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Broker liable to pay the insured's average - we really cannot go on like this!

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Host of super industry mangers and quasi-judicial institutions

In recent years there has been a veritable explosion of new quasi-judicial institutions, ostensibly to assist the public in dealing with claims against companies and other financial institutions. These institutions are increasingly seeing their role to remedy perceived social injustices; to be consumer champions. The insurance industry is greatly impacted by these new institutions. There is a host of them including, the Short-term Ombudsman, the Long Term Ombudsman (internal and external), the Fais Ombud, Pension Funds Adjudicator, etc. The list goes on to include more comprehensive institutions such as Consumer Protection, National Creditor Regulator, Competition enforcement institutions. And so the list goes on and on. They appear; they grow. Never before in the history of mankind has such an almighty expensive Amanda been assembled.

Traditionally private business has been conducted and governed by the law of contract. Business was conducted in terms of the rule of law and if there was a dispute these claims were dealt with by courts of law. The host of new quasi-judicial institutions have largely replaced law based decisions and make decisions irreconcilable with the existing law. These institutions have now all but ousted the historical system of law and courts.

In a case late last year the Fais Ombud facilitated a broker accepting liability to an insured to pay the insured's average where the insured was under-insured. This matter can be used as an example of this modern system in action.

Broker liable to pay the insured's contribution for average!

An insured suffered an insured loss, submitted a claim to the insurer whereupon the insurer established that the insured was under-insured and applied average. There is nothing out of the ordinary about this. When average is applied the insured becomes his own insurer for a portion of the loss, in this case R100 000. The insured then complained to the Fais Ombud who decided that the broker should be liable for the average cost of the insured because the broker did not explain to the insured that if he was under-insured he could be liable for a portion of the loss. The broker accepted liability and made an offer to settle the claim which was accepted. A broker has thus become liable to pay a substantial portion of the insured's claim shortfall due to the application of average. As I have often pointed out, increasingly the broker is regarded as the difference in cover (DIC) insurer of the insured. When the insurer is not liable, the broker becomes liable.

Now there is nothing unusual about this insurance claim, or under-insurance or average being applied. This probably happens millions of times a year around the world including in South Africa. It has been happening for centuries. Average in indemnity insurance is well-know having been included as a term in most short-term policies for hundreds of years. So for example, in South Africa in 1898 a very interesting book was published by Cameron MacIntyre called *The South African Red Book* which gave a detailed picture of insurance in South Africa at that point of time. The *Red Book* contains an article about the fierce competition which had developed between local and foreign tariff insurers and how as part of this competition the Royal, a UK insurer, had placed an advertisement in the SA press that it was prepared to abolish the average clause. So it is clear that the average clause has been part of short-term policies in South Africa for well-over 100 years. There is absolutely nothing unusual about this good old fashioned and well-known average clause.

Broker's liability in law
The question concerns the legal liability of the broker so the point of departure is a discussion of the liability of the broker in law which is now examined. Our law is Roman in origin and Gaius was a great Roman jurist. He pointed out that the basis of obligations is either contract or delict to which can be added statute. So let us start with contract.

Broker's liability - not a contractual obligation - the death of contract
The main function of a broker is to facilitate the contract of insurance with an insurer. The first enquiry is, whether the broker is liable in contract to the insured. The Fais Ombud did not examine this issue. If the broker is liable in terms of his contract with the insured (if such a contract indeed exists), then it is because the broker agreed to the obligation. That is, in this case that the broker specifically agreed to discuss the operation of the average clause with the insured and having done so assess if the insured is under-insured and if so, explain the consequences to the insured of being under insured. Having agreed to all of this the broker would have to also agree that what he has agreed to, is material, and he if breached this material term he would pay the insured damages. Since when the contract of insurance is entered into, it is not know which policy or which term in the contract may in future become a matter in dispute, the broker would have to agree to explain the operation of all policies and all terms in all insurance contracts. Now explaining all the usual policies and all the usual terms is what we do at Wits. It is done so over a period of months. At a push I suppose it could be done in a couple of days. So, to meet the obligation to explain all the policies and all the terms and evaluate the consequences of each term could take several days to achieve, with co-operation from the insured. All of this is unnecessary to achieve the object of facilitation of the insurance contract. Clearly this is not what the broker and insured usually agree to do. It can be accepted that the broker and insured did not enter into any such contractual agreement and the broker thus did not breach any agreement which he entered into with the insured. The obligation of the broker thus does not stem from their agreement. It is not a contractual breach.

The Fais Ombud paid no attention to the contract between the broker and the insured. In imposing this new obligation on the broker there is not the slightest hint that it derived from what the broker and insured had actually agreed to and that the liability stems from the breach of the broker's agreed obligation. The liability of the broker is imposed, externally, on the broker, it is not from the only historical ground of liability, contract. The contract is now irrelevant. It is for this reason some perceptive writers point to the death of contract. It no longer has any importance. It has died.

Broker's liability and modern case 'law' - enter Lord Denning *et al*
So if liability does not come from the contract and its breach, let us now see if we can find some other source for this modern externally imposed liability. One possible source is modern case 'law'. This, also, is not the source used by the Fais Ombud, since no reference was made to any case and the argument did not follow any logic set-out in any case.

When it comes to case 'law' we can start with the United Kingdom case of *McNealy v West Lanc Insurance Brokers Ltd* 1978 2 Lloyd's LLR 18 CA, a judgement led by the controversial iconoclastic Lord Denning. This judgement has been influential in South Africa. It is a very short judgement a mere three pages. A broker had attempted to facilitate cheaper motor insurance for McNealy through an insurance company called The Pennine Insurance Co which indicated a list of occupations it would not cover including a person who was either a full or part-time musician. McNealy was a part-time musician and his broker Mr Carnell called round to assist McNealy to fill-in the proposal form. When asked his occupation McNealy merely replied "Property repairer" which Carnell inserted into the block on the proposal labeled "What is your occupation". Despite knowing that The Pennine did not cover a specified list of occupations, listed on the circular issued to brokers, Carnell simply accepted McNealy's answer and did not check if McNealy was involved in any of the excluded occupations. Carnell when filling in the proposal form did not go through the list with McNealy, which he easily could have done. The main function of the broker is to facilitate cover with an insurer. The most important aspect of achieving this is to help the insured correctly fill-in the proposal form. McNealy had no way at all of knowing that the insurer issued a list of occupations it did not cover. Only Carnell knew that. Immediately after arranging insurance, McNealy went on a six week tour with a band to Italy and on his return he collected what he thought was his now insured car at Bristol. On the way home he was involved in a motor vehicle accident. When he submitted a claim it was repudiated because he was a part-time musician. The facilitation had failed. The broker was then sued and the Lord Denning and the two other judges ruled the broker was liable because Carnell should have gone

through the list of occupations with McNealy when filling in the proposal form. So one can say a broker has a duty to assist the insured to correctly complete the proposal form describing the risk to the insurer. It is interesting to note that none of the three judges suggested where the duty of the broker comes from.

This case is of no assistance to hold the broker liable where the insurer applies average. There is no suggestion in the McNealy case that the broker had to explain any provision in a policy let alone each and every any term in the policy. It is only when the facilitation fails that the duty of the broker comes into issue. When filling in the proposal form the insured could not know he had no cover because of his occupation, only the broker could know this. Some may argue that the McNealy case can be generalized holding that the broker should alert the insured to any unusual term in the policy, but such generalization does not arise from the McNealy case itself. Even if this broad interpretation of the McNealy case is adopted this does not result in the broker becoming liable for average. The average clause is as old as insurance itself and is also common sense; as with any transaction you get what you pay for. There is nothing unusual about that term in the policy. There is no obligation on the broker to draw the attention of the insured to the average term. If this duty exists on brokers it exists on all brokers to educate all their insureds then it is also difficult to know why this particular broker should be liable for not drawing attention to the average provision. Presumably this is not the first time the insured bought insurance so if this duty exists then all previous brokers should also have educated the insured, a long time ago. Clearly no other broker had, and I do not know of any broker that does, so why this broker should be liable and not the other brokers who had arranged insurance in the past for this insured is unclear.

So I cannot see anything in modern case 'law' holding the broker liable for average and in any event the Fais Ombud did not rely on case law. So the issue need not be considered any further.

Delict becomes contract - duties here, duties there, duties everywhere

Another way to get the broker to be liable is to import delict into contract, that is to do away with contract, and replace it with delict. The law of delict (torts in UK and USA) as we know has become big business. The wrongdoer must do what a reasonable man will do, he has a duty of a reasonable man. In reality this duty is of course not what a reasonable man should do but what the judicial officer thinks he should do. It is not a matter of law but a matter of opinion. This has allowed judges around the world to find wrongdoers liable under any and every circumstance. Judges (juries in America) have been able to find duties here, duties there, in fact, duties everywhere. So, if delict gets imported into contract then presumably an adjudicating officer can simply declare the broker has a duty to educate insured about average and the broker did not and thus breached this newly found duty and is liable. The courts have been able to create so many duties that no-one can ever even begin to know all these duties let alone comply with them.

In any event in the matter under consideration the Fais Ombud did not rely on any delictual duties so that need also not be considered any further.

FAIS General Code of Conduct becomes the basis of broker's liability

So, if the broker's liability is not based on any known basis in law, how did the Fais Ombud come to the conclusion that the broker was liable to pay the insured's average costs?

It comes from very terse and general references to the *General Code of Conduct for Authorised Financial Services providers and Representatives* a code promulgated by virtue of s15 of the Fais Act. In relying on the code, no serious attempt was made to interpret and apply the code to the facts. All that there is are some terse references to the Code. I have often noted that law no longer exists and decisions are not based on the law itself. But the end of law is not the end of words. In fact the very opposite has occurred. As law disappeared it has been replaced with an impenetrable, incomprehensible, repetitive and overlapping tsunami of words. To understand this just think of the 200 odd pieces of 'law' now applicable to the finance industry, virtually none of which can be understood. Any bits of this tsunami of words can be cut, paste referred to and then anyone declared to be liable for anything citing the bits and pieces of the tsunami. Holding the broker liable to pay the average is an example of this technique. The Fais Ombud cited three sections of the Code, s7(1)(c)(vii), s7(1)(a) and 8(1)(a)-(e). Firstly it should be noted that there is nothing in the Act which suggests that a breach of the Code leads to civil liability to the insured. If this did the Code extends the liability of brokers (and others) beyond the law and beyond comprehension. The Code could be

an ideal that is not the same as imposing civil liability. If it is the basis of civil liability then it illustrates the point I have made above. Contract is dead and liability is imposed on brokers by third parties, in this case the FSB.

In any event it is clear that the broker did not breach the code.

S7(1)(c)(vii) states the following:

> "7 (1) ... a provider must (c) at the earliest reasonable opportunity, provide full and appropriate information of the following (vii) concise details of any special terms or conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided"

It should be noted that the Fais Ombud did not attempt to show that the provision applies to the broker, is applicable to the transaction involved and that in fact the broker breached the provision or how the breach leads to civil liability. If this provision is applicable to the broker then all that it requires as is clear from the above quote is that the broker provide information. All the information about the cover is contained in the policy document and there is no suggestion that this was not provided to the insured. It should also be noted that the average clause is not a special term or condition, nor the exclusion of liability. So on the face of it, it is difficult to see the breach, if any, of this provision from the facts.

The other section referred to by the Fais Ombud was s7(1)(a) which reads:

> "7. (1) ... a provider must (a) provide a reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision."

As indicated in our modern multi-peril age, usually a suite of policies are entered into at the same time. For a broker to explain all material terms and operation of all the policies, which is implied by the Fais Ombud but not the provision itself would require, as pointed out above, several weeks to achieve. There is no suggestion that any broker ever does this. All the broker can do is what the provision requires, "provide a reasonable and appropriate general explanation ... that would be reasonably expected to enable the client to make an informed decision." The decision is to purchase insurance or not. A multi-week explanation is not a "reasonable and appropriate general explanation" nor needed to decide whether to purchase insurance or not. A detailed explanation of the operation of all terms including the average clause, a normal, usual term in short-term policies is not required in terms of this provision. Sufficient information was provided to enable the insured to make an informed decision to either purchase or not purchase insurance at the quoted price.

8(1)(a)-(c) deals with furnishing of advice. It is not clear that this section is relevant to a short-term broker and it clearly does not deal with the question of average. The preamble to the section reads, 'A provider other than a direct marketer must prior to providing a client with advice.' It is not clear that the broker was or wanted to provide the insured with any information with respect to average. 8(1)(a) requires the information be sought about the ***client's financial position***. This is not relevant to the placing of short-term cover. Insured's do not disclose their financial position to the broker. 8(1)(b) requires an analysis be conducted for purposes of the advice based on the ***information obtained.*** Since the broker does not obtain the information about the client's financial position, this provision is inapplicable. 8(1)(c) required that the financial product be identified. 8(1)(c) deals with selecting the appropriate product again this is not relevant to the short-term broker. 8(1)(c) deals with matching the client's risk profile and financial needs. Clearly these provisions have investment type of products in mind and do not apply to the question of average.

It is my in view inconceivable that a broker can be held liable to pay the insured's cost of average. It seems to me the entire regulatory system and these quasi-judicial institutions need to be rethought. We really cannot go on like this!

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