

# INSIGHT



**ISSUE 012:** February 2010 **Craig Langstone**

## **BROKERS BEWARE!**

**A September 2009 High Court decision, *Graham Strategic Limited v Stratus Finance Services Limited*, concerned an insurance broker's failure to ensure that their client's Professional Indemnity policy covered all the work done by their business. The case contained some interesting commentary on the role of insurance brokers in relation to Professional Indemnity policies, and the obligations of brokers generally with respect to annual reviews of policies.**

### **The Facts**

Graham Strategic Limited ("GSL") was a marketing and communications company specialising in advertising. In 2003 GSL was awarded a marketing contract with the Ministry of Education. The contract between GSL and the Ministry required GSL to have professional indemnity insurance.

At this point Mrs Graham of GSL contacted Mr Collins, principal of Stratus Finance Services Limited. Due to budgeting constraints Mr Collins facilitated, through Lumley Insurance, professional indemnity cover limited to the specific Ministry contract only.

In 2004 GSL secured a contract with the Ministry of Health. The Ministry of Health similarly required professional indemnity cover. The PI policy was amended to provide PI cover for both the Ministry of Education and Ministry of Health work only.

From 2004 on, GSL's business grew considerably. However the PI policy remained unchanged.

In 2006 GSL entered into a contract with the Retirement Commission to commission a television advertising series. The advertising series featured the song "My Way" made famous by Frank Sinatra.

GSL was responsible for obtaining the necessary music license. By the time the television advertisement was scheduled to air in May, the copyright permission had not come through. As a result, the on air time

was moved to August. Despite all efforts by GSL to obtain the necessary copyright approval, ultimately GSL had to abandon the "My Way" campaign and construct a new concept.

The Commission decided that it would not pay for anything to do with the "My Way" campaign, and any money already paid for it would be credited to the costs of the new campaign. Accordingly GSL had to meet the costs of the unusable "My Way" campaign totalling \$433,918.55 itself.

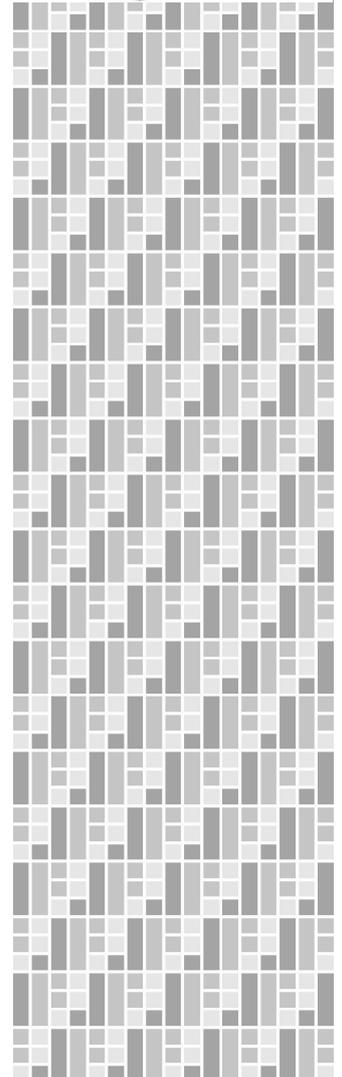
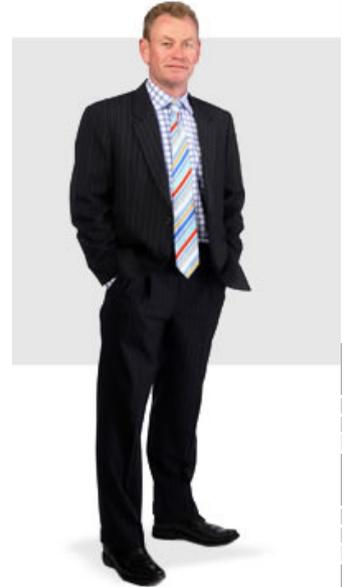
### **The claim against the broker**

GSL's position was that some time in 2005 Mrs Graham had forgotten that the PI cover was limited to the two Ministry contracts only. GSL argued further that the mistaken belief or assumption that the PI cover for the business applied to all their business activities was in fact reinforced by Stratus.

GSL argued that Stratus had breached an implied term of their contract which required Stratus to advise GSL that the PI cover was limited to the two clients, Ministry of Education and Ministry of Health only. Furthermore, GSL said Stratus was negligent through the positive reinforcement of GSL's mistaken belief that the PI policy covered all work by GSL.

Whilst Stratus said it had advised GSL that the policy was limited to the two clients only, the High Court found that it had not. This decision was largely based on answers given by Stratus to three email enquiries from GSL about its PI cover. The three responses from Stratus referred only to the PI limit of indemnity. Stratus made no reference to the fact that the PI cover only covered work undertaken for the two Ministries. The Judge held that the failure to mention the limited nature of the PI cover in the emailed responses fell below the standard of skill and care expected of an insurance broker.

Furthermore, the Judge also decided that Stratus should have provided a quotation for full PI cover each year, regardless of whether GSL had previously indicated its preference



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for limited coverage. The Judge accepted evidence that a broker's standard procedure at renewal should include:

1. Discussion with the client as to any changes in their business.
2. Reinforcing each year that it was advisable to take full PI cover.
3. A covering letter sent to the client referring the client specifically to any limitations on the PI cover that it was taking out.

Again, the Judge held that Stratus had breached the relevant standard of care. Stratus failed to specifically raise the limited nature of the PI cover, or to recommend full PI cover be taken out over a period of four years (including 2008 which was the renewal relevant to the events giving rise to the claim). This amounted to negligence on the part of Stratus, notwithstanding the fact that GSL had each year received documentation regarding the PI policy that noted the limited nature of the cover.

The Judge went on to find that GSL would have taken out more extensive PI cover had it been advised to do so by Stratus.

## Was the claim covered under the policy?

The Court then asked itself—had PI cover been correctly organised, would the claim have been covered? The Judge decided it would not have been.

The Judge held that GSL had no legal liability to the Retirement Commission concerning the failed "My Way" campaign. The Retirement Commission itself suffered no loss. Thus there was no claim for compensation against GSL by the Retirement Commission, nor could there have been.

The Court commented that the purpose of a professional indemnity insurance policy was to provide protection for loss caused to a third party. In this case, there was no loss suffered by a third party; merely a claim by GSL to recover its wasted time and costs for inadequate work which its client did not have to pay for. Thus GSL had no valid claim, even if a full PI policy had been taken out. GSL's claim against Stratus therefore failed.

## General Observations—Brokers Beware!

Whilst the case related to a professional indemnity policy, the Judge's findings concern all types of insurance policies and the duties imposed on an insurance broker.

A number of interesting issues arose in the case. One was the fact that sending policy documentation which noted the specific limitations of the PI cover taken out, was not deemed adequate to advise GSL of the limited nature of the PI cover that they had. This will understandably be of concern to insurance brokers.

Second, brokers need be very cautious when responding to semi-casual email or telephone enquiries from their clients. If the enquiry concerns a policy that contains an unusual "limitation" then the broker should point out that limitation when responding.

Thirdly, some brokers may be concerned that they apparently need meet with their client each year to discuss any changes in their business. Sending standard form documentation advising a client of all types of insurance cover available will not suffice, according to this decision.

Fourthly, the Judge's comment that a covering letter should point out any specific limitations on a policy should be of concern. The problem for brokers is working out what "limitations" need to be pointed out, and what do not.

In our view, the case is a salutary reminder that brokers get paid to arrange the best possible insurance for clients after ascertaining their insurance needs. Anything less will not be tolerated by the Courts.

Anyone wanting a full copy of the decision should contact:

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