

# BROKER NEGLIGENCE: TRAIL OF BREADCRUMBS NOT ENOUGH

In the recent case of *Infinity Reliance Limited (trading as My 1st Years) v Heath Crawford Limited*,<sup>1</sup> the Commercial Court considered the extent of a broker's liability to its client following its failure to advise properly that an alternative type of business interruption cover was more suitable for the client. The case also serves as an example of a fact pattern where, despite breach of duty being accepted by the broker and due in part to the relative financial (but not insurance) sophistication of the client who had incorrectly calculated the sum to be insured, contributory negligence by the insured claimant was established.

## Background

The claimant ("**Infinity**") was an online retailer which, trading as "My 1st Years", sold personalised gifts for babies and children. Because of the personalised nature of its products, Infinity needed to maintain space in the warehouse where its staff could personalise the goods before they were dispatched.

In 2021, Infinity was using space in a warehouse in Northampton owned and operated by a logistics company called Cygnia. Infinity paid Cygnia for much of the logistics work. Infinity had space in the warehouse where its staff could add the personal touches to the goods before they were sent out. There was also equipment at the warehouse to enable Cygnia to pick and despatch orders.

In May 2021, there was a fire at Cygnia's warehouse and Infinity could not use the warehouse any longer. Its business was interrupted and it lost millions of pounds of sales before it was able to find suitable alternative premises. Once it had found those new premises, Infinity also spent more than £2 million to fit them out.

Following the fire, it transpired that Infinity's business interruption ("**BI**") insurance cover was insufficient. Infinity's BI insurance was based on forecast gross profit of £24.9 million over two years. But the right figure, given the policy's terms, would have been about £33 million. Infinity was therefore underinsured, and because its insured exposure was 26 percent less than its full exposure, applying the "average" clause in the policy, it only recovered 74 percent of its adjusted loss – £9.23 million instead of £12.17 million. Further, Infinity's BI policy offered only partial cover in respect of certain other costs incurred by Infinity, such as the costs of equipping its new premises with appropriate equipment, and installing sprinklers which insurers of the new premises required. No criticism of Infinity's insurer was made and its settlement offer, based on the issued policy terms, was accepted.

Infinity sued its broker, Heath Crawford, alleging that if Heath Crawford had given proper advice, Infinity would have been fully insured for the loss. In particular, Infinity alleged that:

1. Heath Crawford provided Infinity with a document describing how to calculate the sum insured that was misleading, and led to Infinity buying insufficient cover.
2. Heath Crawford should have recommended a different type of BI cover (declaration linked cover) which would have produced a full recovery.
3. Heath Crawford should have realised that Infinity needed additional cover for costs it would incur to fit out alternative warehouse space following a fire, or similar event, which put Cygnia's warehouse out of action.

Heath Crawford conceded it had breached its duties, but argued that Infinity would not have accepted a recommendation to purchase declaration linked cover, and argued that Infinity had been contributorily negligent in failing to properly follow the advice of Heath Crawford.

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<sup>1</sup>[2023] EWHC 3022 (Comm).

## Sum insured versus declaration linked BI cover

Infinity's BI cover could have been placed on one of two different bases. "Sum insured" cover requires the insured to forecast its insured profit for the indemnity period (in this case 24 months). The premium is fixed in advance. If the insured has underestimated the risk or its profits grow faster than expected, it will likely be underinsured and the insurer will apply average to any claim, reducing pro rata the indemnity that is paid by the proportion of underinsurance.

By contrast, where the risk is covered on a "declaration linked" basis, the insured must still estimate its profit in advance, so that the initial premium can be assessed. But at the end of each period of insurance the actual performance of the business must be declared. Within broad limits, if the business' performance is higher than forecast, the insured pays an additional premium; if it is lower, premium is returned. Additionally, the insurer agrees not to apply average.

## The Court's decision

Mr Paul Stanley KC, sitting as a Deputy High Court Judge, found that Heath Crawford was in breach of duty in respect of all three complaints made by Infinity.

### Calculation of sum insured

Heath Crawford had provided Infinity with a document entitled "How to Calculate Gross Profit", which consisted of two pages of generic guidance. It was presented as guidance that would apply to any sort of BI cover, and not prepared with Infinity in mind, nor the definitions in Infinity's policy. Infinity had followed this guidance in order to calculate its gross profit.

The Judge agreed with Heath Crawford's acceptance that supplying generic information which was not applicable to the actual policy that it had placed constituted a breach of its duty of reasonable care. Heath Crawford accepted that although the guidance contained a disclaimer of responsibility which stated "we do not accept any responsibility for the adequacy of your indemnity period and the sum insured", this did not absolve it of responsibility for providing adequate guidance on what the insurance policy required to be calculated.

The Judge considered that this was a serious breach by the broker – it consisted of the positive provision of inaccurate and misleading guidance, on two occasions, accompanied by specific recommendations to rely upon and follow the inaccurate guidance note. The Court further held that, were it not for this breach by Heath Crawford, Infinity would have been fully insured because it would have calculated its gross profit correctly.

### Declaration linked BI insurance

The Court held that Heath Crawford had breached its duty of reasonable care by failing to recommend declaration linked cover, and that had Heath Crawford adequately raised the option of declaration linked cover at renewal in 2020, Infinity would have obtained such cover instead of its sum insured cover.

The parties' appointed broking expert witnesses had agreed that a reasonable broker would have recommended declaration linked cover to a client in Infinity's general position, where net profits were forecast to rise following the effects of the pandemic. The evidence was that there was no difference in unit cost between the two types of cover. It was not enough for Heath Crawford to argue that, because in 2018 Infinity's finance director had said that Infinity did not want BI cover on a declaration linked basis, there was no breach of duty for failing to recommend declaration linked cover in 2018 or subsequent years. A reasonable broker would not have accepted the client's preference for sum insured over declaration linked cover without providing further advice, including advice as to the risk that underinsurance would lead to every claim being reduced by average. Secondly, even when a preference has been expressed, the reasonable broker would check that it remained a genuine and informed preference at renewal, especially as circumstances change. Heath Crawford did neither of these things.

On causation, the Court found that if Heath Crawford had, at renewal in 2020, raised declaration linked cover with Infinity then Infinity would have instructed Heath Crawford to obtain it. The Court attached no weight to the fact that declaration linked cover was mentioned in the BI guidance document, not least because the document did not describe such cover in detail, or explain its advantages. On this issue, the Judge commented in particular that:

*An insured cannot be expected to follow breadcrumbs scattered through the documents to discover about suitable insurance products that the broker could, and should, simply have recommended.*

### Fit-out costs

The Court found that Heath Crawford was also in breach of duty by failing to recommend additional cover for costs Infinity would incur to fit out alternative warehouse space following a fire or other event which put Cygnia's warehouse out of action. It should have been apparent to the broker that Cygnia's warehouse was a critical point of failure and that Infinity's ability to trade was dependent upon Cygnia's equipment. There had been a cyber-attack in mid-2019 which put Cygnia's systems out of action and so, if Heath Crawford was not already aware of the importance of Cygnia's warehouse to Infinity's operations, it certainly should have been after this point.

Heath Crawford did not know whether Infinity would need to find an alternative warehouse very quickly, or that its arrangement with Cygnia was difficult to replicate elsewhere without large fit-out costs. However, it did not know this because it had not asked. In the Judge's view, the question "How will you cope if there is a major problem at the warehouse?" was one that the reasonable broker would have focused on.

If Heath Crawford had raised these questions, the Court found that this would have resulted in a sum to cover necessary fit-out costs at alternative premises being added as AICOW (additional increased cost of working) cover under the BI policy.

### Contributory negligence

In relation to the issue of contributory negligence, the Court found as a matter of fact that Infinity's finance director was at fault in how he had calculated the sum insured. The BI guidance document included an explanation of how to calculate the sum insured. The calculation involved taking a gross profit figure based on the 2020 accounts, and then inflating that figure upwards based on forecast growth for 2021, 2022 and 2023. However, rather than applying an actual forecast for Infinity's growth, Infinity's finance director applied a 10% figure which had been given merely by way of example in the guidance document, and which was "manifestly irrelevant to the exercise". Although the finance director did not understand the full implications of calculating the figures incorrectly (as he did not understand that average would be applied to the claim), the document made it clear that it was important to take care, and essential not to arrive at a sum that was too low. The disclaimer, although not an answer to liability, was a warning to take care or ask for advice.

In light of this, the Court reduced the damages awarded by 20% to account for Infinity's fault.

### Comment

Although the case does not make new law, it serves as a timely reminder of a broker's duty properly to familiarise itself with its client's business and to make sufficient enquiries to get to the bottom of a client's particular insurance needs, including at each renewal, so as to make a suitable recommendation to match those needs. A business may legitimately prefer one form of cover over another (even if that decision may result in adverse consequences), however brokers must ensure that the risks and benefits of alternative options are fully explained, so that a client's decision is an informed one.

This case is also an interesting illustration of how contributory negligence may reduce a broker's liability. Contributory negligence is a relatively uncommon finding in professional negligence cases generally, given that a lay client will usually be relying substantially on the professional it is paying for the relevant advice, although previous examples of such findings in brokers' negligence cases do exist.

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