Property/BI insurers had cancelled the insured's policies accordingly;
- non-disclosure of previous fire damage in 2010 and 2011; and
- the insured was in breach of a condition precedent in the property policy which required waste to be stored at a specified distance from the buildings and premises boundaries.

Instead of issuing proceedings against the insurer, the insured claimed against the broker alleging that it had failed to advise the insured properly on the duty of disclosure. The insured also asserted that the broker had failed to take adequate steps to "bring home" the consequences of breach of the storage condition precedent.

Considering the specific facts of this case, the Judge concluded that the broker had failed to discharge its duty to disclose the insured's insolvency and transfer of its business to a new company. The broker was aware of this matter but had disclosed incomplete details to the incorrect division within the insurer's group. Further, the broker had been aware of the insured's breach of its EA licence and the subsequent cancellation of cover by insurers. In addition, whilst the broker had *not* known about the previous fires in 2010/2011, it had failed to give adequate advice to the insured as to the sort of matters that were likely to be material, and which ought therefore to have been disclosed to insurers.

However, the Judge concluded that the broker was not in breach of duty as far as advising on the condition precedent was concerned. At quotation the effect of non-compliance was quite clear on the face of the documents, albeit the Judge noted that the insured's attention had not been specifically drawn to the condition precedent at that time. Nevertheless, whether that amounted to a breach of duty was academic, since the evidence made clear that the condition precedent had been discussed in detail with the insured in the context of a subsequent survey.

This breach of condition precedent by the insured enabled the broker to rely on a causation defence. The insured was in breach of a term under the policy, which the broker argued on the balance of probabilities would entitle the insurer to decline the claim, and this was something for which the broker had no responsibility. As a result, the Judge found that the property loss claim against the broker failed. However, the Judge found that the contractors all risk claim on a CAR policy would, on balance, have succeeded if the broker had not been negligent. For that reason, the broker was liable for the uninsured damage to the plant and machinery, totalling GBP1.6million.

It is worth noting that *Dalamd* was based on the pre-Insurance Act 2015 law, and therefore the proportionate remedies in instances of material non-disclosure under the 2015 legislation were not considered.

THE RISK MANAGEMENT MESSAGE

These cases provide a useful reminder of a number of risk management issues. Both highlight the importance of insurance brokers ensuring that their clients understand and comply with their duties of disclosure to underwriters, and of being able to evidence the advice that has been given in this respect. Brokers can be perceived as easy targets when an insurer rejects an insured's claim on the basis of non-disclosure/misrepresentation.

It is therefore essential that the broker:

- Ensures that the insured is aware of:
    - the existence of the disclosure duty;
    - when it applies;
    - what is meant by 'material circumstances';
    - the consequences of failing to discharge this duty; and
    - examples of information which may be considered to be material.
- Is satisfied and can demonstrate the insured understands the above, keeping a detailed note when oral (rather than written) advice is given; and
- Takes reasonable care to elicit information that the insured might not consider needs to be disclosed.

Dalamd also reinforces the importance of being able to establish that an onerous provision, a condition precedent in this instance, has been highlighted to the insured, as have the consequences of non-compliance. In the *Dalamd* case it was this evidence which resulted in the failure of the property loss claim against the broker. For this reason it is also essential that the broker highlights any important or onerous provisions to the client and is able to evidence that the client is aware of the consequences of breach. In challenging situations, where the presentation of risk or the application of policy provisions is complex, it is particularly important that the broker has confidence that these provisions are adequately understood.

Finally, having documentary evidence available to support any steps taken on behalf of a client, or advice given, is essential for the successful defence of any E&O claim. In considering the evidence in *Dalamd* the Judge commented *"As with most commercial cases, the most reliable evidence is provided by the contemporary documentation and the inferences which can be drawn from it."*

Griffin has issued a number of bulletins on the duty of disclosure, and some recommended standard duty of disclosure warnings, all of which can be found on the website at www.griffin-insurance.co.uk. However, these should only be used as a starting point and the extent of the advice required to be given by the broker will always depend on the specific facts of each particular risk being placed.

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