

INSURANCE FOR NEGLIGENT ADVICE\*

My brief is to comment on the extent to which liability arising out of negligent advice may be insured against.

At the outset it is necessary to draw a distinction between advice resulting in bodily injury or loss of or damage to property for which there is insurance protection available and advice resulting in claims for purely economic or financial losses which is much more difficult - a distinction to which I shall return later.

Let me deal first of all with the position of the person who earns his living by giving advice, the professionally qualified practitioner in private practice. Here there is no real problem. Solicitors, accountants, barristers and others may obtain insurance protection and will find there is an insurance market prepared to deal with their liabilities arising out of negligent advice although the level of premium to be charged will reflect insurers' growing concern at the increasing number of claims made under professional negligence policies.

Such policies indemnify the insured in respect of claims for damages made against him due to any negligent act, error or omission committed by himself or his employees in the conduct of the business. Normally, as we are dealing with the contractual situation between the professional man and his client, the claim will be one based on a breach of contract but the policy cover is not limited to this. Thus, claims from third parties within the Hedley Byrne principle are covered or can be covered. Indeed, one of the largest professional indemnity claims I have seen in excess of £1,000,000 related to a Hedley Byrne type claim. This was against an accountant who, it was alleged, had persuaded a bank on the basis of draft accounts to advance money to a building contractor who subsequently went into liquidation. The claim was against the accountant for recovery of the monies loaned by the bank.

The cover under a professional indemnity policy is not limited to claims for bodily injury or property damage but includes also claims for financial or economic loss.

I said the policy covered negligence committed in the conduct of the business. The business will be defined in the policy and it is wise to make sure it is wide enough to cover all the insured's activities. If there are any areas of doubt they should be cleared beforehand with the underwriter not when a claim arises.

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For example, I have seen a claim turned down under an estate agents' professional negligence policy where the estate agent had been acting on behalf of his client to recover an uninsured loss claim under a motor policy from the third party motor insurers. The underwriter didn't expect to get involved in this sort of claim.

Because there has always been a market prepared to underwrite the professional negligence risks of professional men it has not been a far step to arrange cover for quasi-professional risks such as banks or for professionally qualified people engaged not in private practice, but employed by commercial firms. Here the demand for cover is less frequent because many large firms are prepared to carry for themselves the risk of being held liable for the negligence of their staffs. One does, however, often face requests from the legal departments of commercial undertakings for professional indemnity insurance to cover their liability to third parties arising out of their activities and many policies are so arranged. A similar situation arises with the insurance departments of commercial undertakings. I wonder why, however, so many enquiries stop short with the legal and insurance departments. The same principles of liability may apply to other departments as well. Could it be that while the lawyers appreciate their liabilities and the insurance people know the insurance risks, no real thought has been given to other departments?

Provided we are concerned with professionally qualified and experienced staff the risk is usually insurable.

The departments are not seeking to insure their internal liability but rather their liability to a potential third party to whom advice may have been given for a fee or gratuitously. Very often it is a risk which is overlooked or mistakenly thought to be covered by the public liability policy, a point I shall refer to later.

Consider the sort of liabilities which may arise. Professional employees employed in departments may often advise fellow employees about their own personal problems, possibly exposing themselves to a Hedley Byrne claim.

Professional departments of companies may be involved in giving advice to subsidiary or associated companies in the same group or to customers or business associates.

On the personal level, employees of commercial undertakings may nevertheless in their off-duty hours carry out professional work for friends. The solicitor may help with the house conveyance or the accountant may look after his friends' business or tax affairs. Here they are in the same position as full-time practitioners and require their own policies.

Even if spare-time professional activities are not carried out, all of us at some stage have been approached by friends for advice on some particular aspect or other. Often with a close relative or friend it is difficult to avoid the request. It is often even more difficult and perhaps more an affront to our professional dignity to preface the advice, as we should, with a disclaimer of responsibility.

I doubt very much if any of us have insurance cover against the potential liability arising out of this sort of unpaid advice.

Whilst there is, therefore, a market prepared to underwrite the risks attaching to professionally qualified persons, advice generally, that is commercial advice given by persons other than professionals, is treated differently. Here the extent of cover, if any, will be found under the insured's public liability or products liability policies.

A public liability policy indemnifies the insured in respect of his legal liability for bodily injury to persons or loss of or damage to property but often specifically excludes liability arising out of faulty advice. The reason for this is that there is only a small section of the insurance market prepared to underwrite professional negligence risks. Many established public liability insurers do not want to know anything about professional negligence risks and regard advice as a risk to be more properly insured under a professional negligence policy. It is, however, possible to obtain public liability policies with the exclusion omitted or negotiate to have the exclusion removed. Even so, there is one important qualification. Public liability policies are limited to bodily injury or loss of or damage to third party property. Consequential loss claims flowing from such injury or damage are covered to the extent that the insured is liable but no cover operates for claims for economic losses only.

The same situation arises under a products liability policy. This indemnifies the insured in respect of his liability for injury or damage caused by goods sold or supplied, repaired, serviced or tested. Here liability for advice is often excluded. Typical exclusions may remove from the policy cover liability arising out of advice or the design, specification or formula of any goods sold or supplied by the insured; or instructions, advice or information regarding the use, storage or application of goods sold or supplied.

Of course, much of the advice given commercially relates to or is connected in some way with the sale or supply of goods or services. Such advice is not limited to oral advice but may also include advice often much of it in a detailed form on instructions, labels or other literature supplied with the goods or services.

For example, a plant hire contractor may give advice as to the best type of plant to use or how it is to be operated or used. Faulty advice could well result in injury to the operator or damage to property.

Labels attached to a product may contain incorrect instructions or, in a negative way, fail to warn of certain risks.

A commercial traveller for a firm of glue manufacturers may give faulty advice to a glazier on the type of glass to be used as a sealant for double glazing.

In the supply of services a waste disposal contractor may give incorrect advice on the storage or treatment of waste, or a firm of fire prevention experts may advise the wrong type of sprinkler system or a burglar surveyor the wrong type of alarm.

An exclusion of advice on a products liability policy, therefore, is dangerous and should be deleted, although it is surprising how often one finds products policies nevertheless with the exclusion still operating. Not all insurers, however, are prepared to remove the exclusion, a great deal depends on the product and the risk involved. For example, advice given in connection with the use of pharmaceutical products would be very difficult to insure.

But even with the exclusion deleted the limitation of cover to bodily injury or damage to property has to be appreciated. No cover operates for the purely economic loss claim.

There is still another area of risk, however, namely advice which is not related to the sale or supply of goods or services to a customer. I can illustrate the sort of risk I have in mind by using the insurance industry as an example.

Take the case of a property developer having an office block built. He will appoint a contractor and under his contract conditions make the contractor responsible for certain risks and for insuring them, e.g., E/L and P/L and Contract Works, by means of indemnity and insurance clauses. To satisfy himself that he - the property developer - is adequately protected under the contractor's policies the developer may call for a sight of the policies or ask for completion of a certificate of insurance. This certificate of insurance is usually drafted by the developer for completion by insurers and states that the contractor has insurance protection against all the liabilities he has assumed under his contract. Of course, in this manner the certificate cannot be signed by insurers because no policy covers all the contractor's responsibilities, it will invariably have certain exclusions and limitations. It seems to me that such certificates can only be signed by insurers with a qualification "Subject otherwise to the terms and conditions of the policy". Yet a great many insurance companies do not do so and sign the certificates in their original form.

It seems to me that if the developer sustains a loss which he thought was insured but wasn't because he relied upon the certificate he would have a Hedley Byrne type claim against the insurers.

Incidentally, to my knowledge no insurers insure against this risk.

No doubt many of you can think of a similar situation in your own organisations.

Having mentioned the limitation of the policy cover to injury to persons or damage to property, it is necessary to look at the word 'property' to know what it means. You will find that in the vast majority of insurance policies the word is not defined at all. In law, of course, it has a very wide meaning but not so in insurance policies where the intention of insurers is to indemnify in respect of loss of or damage to material property only, plus of course the consequential losses flowing from that material property damage. On this interpretation a claim for a purely economic loss would be outside the scope of the policy.

Some years ago the definition of the word 'property' in liability insurance policies came under close scrutiny in the liability insurance market, as a result of which the traditional approach to property is very gradually changing. There are some insurers who are prepared to give the word its wide meaning in law. They do not specifically say so in their policies. The word 'property' still remains undefined but an additional exclusion appears in the policy excluding liability for damage to certain forms of non-material property, such as the infringement of plans, copyright, patent, trade-names, trade-marks or registered design.

One can only interpret such a policy to mean that damage to other forms of non-material property not specifically excluded is covered. A policy of this nature, therefore, with the advice exclusion deleted would go a long way to closing the gap which exists for economic claims, although I should emphasise that the insurers adopting this approach are very much in the minority. Moreover, the development is very recent and it remains to be seen whether insurers using this wording who are requested to delete the exclusion of advice restrict the cover again to material property.

There are products liability insurers, again in the minority, who are prepared to enter into the field of economic loss claims where there has been no damage to property. The normal products liability policy is extended to provide that the policy will apply to liability for financial loss even if not accompanied by loss of or damage to property sustained by a customer or user of any goods supplied by the insured due to the defective or harmful condition of the goods or their failure to perform the function for which they were supplied.

The object of this extension is basically to deal with liability arising out of faulty products rather than faulty advice. For example, if the insured manufacture and supply machinery for a factory and the machine does not work, resulting in a close-down of the factory and a loss of production, this endorsement picks up the insured's liability. If, however, the fault is due in whole or in part to advice given by the insured in connection with the machinery, for example, as to the method of its use or its position or operation, this would be covered provided the advice exclusion had been deleted.

Even then the extension will not be given unless the insurer is also given the employers' liability, public liability and products liability risks, so you can see that the cover is scarce enough for the insurer to dictate his own terms.

Although this wording does primarily cover the situation in contract between the insured and his customer, a certain amount of Hedley Byrne liability may nevertheless be covered by the endorsement. I should emphasise again, however, that the extent to which this coverage is available is very limited, it provides only a low limit of indemnity and it is not every case that will be accepted.

You will appreciate from this brief résumé that insurers' approach to cover for advice is cautious. Why should this be?

I think the answer is that insurers at the moment do not wish to become involved too much with what may be called the business risk. They are quite prepared to cover a claim due to some accidental or fortuitous event - for example, some foreign body entering a product during its manufacture, but they are very reluctant to become involved in covering the insured's business know-how or lack of it. The reason for this is because once insurers start covering the business know-how of a firm they are in a sense going a long way to guaranteeing the efficiency or accuracy of the goods or advice given or supplied by the insured. Insurers, however, do not see it as any part of their function to guarantee the business they insure. This view may be summed up in the words of one underwriter who argues that if he is expected to cover the business know-how of a firm he is expected to pay out in claims if it is wrong. He sees no reason, therefore, why he should not take a share of the firm's profits if the advice turns out to be good, on the basis that he is really a co-partner in the business.

It is true that professional negligence insurance is perhaps an exception to this rule because here insurers are virtually guaranteeing the competence of the insured. If he is negligent in the conduct of the business and this produces a damage claim, insurers pay. But here the underwriting considerations are different. The underwriter has some means of assessing the potential risk. Most important of all,

the professional qualifications of the insured will tell the underwriter whether or not the insured has satisfied experts in his own professional field that he has reached a certain standard of professional competence. The standards and disciplines of the professional body too will impose certain levels of conduct. The method of training in professional practice is such that it will instil a note of caution in the giver before advice is offered and usually there will be no end product to sell or perhaps more to the point to oversell. The advice cover given by the policy will be limited to advice in which the insured is qualified to practise.

But in commercial life the situation is different. Normally, there are no yardsticks to use to help the underwriter to decide whether an insured is competent to give the advice he does. How do you know whether a representative is competent to advise on the products he is selling?

Certainly, if you limit the advice cover to advice given in connection with products or services sold or supplied by the insured, the past claims experience will prove helpful, and it is indeed on this basis that some underwriters are prepared to give advice cover or cover mistakes in designs, specifications or formulas. But, again, the cover is against injury or property damage only, not economic losses.

Insurance cover against negligent advice producing economic loss claims is not generally available except for professional people. Insurers do not want to give it and there has been no real pressure upon them to do so. Perhaps this is because the principles of tortious liability within the Hedley Byrne principle are not yet sufficiently known. Perhaps those who give advice are prepared to rely for protection upon the terms of a suitable disclaimer given with the advice. Until the demand comes, therefore, I cannot see insurers voluntarily offering it. Most liability insurers at the moment are struggling hard to get their accounts back into profit and have enough problems coping with inflation and rising damages. At the moment their plates are full.

Insurance against economic loss claims due to negligent advice may very well come. It depends how far Hedley Byrne is developed in the future. But in my view it will not come for a good many years yet.

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