The legal position of marine insurance brokers in a changing environment.

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THE LEGAL POSITION OF MARINE INSURANCE BROKERS IN A CHANGING ENVIRONMENT

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ABSTRACT

This research is focused on the position of a marine insurance broker in a changing environment. As a result of a number of recent cases, the obligations of the broker have been made more onerous and this constitutes a significant departure from the previously obtaining legal position. The thesis examines the major obligations of the marine insurance broker in the context of these developments and against the backdrop of other changes in the industry's self -regulating mechanisms.

In chapter 1 some aspects of Lloyd's organisation are examined like the monitoring and the investigations and regulatory proceedings. Very relevant is also chapter 2. This is dedicated to the latest developments in respect of the position of brokers. The introduction of the General Insurance Standards Council reform is one of the factors that make the whole area a changing environment.

In Chapter 3 the role of brokers is examined; aspects of both insurance and reinsurance are dealt with. In the part dedicated to premium the recent change by the Lloyd's Insurance Broker's Committee according to which a broker will not be held liable in respect of a premium when there is no fault on his part is discussed. The last part is about liens. Very important are chapters 4-6, which are dedicated to the duties of insurance brokers, the duty of the utmost good faith and the issue of proposals, slips, policies and renewals.

Chapters 7 deals with binding authorities and other special arrangements. Chapter 8 relates specifically to the liabilities of insurance brokers and examines generally their legal obligations. In chapters 4 and 8 very significant case law is discussed in relation to the duties that a broker may owe towards his principal or other parties.

Chapter 9 contains the conclusion.

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Introduction

The aim of this research is to examine the legal position of insurance brokers in the modern insurance market. As a starting point it needs to be said that great reference is made to Lloyd's regulations and the reason for this is that Lloyd's is the most influential organisation in the U.K in respect of brokers. This is the reason why in the first chapter of this research a reference is made to Lloyd's organisation, dealing with a few very important things such as the governing bodies of Lloyd's and other aspects like monitoring, authorisation and regulatory proceedings.

The other thing that needs to be said is that at present the position of brokers is one affected by a changing environment. The reason for this is that there is a significant reform – the General Insurance Standards Council regime – that will influence the whole regulatory environment around brokers. The second chapter of this research is dedicated to this reform. The General Insurance Standards Council will be a self-regulated body and it will have nothing to do with legislation. The practical effect will be many activities that are now carried on by Lloyd's will pass on to the General Insurance Standards Council. All the members of GISC will have a contractual relationship with it. However, as I explain in the second chapter, there are quite a few problems that need to be resolved. One of them has to do with **the Competition Act 1998**. The problem derives from the fact that the members will be allowed to do business only with intermediaries that are members themselves. It remains to be seen how the market will react to these changes and how significant the differences will be.

The other chapters of the research are dedicated to the important aspects of a broker's activities while performing his duty to his principal. One of the main chapters – chapter 5 - deals with the duty of utmost good faith, something that is related to fraud on the part of brokers, imputation of knowledge and the conflicts of interest that a broker may find himself involved quite often. The Marine Insurance Act 1906 is very important in respect of this because in all the cases the main issue was to try and elaborate on what was the exact meaning of the relevant sections of it. Quite a large number of cases arose on the basis of an allegation of breach of utmost good faith because it was quite a common argument. But, as it is shown by case law there are a number of circumstances that a court will have to examine before

upholding that a breach of utmost good faith could be found, such as the relationship of the parties and the particular facts of each case.

A reform also took place as to the liability of brokers in respect of premiums. The Lloyd's Insurance Broker's Committee decided in 1997 that in respect of every premium after 31st of August, the brokers will not be held liable by the underwriters when the fault is on the part of the assured. In the chapter about premium there is also a reference to non-marine risks when the Marine Insurance Act does not apply and to a number of recent cases.

The most important, however, chapters of my research are dedicated to the duties and liability of brokers. In the chapter about duties of insurance brokers I refer to most of the activities that a broker is involved in order to do his job properly. For example, when he obtains or places the cover. Something that needs to be said is that a broker owes a duty of care not only to his principal. There can be instances where he owes a duty of care to other parties as well. Through case law I made an effort to make clear what is the exact duty of care that is required by a broker under the circumstances of each case. Finally, in the end of the chapter about duties a reference is made to the Code of Conduct that regulates the brokers industry. This is the theoretical background of what a broker is expected to do, although deciding whether or not a code can be enforced in the reality of a commercial world is always a difficult task.

In respect of the potential liability of a broker I have concentrated, first of all, on what are the requirements for liability to exist. As a result, the principles of law of contract and tort are mentioned. Many cases are mentioned in both chapters – duties and liability- because they are interrelated. Also, very important aspects of reinsurance such as the spiral business and pools and fronting are mentioned always in accordance with the relevant cases.

Finally, parts of this research are dedicated to binding authorities, liens and umbrella arrangements. The purpose of these chapters is to try and cover all the activities of a broker ever under special arrangements like binding authorities and umbrella arrangements. The last thing I want to submit is that the law of reinsurance proved to be very significant since things are sometimes more complicated and the broker can find himself in a difficult position. Also, I mentioned a number of non-marine cases as well because a number of important principles have developed in these cases and I tried to cover the whole scope of the profession of broking.

CHAPTER

1 *Lloyd's Organisation*

1.1 Introduction

This chapter will discuss Lloyd's organisation. Although my research is generally dedicated to insurance brokers, Lloyd's remains one of the most vital aspects. A very large number of insurance brokers and insurance contracts are governed by Lloyd's regulations. Especially before the new system – GISC scheme – to which I will refer in the next chapter, Lloyd's role was even more important. Most of the disciplinary and other proceedings involved Lloyd's. This is the reason why a reference to Lloyd's in the beginning of this research is essential.

1.2 Governing Bodies

The first governing body I need to refer to is **the Council of Lloyd's**. This was established under the Lloyd's Act 1982 and it has 18 members. Six of them are elected by the working membership. Another six are elected from the external membership and six are individuals. It must be said at this point that the members have no business relation with the Lloyd's market and they are not Names[1]. **The Lloyd's Market Board** has 15 members. It is chaired by the Chairman of Lloyd's who is co-operating with the Chief Executive Officer. Its responsibility is the overall development of the Lloyd's business[2]. Thirdly, we have **the Lloyd's Regulatory Board**. This is responsible for the development and the monitoring of the regulatory procedures within Lloyd's. Its activities are now overseen by the Financial Services Authority. Finally, we have **the Corporation of Lloyd's**. This actually provides support to Lloyd's in a variety of ways[3].

1.3 Monitoring

Monitoring is one of the main activities of the regulatory division. From the 1st October 1999, the two departments, which were responsible for the monitoring of underwriters and brokers, became one single department. It is now called **the Business Conduct Review Department** – BCRD - [4]. The main reason for the change

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[1] http://www.lloyds.com/regulation/governance.htm.
[2] *Ibid.*
[3] *Ibid.*
[4] http://www.lloyds.com/regulation/core.htm.

is that, as I have already cited before, the whole insurance market is a changing environment. In ten years time, the number of syndicates was significantly reduced together with the number of managing and members' agents. The same thing happened to the number of individual members[5].

The effect of all the above changes is a new ***supervisory approach*** to the insurance market. This new approach has some key features. The first one is that each underwriting agent has now a dedicated supervisor responsible for the monitoring of his activities. The aim of this is actually to improve precision. Also, the degree of monitoring by the supervisors depends very much on how "risky" an agent or a syndicate is. The department's automated transaction monitoring system is the main source of information. Another important thing is that the quantity of information asked before each visit is reduced on the basis that supervisors hold certain pieces of information in their portfolio[6].

For the more effective operation of the department supervisory meetings are being held between the senior management of the department and the management of each agency[7]. If an agent receives an unsatisfactory monitoring review, this means that the members of a syndicate like that must put an additional amount of capital. But monitoring requires also a great degree of research. I am going to make a very brief reference to the monitoring projects that took place in 1999. One of them had to do with **market liquidity**. This is a very important aspect because liquidity is one of the key elements of the insurance market. Very significant was also the fact that every agent had different approaches towards liquidity. For example, only a few included realistic disaster scenarios in their plans[8]. The second project I will refer to is that about **political risk exposure**. After quite close examination, it was concluded that although there is no real reason for immediate concern, it is a factor that will have an important role in the following years because of the large losses that it may cause. This is the reason why this project will be repeated in the following years[9].

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[5] *Ibid.* Page 9.
[6] *Ibid.* Page 10.
[7] *Ibid.* Page 11.
[8] *Ibid.* Page 12.
[9] *Ibid.* Page 13.

Another very important part of monitoring is **the business conduct review**[10]. Its importance derives from the fact that many of the practical problems that the insurance market has to deal with are being examined very closely and effective solutions can be found. For example, in the handling of binding authorities by Lloyd's brokers the most common problems were the absence of written procedures in respect of binding authorities, the fact that the coverholder had bound risks under a binding authority that are not yet placed properly by the broker and the failure of the brokers to be positive that binding authorities agreements are in place[11]. Other areas that were examined were **controls over consortium underwriting arrangements, controls over proportional treaty underwriting, controls over line slips and marine open cargo covers** and **review of Internet sites**[12].

More specifically about brokers, the results of monitoring in 1999 were very useful. Lloyd's brokers were responsible for more or less the control of 19 billion pounds. More than 50 per cent of them made a pure operating loss with a turnover of less that 3 million pounds. GISC – the scheme that is in force now – has to deal with quite effectively since it is an area of great concern[13].

Finally, the priorities for 2000 were as follows. In respect of monitoring the areas that it was going to be focused on is the impact of market conditions, the accuracy of syndicates' results and the review of all agents[14]. In relation to business conduct review, reviews would take place in credit management at syndicates, cash flow in the market, long term insurance contracts and on how effective reinsurance security arrangements are at managing agents[15]. In respect of brokers the main issue was that all the UK brokers are going to be regulated by **the General Insurance Standards Council**. The effect and some details of this change are discussed in the next chapter.

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[10] *Ibid.* Pages 14 -17.
[11] *Ibid.*
[12] *Ibid.*
[13] *Ibid.*
[14] Compliance with the 300 per cent rule – the requirement for separate individuals for the posts of managing director and financial director. http://www.lloyds.com/regulation/core.htm. Page 19.
[15] http://www.lloyds.com/regulation/core.htm. Pages 19-20.

1.4 Investigations and Regulatory Proceedings

Quite relevant to all the regulatory aspects of monitoring mentioned above are the actions of the Investigations Department and the Regulatory Proceedings Department. The first one is responsible for the examination of allegations of misconduct and other breaches. If there is evidence of misconduct, a formal inquiry is directed. The second one is responsible for these formal inquiries and the prosecution of these disciplinary cases [16]. Some examples of disciplinary cases have to do with brokers misleading their clients on purpose in relation to the placement of the cover, the "grossing up" that brokers had conducted and the failure to take or give proper inducements [17].

The priorities for 2000 were the following. The whole disciplinary arrangements would be reviewed. External investigations were also to be reviewed so that their usefulness is maximised. The third area of concern would be the **Financial Services Authority**. Under the Competition Act 1998, FSA has the authority to oversee Lloyd's enforcement processes. The same happens in respect of managing and members'agents and the Society of Lloyd's. The exact role of FSA would be clarified over 2000[18]. The last aim is that minimising the cost, so that the defendants in every case know exactly what to do in order to achieve this. This would be done through guidance notes[19].

Finally, something that has to be mentioned is the role of **the Lloyd's Disciplinary Board**. The aim of this board is to perform disciplinary procedures, which came into effect under Lloyd's Act 1982 and byelaws. These functions include the dealing of proposals of summary and formal disciplinary proceedings, the selection and appointment of Disciplinary Tribunals and the imposition of fixed penalties[20].

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[16] *Ibid.* Page 31.
[17] *Ibid.* Page 32.
[18] *Ibid.* Page 33.
[19] *Ibid.*
[20] *Ibid.* Page 34.

1.5 Authorisation

This department is separated in three areas, **authorisation, individual registration and correspondents** and **development**. The first area is actually responsible for the authorisation of agents and syndicates and the granting of certain conduct of business permissions. The second one has to do with the approval of coverholders and correspondents. The third area is focused on how the reaction of the insurance market should be because of the changes such as the involvement of FSA[21]. In 1999, according to the formal information provided by Lloyd's there have been improvements in some areas like the documentation for the admission of corporate members, the introduction of an advance consent process and also a process that can be used by managing agents when they deal with transactions where a breach of a fiduciary duty may be involved [22]. Other areas in which this department focused on in 1999 are **agents' fees and profit commission, financial resource requirements for agents, captives and alternative risk transfer products, individual registration** and **coverholder and correspondent approval**[23].

The development area – mentioned above - was concentrated on the process of the agent's fee increase applications, the regulatory approach of fronting and on a review of the whole regulatory structure[24].

The priorities for 2000 as these were set had to do first of all with raising standards. This means that only top quality entries would be permitted and scrutiny of all the applications would be granted. Secondly, the boundaries with FSA would have to be clarified. This is quite a vital aspect according to the new regulations. Finally, accreditation of intermediaries and agent's fees and charges are areas that would be examined as well[25].

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[20] *Ibid.* Page 34.
[21] *Ibid.* Page 21.
[22] *Ibid.* Pages 22-25.
[23] *Ibid.*
[24] *Ibid.* Pages 25-26.
[25] *Ibid.* Pages 26-27.

1.6 Conclusion

The purpose of this chapter is the reference to a few aspects of how Lloyd's operates. Many of the regulatory departments mentioned above will be faced with a significant change now that **the General Insurance Standards Council** is responsible for the regulation of the UK brokers. As I cited above, details about GISC are given in the next chapter. However, I submit that the reference to how Lloyd's operates will make clear why the position of the insurance brokers and the insurance industry generally is such a changing environment.

CHAPTER

2 *Latest Developments*

2.1 Introduction

The position of the insurance brokers in the insurance market has been the center of discussions and research over the years. The reason is that there have been quite a few problems with brokers not doing their job properly. The most common problems have to do either with the duty of disclosure, to which I have referred to earlier, and with the premium that sometimes was much higher than what it should have been. The result is that this whole area is now a changing environment. In order to make things more clear, I will make a brief reference to the factors that made this need for change compulsory[1].

Until 1977, things were relatively simple. There were no formal qualifications for somebody to be an insurance broker. Everything was a matter of talent and experience. Only Lloyd's imposed a number of criteria that a broker had to meet, in order to be able to co-operate with Lloyd's. In 1977, however, things started to change. There was an immense need to "professionalise" the business of insurance broking[2]. This led to the passing of the **Insurance Brokers Registration Act 1977**. The effect of this Act was really significant. It was the first effort to regulate those who acted as insurance brokers. Of course, the brokers that did business for Lloyd's continued to be regulated by Lloyd's. This was done after a while through **the Lloyd's Byelaws**. This was a codified system, which dealt with registration, conduct of business and other important aspects of the insurance broking business[3]. The result of all these was that Lloyd's and the Insurance Brokers Registration Council addressed a few very important principles that a broker had to follow, in order to do his job properly. Although, the effort was very important, various problems existed in the conducting of the business. The main problem was that brokers always tried to maximise their brokerage. This is in a way logical, if we take into consideration the fact that, most of the times, everybody in the chain of intermediaries had to be paid from this brokerage. However, there have been many instances, where there was no real disclosure of the expenses involved and the brokerage was increased without the consent of the client. This procedure followed by the brokers was called "grossing

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[1] Pincott Andrew & Elborne Mitchell. London Insurance Brokers, A Changing Environment. Shipping and Trade Law. November 2000, Volume 1- Number 2.
[2] *Ibid.* Page 1.
[3] *Ibid.*

up". It is something, which would be completely right if consent was given, but this rarely happened[4]. The problems continued to remain unsolved and the disciplinary proceedings against the brokers increased. Another very significant aspect of the problems that had arisen was the fact that the 1977 Act dealt only with those acted as insurance brokers and not with any other kind of intermediaries, who as a result were not regulated at all[5].

2.2 The Reform

The Insurance Brokers Registration Act 1977 will be repealed on 30 April 2001 and a whole new system will be introduced. The differences will be very important. First of all, the **Insurance Brokers Registration Council** will be abolished. Its duties will pass on the **General Insurance Standards Council** – GISC- . This will be a self-regulated development by the insurance industry and not a system based on legislation. Another aspect of GISC will be that all the members will have a contractual relationship with it, and everybody who is involved in the insurance industry will be free to join. Also, everything will be regulated from branches in the United Kingdom irrespectively of where is the location of the risk of the customer[6]. Of course, customer codes will exist that will try to regulate the relationship between the parties. I am going now to make a brief reference to the obligations imposed by the Commercial Code in question [7]. The first obligation had to do with marketing. It is cited in paragraph 3 of the GISC Commercial Code that all advertising must be done in clear terms and not be misleading[8]. The others deal with the actual arrangement of insurance. One of the main issues is that the members must provide their customers with certain and accurate pieces of information. This information might have to do either with details of the proposed insurance or the customer's requirements. It is also stated that members should not in any case impose any additional fees other than the premium. Finally, there is also a duty of disclosure of the members to their commercial clients[9].

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[4] *Ibid.* Page 3.
[5] *Ibid.*
[6] *Ibid.* Page 4.
[7] *Ibid.* Pages 4-5.
[8] http://www.gisc.co.uk. Paragraph 3 of the GISC Commercial Code.
[9] http://www.gisc.co.uk. / Pincott Andrew & Elborne Mitchell. London Insurance Brokers, A Changing Environment. Shipping and Trade Law. November 2000, Volume 1- Number 2. Pages 4-6.

Moving on, it is cited that under the GISC scheme, the members must provide their customers with written details of the insurance in question. And the members will have to provide an on-going service to their customers; namely they will have to help their customers with the confirmation and the amendments of the policy. In respect of claims, it is stated that members have to give their guidance, so that their customers are fully informed. The same applies to possible complaints[10]. The next thing that needs to be said is that there are two Codes that are imposed under the GISC, **the Private Customer Code** and **the Commercial Customer Code** – mentioned above. I will make a reference to them later on[11].

It must be understood that the system has to overcome the problem of **the Competition Act 1998**. The reason for this is that GISC members will have to do business only with intermediaries, who are themselves, members of the GISC. This, of, course contains, an anti-competitive idea for which the system must be granted an exemption [12]. Also, the support of the London insurance market is essential for the system to operate. Groups of brokers such as the Institute of Insurance Brokers had opposed and expressed the indication to keep a separate regulatory system. However, uniformity is essential if GISC is to work properly[13]. Very important as I mentioned above is also the fact that the insurance business will be conducted from branches in the United Kingdom. It must be understood that brokers will have to comply both with the requirements imposed by CISC and by Lloyd's in order to be registered as Lloyd's brokers. The same procedure will apply for the brokers that conduct their business in Europe. Finally, it must be said that a few responsibilities will remain with Lloyd's such as a number of disciplinary proceedings[14].

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[10] *Ibid.*
[11] *Ibid.*
[12] Pincott Andrew & Elborne Mitchell. London Insurance Brokers, A Changing Environment. Shipping and Trade Law. November 2000, Volume 1- Number 2. Pages 5-6.
[13] *Ibid.*
[14] *Ibid.*

2.3 General Insurance Standards Council (GISC) System

It will be interesting at this point to look at the GISC in quite a more detailed view[15]. The Newro Executive Committee announced the creation of the General Insurance Standards Council by saying that it will be responsible for the regulation of the whole insurance business. It is obvious only from this kind of announcement how important this self-regulatory body is considered to be. This is how Anthony Howland Jackson, the chairman of the Executive, addressed his thoughts about GISC: *"the first consultation exercise addresses key questions about the GISC regime and will be central to shaping its future. GISC will stand for effective, independent, straightforward regulation with minimum bureaucracy. It will aim to ensure that all general insurance customers, from holiday makers buying travel insurance to commercial corporations considering the placement of their insurance programmes, are properly protected"*[16]. We can also look at the key objectives of the new scheme as these were announced by the Committee: *" to establish and enforce principles and rules designed to ensure that general insurance customers receive the appropriate degree of protection, taking account of the type of business and in particular the customer's knowledge and experience"* [17]. In a more specified way, it was also mentioned by the GISC that the regime will *"establish, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence for those it regulates"*, *"ensure that, as far as possible, policies which are proposed are suitable to the needs and resources of customers, and that customers are informed about the product they are buying and its price"*[18]. Finally, it will *"ensure that adequate systems are in place for dealing with consumer complaints and ensuring that redress is available"*[19].

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[15] http://www.abi.org.uk/hottopic/nr177.asp. News Release – 3 November 1998 – General Insurance Standards Council. General Insurance Standards Council to be set up.
[16] *Ibid.* Page 1.
[17] *Ibid.* Page 2.
[18] *Ibid.*
[19] *Ibid.*

2.4 Commercial Customer Code [20]

Some of the things mentioned in the Code, I have already talked about when dealing generally with the reform. As I said also above, this is not the only Code, since there is the **Private Customer Code** to which I will refer to after. Hence, the first part of the Commercial Customer Code is dedicated to the principles under which the Code operates[21]. The basis of these principles is that commercial customers must be happy with the service provided by the GSIC members. Some of their duties are to act with due skill and care and to conduct their business in a prudent manner[22]. After the theoretical principles there are a few practice notes[23]. I will just mention in which areas the practice notes are focused on. The first area is marketing[24]. After that, there are some very important details about arranging the insurance[25]. These are about Commercial Customer relationship, Commercial Customer requirements, and information about proposed insurance. Also, there is guidance about advice and recommendations, information about costs and remuneration, the duty of disclosure, quotations and placement. The next areas are that of the confirmation of the cover and the provision of an ongoing service, to which I have referred briefly earlier[26]. Finally, there are principles that are related to claims, documentation, conflicts of interest, confidentiality and security, complaints and the Commercial Code itself[27].

Introduction to the Private Customer Code [28]

The explanation of the Code starts with the products of general insurance, which may be covered. In these products someone can find insurance for his home, legal expenses insurance, travel insurance and other areas where an individual may require protection. Pensions and life assurance are excluded. After this there is a brief

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[20] http://www.abi.org.uk/hottopic/nr177.asp. Part dedicated to the Commercial Customer Code.
[21] *Ibid.*
[22] *Ibid.* Paragraphs 1.1 to 1.8.
[23] *Ibid.*
[24] *Ibid.* Paragraph 3.
[25] *Ibid.* Paragraphs 4-24.
[26] *Ibid.* Paragraphs 25-34.
[27] *Ibid.* Paragraphs 35-50.
[28] http://www.abi.org.uk/hottopic/nr177.asp. Part dedicated to the Private Customer Code.

explanation of what kind of protection is offered. Emphasis is given to the fact that the individual customer has the right to complain if he believes that he did not receive the adequate standard of service and that all the members of GISC are monitored, in order for GISC to be positive that they follow the principles of the Code. Finally, there is a section focusing on what an individual must expect from GISC members. For example, they must expect to be given unambiguous and correct information, to be sure that the members will handle their claims effectively and correct any kind of mistakes[29].

2.5 Private Customer Code

I am going to refer now to the Private Customer Code in a more detailed way. What this Code is, according to the definition given, is the setting of the minimum standards of good practice that the members of GISC must follow when they have to deal with private customers[30]. There is also a special part, which is dedicated to the understanding of the Code, although it is very small in length[31]. The formation of the Code is very similar to this of this of the Commercial Customer Code. The Code starts with the commitments of the GISC members[32]. The first area is again marketing[33]. After, there is a part dedicated to the finding of an insurance that will meet the customer's needs[34]. This is quite extensive and quite a few details are mentioned such as the explanation of the service given, the matching of the requirements given by the customer, the giving of accurate information in relation to products, services and costs and the "cooling-off period"- which means that under the Private Code, the space of 14 days will be given to customers from the day they receive the information about the requested insurance. Within these 14 days customers have the right to cancel their insurance cover and get all their money back[35]. The fourth part is about the confirmation of the cover[36]. This contains information about the actual confirmation

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[29] *Ibid.*
[30] http://www.abi.org.uk/hottopic/nr177.asp. Introduction of the Private Customer Code.
[31] *Ibid.*
[32] *Ibid.* Paragraph 1.
[33] *Ibid.* Paragraph 2
[34] *Ibid.* Paragraphs 3.1-3.10.
[35] *Ibid.*
[36] *Ibid.*

of the cover, the proof of payment and the documents of the policy. Moving on, we have information about the provision of the service by the GISC members. Here, someone can find information about how changes can be effected to a policy, notice of renewal and expiry or cancellation[37]. Afterwards, we have the parts that are about provision of service by the GISC members, claims, documentation and confidentiality and security[38]. Finally, the last two are dedicated to complaints and other relevant information. If someone reads all the pieces of information given, he will see that although it is not very analytical, it is very helpful for the customer. Especially when we talk about private customers this is very important because their level of expertise cannot be expected to be high.[39]

2.6 GISC Dispute Resolution Facility

According to the GISC scheme, its members are under an obligation to maintain membership of the Dispute Resolution Facility. This facility is actually operated by GISC Complaints Department. The only circumstance when such an obligation does not exist is when they are members of any of the eight dispute resolution schemes that will be brought together under the Financial Ombudsman Service [40]. However, there are some rules and some procedures that have to be followed. First of all, the complaint must be made on behalf of a private customer and concern the activities of a member with whom the complainant has direct dealings. And the complain could only go through only when the activities in question have occurred after the member has joined GISC. The GISC had the option to deal with the complain if it is not within the jurisdiction of the GISC Dispute Resolution Facility, to submit that it can be better dealt with by another complaints procedure or that is considered frivolous or vexatious [41]. As to the procedures that must be followed it is cited in the explanatory guide that the Dispute Resolution Facility must operate from GISC premises, provide an Advice desk for information and act as a counsellor in order to solve any problems. The appendix of the GISC deals first of all with the

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[37] *Ibid.*
[38] *Ibid.* Paragraphs 5.1-8.2.
[39] *Ibid.*
[40] http://www.abi.org.uk/hottopic/nr177.asp. Part dedicated to the GISC Resolution Facility.
[41] *Ibid.*

aspect of jurisdiction. The second paragraph is dedicated to the functions of the Resolution Facility. Finally the last two are about the duties and the powers given by the GISC scheme to the GISC Resolution Facility[42].

2.7 Conclusion

It is necessary to examine at this point – after mentioning above a few basic things about how the General Insurance Standards Council Dispute Resolution operates – what are the procedures when a broker is reported to have misbehaved. GISC through monitoring visits and investigations tries to keep an eye on its members. Hence, when there is something that leads to the conclusion that there is an act of misconduct on the part of the GISC member an investigation may take place and it must be noted that part or all the costs should be borne by the member. Moreover, GISC has the right to require from the member in question any kind of information that is considered to be relevant[43]. The second aspect that needs to be examined in relation with misbehaviour from a member is that of *enforcement.* If GISC submits that there are grounds that a member has committed an act of misconduct, then the case is referred to the Enforcement Committee, which must decide within 20 business days whether or not to take disciplinary action against the member after serving both on him and GISC a Warning Notice[44]. This Notice contains a statement and particular facts of the misconduct, details about the member's disciplinary record and the proposed penalty. When the meeting of the Enforcement Committee takes place a Decision Note is served on the member. If however the member does not agree with it, he has the right to refer the case to the Disciplinary Tribunal where the burden of proof is on the part of the GISC. The chairman of the Tribunal must decide the exact procedure that will be followed in the Disciplinary Tribunal hearing. Of course there is a permission to appeal by any party within 10 business days[45]. Finally, GISC has the right of *intervention.* This means that when GISC believes that a member has committed or is likely to commit an act of misconduct or cannot engage in his activities, it can intervene in order to stop or limit

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[42] *Ibid.*
[43] http://www.gisc.co.uk. Section H – Monitoring and Investigation.
[44] http://www.gisc.co.uk. Section I – Enforcement.
[45] *Ibid.*

the member's activities[46]. An Intervention Order will make specific the particular steps that a member is forbidden from taking, the date and time that the Order will take effect, the period that it will operate and the reasons for it. Again, the member has the right to apply for a stay of or appeal in respect of the Order[47].

We can clearly see from the above that the GISC scheme is an effort to improve the previously existing situation. I mentioned above quite briefly some of the problems that have to be faced. Insurance broking is a very complex job. A number of factors such as personal relations, experience and unprecedented events can influence an insurance policy. It is very important that quite a lot of pressure is moving from Lloyd's to GISC. The theoretical part of the scheme seems to be quite well established. The problem is how this theoretical background will be addressed in practice. This will be the decisive factor according to which an improvement may take place or everything will remain the same but for the theoretical background that will make no difference at all. It is up to everybody that is concerned with the operation of the insurance industry to try and make it work.

[46] http://www.gisc.co.uk. Section J – Intervention.
[47] *Ibid.*

CHAPTER

3

Dual Role Of Brokers- Premium- Liens

3.1 DUAL ROLE OF BROKERS

3.1.1 Introduction

The field of reinsurance is quite a complex one in the maritime world. The first thing that needs to be mentioned is that quite relevant to it are some basic concepts of agency law. I am going to make a very brief reference at this point to them, in order for the relationship between the parties- broker, insured, and reinsurer – to be easily understood. It is quite clear that in a marine contract of insurance the broker is in the beginning the agent of the insured although there are exemptions to this general rule. There are some types of contract in which a broker can enter with his client. The contract can be for a particular purpose and when this purpose is achieved, the contract is terminated. Also, it can be for all insurance purposes. His duty is to exercise his activities with due care and skill. What an agent can or cannot do during the transaction where the contract comes into existence is a matter of authority. It all depends on the extent of authority that is given by the principal to his agent. This authority can arise either from the direct orders given by the principal or it can be implied authority. Also, it can be apparent or ostensible authority or agency of necessity. Another rule that needs to be mentioned is that it is not necessary that an agent should not have contractual capacity in contrast with the principal who must have full contractual relationship. However, I do not intend to analyse this here. Perhaps, the only thing that must be said now is that when we deal with reinsurance, the problem is that there is a chain of parties that a broker is related to and it is possible for him to change principals from one time to another [1]. An example is, when a broker is asked to place a retrocession cover, he suddenly becomes the agent of the reinsurer.

3.1.2 Differences between direct insurance and reinsurance

It is time now to cite some differences between reinsurance and direct insurance as far as the role of the brokers is concerned. First of all, in reinsurance, there is no consumerism and both sides are professionals [2]. This means in simple words that the procedure becomes quite more complex, but on the other hand

[1] O'Neill P.T & J.W Wolonieski. (1998). The Law of Reinsurance. Sweet & Maxwell. Chapter 9.
[2] *Ibid.*

mistakes are not made so often, because of the expertise of the parties that are involved [3]. Secondly, there is a difference, in respect of liability. In cases of reinsurance, there is no liability on the part of the broker for the payment of the premium [4]. In direct insurance, so far as marine cases are concerned, the brokers are liable in relation to premiums [5]. In non-marine cases, things are not so clear. It depends again on arrangements between the parties [6]. Thirdly, as I have already mentioned above, in the context of reinsurance, although the broker will place the original insurance as the agent of the insured, afterwards he becomes the agent of the reinsurer in placing the reinsurance cover [7]. A relevant case is **Vesta v Butcher** [8]. It was a case about fish farms. The facts were as follows. A fish farm in Norway was insured with the plaintiff Norwegian insurance company that actually reinsured 90 per cent of the risk in question with Lloyd's underwriters. Two were the important aspects of the reinsurance policy. The first one was that the reinsurance policy was arranged to be "back to back" with the original insurance policy. This simply means that the two insurance policies needed to be on identical terms. The second aspect was that in both the original insurance policy and the reinsurance policy an identical provision was contained that a 24-hour watch should be kept on the farm. This did not happen but the problem was that under Norwegian law this could not provide the insurer with a defence. The position was very different in English law under which the insurer was entitled to repudiate liability. As a result, Vesta brought an action against the reinsurers and the firm of the brokers. In respect of the action about the 24-hour watch clause, it was held that since the two policies were "back to back" the reinsurance policy had to be governed also by Norwegian law, which did not provide the Lloyd's underwriters with a valid defence and not according to English law that would render the policy null and void. This case, at the court of first instance and the Court of Appeal , dealt also with aspects of contributory negligence, breach of the warranties

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[3] *Ibid.* Paragraph 9-13.
[4] O'Neill P.T & J.W Wolonieski. (1998). The Law of Reinsurance. Sweet & Maxwell. Chapter 9.
[5] *Ibid.*
[6] *Ibid*
[7] *Ibid*
[8] (1988) 1 Lloyd's Rep. 19.

and breach of duty by the brokers. In the court of first instance, in respect to the action against the brokers, it was held that although the brokers were under a professional duty to Vesta, their breach did not cause the actual loss. On cross-appeal by the brokers, it was decided that there was no doubt that the brokers were acting in a dual capacity and that it would not be concluded that the brokers were not authorised to act on behalf of the reinsurer. Sir Roger Ormrond stated: "*in he first place, the brokers were not acting in the conventional role of Lloyd's brokers- exclusively as agents for the client (Vesta)... They designed the form of words and they negotiated with underwriters for the approval of these words...the inevitable and obvious conflict of laws seem to have been completely overlooked*" [9]. From the above case, it is obvious that it can be easy for a broker to become involved in a situation where he can be in a kind of conflict with his principal(s). Whether his dual capacity is accepted or not by courts or by insurance practice and if so under which circumstances is something that will be discussed below. Fourthly, in the context of reinsurance there is a difference in the standard of the duty of the utmost good faith that is required by the broker. This will probably be higher, because all information that is given is the result of expectation and facts [10]. Finally, there are two more differences that I must refer to. The first one is that when we have a reinsurance open cover- I will analyse this later on [11]- the broker has the right to bind both the reinsurer and the reinsured [12]. The second is that in a reinsurance contract, the ability of the draftsman that deals with the wording is much more relevant [13].

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[9] *Ibid.* Page 33. Per Sir Roger Ormrond.
[10] O'Neill P.T & J.W Wolonieski. (1998). The Law of Reinsurance. Sweet & Maxwell. Chapter 9. Paragraph 9-13.
[11] Look at the chapter about Binding authorities and Brokers.
[12] O'Neill P.T & J.W Wolonieski. (1998). The Law of Reinsurance. Sweet & Maxwell. Chapter 9. Paragraph 9-13.
[13] *Ibid.*

3.1.3 Dual Capacity of the Brokers

So, what about the dual capacity that a broker may have? It is more or less accepted that brokers can be involved in several kinds of activities. It is possible for a broker either to place direct insurance for the insured or while acting for his principal to become involved with a reinsurance contract and place cover with the reinsurer. Even, if a retrocession contract takes place, a broker can become the agent of the reinsurer. Also, a broker may act under a binding authority or be an intermediary through whom claims, premiums and accounts are settled. In the case of **Vesta v Butcher** that I referred to in the introductory part, it is obvious how difficult this can be. Sometimes, a broker even without fraud or any other misconduct on his part can get confused with the number of principals he may have during each stage of a transaction. It would be quite helpful to look at some of the cases. In **Trading and General Investment Corporation and another v Gault Armstrong and Kemble Ltd** [14] – or briefly **the Okeanis** case – the main question that was addressed to the court related as to whether an Italian company acted as sub-brokers or as agents of Italian underwriters and if there could be recovery for the plaintiffs from the brokers. Actually, the plaintiffs owned the vessel in question – *Okeanis* -. GAK were Lloyd's brokers and they were the placing brokers for the marine risks of the owners of the vessel in question. Italrias, an Italian company, was the company whose role has to be discussed. GAK approached Italrias in order to place the risk in respect of the vessel *Okeanis* in the Italian insurance market at rates lower than those prevailing in the London insurance market. As a result, 15 per cent of the whole risk was placed through Italrias in the Italian market and a cover note was issued by GAK to the plaintiffs in 1976. At renewal, after one year, another company called Mutuamar Ltd. agreed to take up the 15 per cent mentioned above, because the Italian underwriters did not agree to a renewal at the reduced rates that the plaintiffs wanted. Again a cover note was issued to the plaintiffs. In January 1978 *Okeanis* suffered damage to her engines. When the time for renewal came again, Mutuamar Ltd. declined to renew but Italrias agreed to place a smaller percentage with another Italian underwriter. However, by the time that Italrias placed the percentage, a payment was made by

[14] (1986) 1 Lloyd's Rep. 195.

London underwriters in respect of the damage in the engines of *Okeanis*. The result was that GAK asked Italrias for an amount of money in respect of a second payment made by London underwriters and in respect of Mutuamar's 15 per cent share. The Italian company denied to pay and submitted that they were not obliged to pay. The plaintiffs on their part brought an action against GAK and the issue that arose was whether Italrias acted as sub-agents for GAK. The court held that Italrias could not be accepted to act as a sub-agent of GAK. According to the facts the Italian company was deemed to act as agents of Italian underwriters. If one reads the judgement of Bingham J., the complexity of the relationship between the parties of the contract is not surprising. In his own words he concluded that *"although the evidence is not entirely satisfactory, I find myself in little doubt but that the Italrias should be regarded as agents of the underwriters. The evidence on which the plaintiffs relied to show a sub-agency was not very convincing... It does on the other hand seems clear that GAK on the other hand regarded Italrias as agents for a number of Italian underwriters and not as agents on their own behalf"*. In order to be proved that Italrias were the sub-agents of GAK, it should be shown that Italrias had received cash or credit or settled in account with Mutuamar. This was not proved to be the case. However, the plaintiffs were entitled to recover the premiums held by GAK on behalf of them and never paid or settled in account with Mutuamar [15]. The importance of this case lies on the fact that it is quite usual, even if this is not the intention of the parties, for a broker, although he performs his duty, to have to face problems about whom he is acting for.

The next case I am going to refer to is a non-marine one: **Kelly v Cooper** [16]. Here, the situation was quite different and the defendants were estate agents. The argument that was raised by the plaintiff had to do with the duty of disclosure of all material facts that an agent has towards his principal. More precisely, the estate agents dealt with the sale of two adjoining properties. These were both sold to the same buyer, something that the agents failed to disclose before the sale to the second vendor. The decision was in the court of first instance that the defendants were in breach of their duty of disclosure, so, they could not recover their commission. This outcome was reversed on appeal. Lastly, on appeal by the plaintiffs again, the appeal

[15] *Ibid.* Page 198. Per Bingham J.
[16] (1993) A.C. 205.

was dismissed [17]. The reasoning of the decision was very much based on public policy concerns. In brief, the court stated that the nature of the business of the estate agency is such that it is expected that the agents will act on behalf of a number of principals. Therefore, since this situation is quite known to everyone, it would not be fair and reasonable for estate agents to impose on them, under implied terms of the agency agreement, a duty to disclose facts, which are related to other principals. This case is a classic example of how difficult the role of an agent can sometimes be. Although, on this occasion, the brokers were not agents of both the insured and the insurer in the same time, it was just the nature of their business that put them in such a difficult position.

Quite interesting in respect of all the above about the role of the brokers is the decision of Hirst J. in the case of **IGI Insurance Co.Ltd v Kirkland Timms Ltd QBD, Commercial Court (unreported)** where it is stated in the judgement that *"when the broker administered claims and premiums between underwriters and brokers, while holding a binder he was an intermediary with agency obligations to both parties"* [18].

3.1.4 Conclusion

There are actually quite a few difficulties in relation to the position of brokers and one of the reasons is that the relationship between the brokers and the others is usually governed by what is implied by law and not by written documents. This means that in each case different rules may apply. It is a matter of business and legal practice. Another reason is that the law of agency is not a part of any code. And this creates practical and theoretical obstacles. An example will make things much more clear: it is very common in Lloyd's for underwriters to use brokers for claims assessor or loss adjusters without the insured's knowledge. In the case of **North & South Trust Co. v Berkeley** [19], the court held that this was completely unacceptable and could not be justified to be a legal custom. This can only happen if the insured gives his consent. This case played a very significant role in the **Kelly v Cooper** case at the court of first instance. The principle that was upheld as it is directly quoted from the

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[17] *Ibid.*
[18] O'Neill P.T & J.W Wolonieski. (1998). The Law of Reinsurance. Sweet & Maxwell.
[19] (1971) 1 W.L.R. 470.

decision is *" an agent cannot lawfully place himself in the position, in which he owes a duty to another, which is inconsistent with his duty to his principal, but if nevertheless he does so, his action is not a nullity. Thus his unlawful act provides him with no defence to a claim by his true principal for compensation of loss resulting from the agent's inability, due to the conflict of duties, fully to discharge his duty to that principal"* [20]. This was the exact principle that was followed in the court of first instance in **Kelly v Cooper** case, but it was reversed on appeal [21].

[20] *Ibid.* Page 471.
[21] (1993) A.C 205.

3.2 PREMIUM

3.2.1 Introduction

The payment of the premium is one of the factors, which is pivotal to the relationship between the parties of an insurance contract. It is also one of the areas, where significant changes are taking place. This means that some of the traditional cases, which are going to be mentioned, will have to be viewed with a different scope. The basic reason for the changes is a decision that was taken by the Lloyd's Insurance Broker's Committee in October 1997[1]. It related to the payment of the premium and according to it, it was said that underwriters would not hold brokers liable for premiums where there is a fault on the part of the assured. This was to take effect for every premium after 31st August 1996. I am going to refer to the significance of all these later on together with some of the cases, which were the direct result of this change.

3.2.2 Marine Insurance Act 1906

I will start with the traditional view of the law towards the premium. **MIA 1906** deals with this in quite a detailed way. The main section is **53(1)**: *"Unless otherwise agreed, when a policy is effected on behalf of the assured by the broker, the broker is directly responsible to the insurer for the premium, and the insurer is directly responsible to the assured for the amount, which may be payable in respect of losses or in respect of returnable premium"* [2]. According to **subsection (2)**, *"unless otherwise agreed, the broker has, as against the assured, a lien upon the policy for the amount of the premium and his charges in respect of effecting the policy; and where he dealt with the person who employs him as a principal, he has also a lien on the policy in respect of any balance on any insurance account which may be due to him from such person, unless when the debt was incurred he had a reason to believe that such a person was only an agent"* [3]. The importance of section 53(1) is obvious, since it regulates the responsibilities that arise between the parties. So, the broker is

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[1] Lloyd's Insurance Broker's Committee. LIBC No. 69/97.
[2] Chalmers D. Mackenzie. (1966). MIA 1906. 6th edition. Page 70.
[3] *Ibid.*

deemed to be directly liable towards the underwriter for the premium. It must be stated that this was the position of the insurance market before the commencement of the MIA 1906. In the case of **Power v Butcher** [4] Beyley J. said: *"according to the ordinary course of trade between the assured, the broker and the underwriter, the assured does not in the first instance pay the premium to the broker, nor does the latter pay it to the underwriter. But, as between the assured and the underwriter, the premiums are considered as paid. The underwriter, to whom, in most instances, the assured are known, looks to the broker for payment, and he to the assured. The latter pay the premiums to the broker only, who is a middleman between the assured and the underwriter. But, he is not merely an agent: he is a principal to receive the money from the assured and to pay it to the underwriters"*[5]. This statement exactly shows what is the mechanism according to which the relationship between the broker, the assured and the underwriter is governed.

Moreover, **section 54** provides that *"where a marine policy effected on behalf of the assured by a broker acknowledges the receipt of the premium, such acknowledgement is, in the absence of fraud, conclusive as between the insurer and the assured, but not as between the insurer and the broker"*[6]. This section is very significant in respect of the effect of the receipt of the premium.

It is time now to deal with the classic case of **Universo Insurance Co. of Milan v Merchants Marine Insurance Co.** [7]. The action here was brought by an insurance company against the assured. The main argument of the case had to do with the question whether the custom, according to which, the broker and not the assured was liable, was to be followed or not. There was a dictum by Collins J., which has been proved to be very influential: *"it is a very well-recognised practice in marine insurance for the broker to treat himself as responsible to the underwriter for the premiums, by a fiction he is deemed to have paid the underwriter, and to have borrowed with him the money with which he pays"*[8]. This statement seems to explain in quite an adequate way why the custom of the liability of the broker exists as it is.

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[4] (1829) B and Cr. 329.
[5] *Ibid.* Page 340.
[6] Chalmers D. Mackenzie. (1966). MIA 1906. 6th edition. Page 71.
[7] (1897) 1 Q.B. 295; 2 Q.B. 93.
[8] *Ibid.* Page 101.

3.2.3 Non-Marine Risks

I will talk about the situation where the risk that is placed is a non-marine one. The provisions of **the Marine Insurance Act 1906** do not apply here. However, it is not so clear whether the broker is liable under these circumstances. The case of **Wilson v Avec Audio –Visual Equipment Ltd.** [9] is very relevant. The broker was instructed to obtain cover against burglary and goods in transit for the defendants. The plaintiff in the case was the broker who effected the insurance policies. The policies were arranged with a company, which was eventually wound up. The result was that the defendants submitted that they would pay the amount of premiums until the liquidation of the company, so, that this amount would be passed to the liquidator, but nothing after that period. Despite this, the liquidator asked the plaintiff to pay the whole amount and they did so. After that, the argument on behalf of the plaintiff was that he should be indemnified by the defendants on the basis that he was personally liable to the company, which was liquidated in relation to the premiums. The decision of the court was that it could not be accepted that the plaintiff was personally liable. The broker was wrong to believe this and as a result, the judgement was for the defendants. Simply, he assumed to be in the wrong legal position vis-à-vis a third party. For an agent to become personally liable there must be very special circumstances, which must exist. These circumstances have to do with the relationship between the agent and the principal. John Butler wrote a paper, which dealt with **the Wilson case** and it will be quite interesting to try and understand what his conclusions were by assessing his thoughts and quoting some extracts of the paper[10]. The first thing that he concluded was that the case was not fully argued in the court of first instance and this could create problems to the analysis of the case. He then quoted himself a part of the judgement of Lord Justice Edmund Davies: *"it requires clear and precise evidence of a very special relationship before an agent can be rendered personally liable in respect of a contract entered into on behalf of his principal. The sole basis of the claim brought in the present case that such a relationship existed. There was no clear or precise evidence"*[11]. It is obvious that it is not easy at all for

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[9] (1974) 1 Lloyd's Rep. 81.
[10] Shaw Gordon. (1995). The Lloyd's Broker. Lloyd's London Press. Pages 103-105.
[11] Wilson v Avec Audio –Visual Equipment Ltd. (1974) 1 Lloyd's Rep. 81. Per Lord Justice Edmund Davies.

such a relationship to be established. And this is one of the reasons why the situation is not so clear when there are non-marine contracts that need to be concluded. When we are dealing with Lloyd's brokers it can be ascertained that they are liable to underwriters: *"The Lloyd's broker hereby undertakes that it will at all times indemnify the underwriters...against non-payment ...not-withstanding that the Lloyd's broker may...be unable to collect ...payments from assureds or from the non-Lloyd's intermediary"* [12]. The position of a broker is very difficult according to this statement, because it seems that it does not matter whether it is the broker's actual fault or not in respect of the premiums. He will still be liable. Whether an insurer would bring an action against a major broker, when he knows for example that it was important for him to collect the premiums, this is another matter. The insurance market has sometimes its own risks in practice and when an insurer needs quite often the services of a broker; he would not bring an action against him on every occasion.

3.2.4 The Position of the Assured

What is the position of the assured? According to the custom, he is liable to the broker whether or not the money he gave for the premium has in fact been paid off or not. The payment of the premium by the assured or the broker is a concurrent condition with that of the insurer to issue the policy. **Section 52** of the MIA 1906 provides that *"unless other wise agreed, the duty of the assured or his agent to pay the premium, and the duty of the insurer to issue the policy to the assured or his agent, are concurrent conditions, and the insurer is not bound to issue the policy until payment or tender of the premium"*[13]. So, because of this section, no policy can be issued if the premium is not paid. The solution, which was found in order for the

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[12] Hodgin Ray W. Insurance Intermediaries and Regulation. Lloyd's of London Press. 1992. (Revised to May 1995). Page 5-815. May 1995). Page 5-815.
[13] Chalmers D. Mackenzie. (1966). MIA 1906. 6th édition. Page 70.

conclusion of insurance contracts to flow in a proper way, was that the premium was considered to be paid[14]. It must be said however that as the assured was liable to the broker immediately, the same applied when the assured was entitled to claim the return of premiums. He was more or less immediately entitled to recover them from the underwriter. However, it must be said that there can be circumstances under which the liability of intermediaries - and in respect of the payment of premium - and the position of the assured can become a much more complicated issue. An example of this is where an umbrella arrangement takes place. In the case of **John v Kelly** that is mentioned in detail in chapter 7 the liability of intermediaries under an umbrella arrangement was the main issue. The Lloyd's broker in this case was held to be liable for the actions of the non-Lloyd's broker. In respect of the payment of premium, if for example a non-Lloyd's broker becomes insolvent and fraudulently keeps the premium, the Lloyd's broker will be liable to the assured in tort. Finally, when there is illegality, again things change. The underwriter or any other party is not entitled to recover any money for premiums that have to do with insurance or reinsurance contract, which is illegal[15].

Conclusively, everything depends on the authority – implied, or actual – that the agent has and on the facts of each particular case.

3.2.5 Recent Cases

I am going to make a reference to a few recent cases to examine how the courts have reacted to cases where the premium was one of the main issues. The first case I am going to refer to is **Figre Ltd. v Mander**[16]. The facts were as follows. CBC was a firm of Lloyd's brokers, which was instructed to obtain reinsurance for a US insurer called PMMI. The cover, which had to be obtained, was for the year 1984. The broker obtained a quotation for retrocession cover for any potential reinsurers. On March 1984, the plaintiff wrote a 5 per cent for the reinsurance of PMMI. However, this was subject to the retrocession cover. After four days CBC sent a cover note to the plaintiff – the insurer of the retrocession cover - for the confirmation of the terms

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[14] Shaw Gordon. (1995). The Lloyd's Broker. Lloyd's London Press. Chapter 12.
[15] *Ibid.*
[16] (1999) Lloyd's Law Rep. 193.

of the retrocession cover. And on March 22, the defendant – PMMI - gave an effect to an amendment to the slip. According to it, the plaintiff was classified as a party. And on January 1985, CBC sent debit notes to the plaintiff in relation to the deposit premium due. On November 1985, 1985, the plaintiff's agents wrote to CBC seeking confirmation of the balances due. After a calculation of the adjusted premium due from PMMI to the plaintiff, another firm – J & H – approached the defendant and tendered the original premium plus interest on behalf of the plaintiff. The defendant did not accept this proposal[17]. The final reply of the defendant was that no retrocession contract existed. The result was that the premium could not be accepted after such a long period. The **Lloyd's Policy Signing Office** was given instructions accordingly. There was a commencement of proceedings by the plaintiff. The main issue was a declaration that the contract of retrocession really existed and the sum claimed was the outstanding claims. On the other hand, the argument on the part of the defendant was that there was a repudiation of contract by the plaintiff that was accepted by the defendant[18]. The plaintiff was deemed to be entitled to the declaration.

The next case I am going to mention is **Society of Lloyd's v Jaffray** [19]. This case was concerned with Lloyd's Names. The proceedings were for the recovery of premium. The allegation on the part of the Names was that from 1980 and onwards they became members of Lloyd's by fraudulent inducement. Also, they argued that the renewal of their membership each year took place because of a fraudulent misrepresentation by Lloyd's[20]. Finally, they submitted that one of the consequences of their membership was that because of a Reconstruction and Renewal Agreement where a "pay now sue later" provision was included, the Names had to pay premium for covers obtained without set-off in relation with sums owing to them[21]. Hence, as a result of all these, the Society made an application to have the proceedings stayed but this was not upheld. In respect of the recovery of the premiums and costs it was held

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[17] *Ibid.*
[18] *Ibid*
[19] (1999) Lloyd's Rep. 182.
[20] *Ibid.*
[21] *Ibid.*

that Lloyd's was entitled to ask for the premiums and all the relevant costs and orders that were made in favour of Lloyd's earlier could not be changed [22].

3.2.6 Set – Off

This is quite a common practice in the insurance market between two parties although sometimes especially in the reinsurance field an intermediary can be involved. For example if A is sued by B for a sum of money but at the same time B owes to A another sum of money, then, set-off is requested. It must be said at this point that legally, set-off is a defence to the original claim. One quite common category of cases is when an insurance contract results in unliquidated damages. This creates problems because a right of set-off cannot be utilised. The reason for this is that damages have to be liquidated. However, the whole matter is not as vital as it used to be in older times, because now the parties have the alternative solution of counterclaiming. This will have merely the same effect, as the only significant difference is that relating to costs[23]. In the case of set-off, the costs must be calculated in relation to the net sum recovered as in the case of a counterclaim where the plaintiff is entitled to the costs of the claim and the defendant to the costs of the counterclaim, following, of course, the court's discretion[24].

The only situation, where it can be submitted that the right to set-off is still important is in the case of bankruptcy of the parties. The relevant act is **the Bankruptcy Act 1914**[25]. The significant section of the Act is **section 31**, according to which someone has the right to set-off, only if there was some kind of mutuality between the parties. This, in other words, means those mutual debts, credits or any

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[22] The cases of **Society of Lloyd's v Fraser** ***(1998) CLC 127, (1999) Lloyd's Law Reports IR 156 (CA)*** and **Society of Lloyd's v Leighs and Others** ***(1997) CLC 1012, (1997) CLC 1012 (CA)*** were discussed and applied.

[23] O'Neill P.T & J.W. Woloniecki. (1998). The Law of Reinsurance. Sweet & Maxwell. Paragraphs 11-54.11-72

[24] *Ibid*

[25] See also the Insolvency Act 1985 and Insolvency Act 2000.

other similar agreements have to exist[26]. From the things that are discussed above, someone can see that it is not easy at all for such a kind of mutuality to exist.

I am going now to compare two cases that deal with the aspect of mutuality. First of all, **Wilson v Creihton**[27]. The action was brought by the assignees of a bankrupt underwriter. The defendant was an insurance agent and the point of the action related to premiums. On his part, the defendant tried to set-off losses and premiums. It is important to mention that the defendant had not acted ***del credere***[28], but as a usual agent acting for his foreign principals. It was held by the court that set-off could not be established, because simply there was no mutuality[29]. On the other hand, in **Grove v Dubois** [30] the facts were quite similar. The only difference was that the agent acted ***del credere***, but this seemed enough for the defendant to be entitled to set-off under a mutual credit clause. It must be said at this point that a right of set-off can exist also in respect of premiums.

3.2.7 Conclusion

This is the position as it was established in very old and authoritative cases. But as I said above, the situation is not the same any more. After discussions between Lloyd's and Lloyd's Insurance Brokers Committee, it was decided that after 31st of August 1996, underwriters would not hold brokers responsible for premiums, when the assured is at fault. There are some requirements that need to be fulfilled in order for the brokers not to be held liable. These requirements were the result of discussions. One of the aims was actually to try and change the position as it was until this agreement, but at the same time without interfering with the provisions of **the**

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[26] O'Neill P.T & J.W. Woloniecki. (1998). The Law of Reinsurance. Sweet & Maxwell. Paragraphs 11-54 – 11.72.
[27] 3 Dougl. 132.
[28] An agent acting *del credere* is when he agrees to protect his principal against the other party's insolvency.
[29] For more details see judgment.
[30] (1786) 1 T.R. 112.

Marine Insurance Act 1906. A Code of Conduct had to be established. This Code was based on the following principles: ***(1) Brokers and underwriters should not knowingly do business with clients likely to default. (2) Brokers should inform the leading underwriter without delay when knowledge of a likely default is known. (3) Brokers should make any endeavour to collect the monies owing and pass them to underwriters without delay. Underwriters to be supportive of these endeavours"***[31]. These principles are very significant in order for this agreement to work properly. However, there were also some undertakings, which had to be combined with above principles. These were ***(1) Underwriters acknowledge and accede to the terms and intent of David Rowland*** – the President – ***letter of 31st July 1996. (2) The brokers acknowledge section 53(1) of the Marine Insurance Act 1906 where insurance policies are governed by English law, but no broker will be held liable for premium unless it is evidenced that the broker has been in breach of any the three broad principles. (3) If a broker has been in breach of the three broad principles and the insurance policy is governed by English law, underwriters have the option to invoke section 53(1) of the Marine Insurance Act 1906, in respect of that insurance. (4) A small panel of one underwriter, one broker and an independent chairman (none of whom shall be party to the insurance concerned) shall adjudicate on compliance with the three broad principles. (5) In the event of any of the foregoing imposes on a broker obligations which conflict with his duties of agency to the assured, underwriters acknowledge that those duties of agency shall prevail***[32].

This is the theoretical basis for the new agreement. The main question now is how the insurance market will react to this change of rules.

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[31] Lloyd's Insurance Broker's Committee. LIBC No. 69/97.
[32] *Ibid.*.

3.3 LIENS

3.3.1 Introduction

A very important part of an insurance broker's rights is his entitlement to a lien. This is actually reflected in **section 53(2)** of the **Marine Insurance Act 1906:** *"unless otherwise agreed, the broker has, as against the assured, a lien upon the policy for the amount of the premium and his charges in respect of effecting the policy; and where he has dealt with the person who employs him as a principal, he has also a lien on the policy in respect of any balance due on any insurance account which may be due to him from such person, unless when the debt was incurred, he had reason to believe that such person was only an agent"* [1]. This lien is general. There are some circumstances, under which this may change, but I am going to refer to them further down. First of all, I will try to summarise the background of liens generally, in order to ascertain and clarify the position of brokers in relation to them. The thing that needs to be said is that insurance brokers are not the only ones, who are entitled to a lien. There are also other persons that are related to the marine industry and they have a right to make claims, which are secured by a lien. These people range from, for example the crew of a vessel to the person who simply repairs a ship.

3.3.2 Types of Liens

A lien is nothing more than a type of legal security. And it is something, which is created not by agreement between the parties but by operation of law. As a starting point, we need to say that there are several types of liens [2]. The first type of liens is **a possesory legal lien** [3]. It is thought actually to be the most important class of all. What must be noted here is that possession is a very vital factor for a legal lien to be constituted. An example where a legal lien is created is by stockbrokers or bankers. There is also **a non-possessory lien** [4]. This can exist in equity, by statute or under a court order. Examples of this kind of lien are that of a trustee on a trust estate or that

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[1] Ivamy E.R. Hardy. (1966). Chalmers' Marine Insurance Act 1906. Butterworths, London. 6th edition. Pages 70-71.
[2] Halsbury's law's of England. (1983) Volume 28: Liens.4th edition. / Goode Roy, (1995), Commercial Law. Penguin Books. 2nd edition. Pages 668-670.
[3] *Ibid.*
[4] *Ibid.*

of a solicitor as a security for his costs. The difference between the two is that in the latter one possession is not essential, although the right that is conferred is analogous to that of a legal lien. The third type of lien is **an equitable lien** [5]. It operates by law and not by contract. By its nature it can be exercised over both personal and real property but it is inapplicable to a contract of sale of goods. Next one is **the statutory lien.** This simply arises by statute and an example is that of an unpaid seller under the **Sale of Goods 1979**.Moving swiftly on, we have **the contractual lien.** The main thing that needs to be said about it is that it is very much influenced by the terms of its particular contract. And there is also another kind of lien, **the subrogatory lien** [6]. This takes place when there is a primary and secondary liability of two persons for the same debt. Finally we have **the maritime liens** [7]. The effect of the maritime lien is that it remains attached to the property even if there is a change in the ownership. It does not as well depend on possession.

3.3.3 Brokers' Liens

It is time now to move on and focus on insurance brokers' liens. Generally, as I mentioned above, a broker enjoys a general legal lien. The only reason when this is not applied is when a broker discovers that he is a sub-agent [8]. Under these circumstances, he will have a general lien until the moment of the discovery and a specific lien afterwards [9]. The case in point is **Near East Relief v King, Chasseur & Co. Ltd** [10]. I will summarise quite briefly the facts of the case. The plaintiffs were an American corporation, which were interested in a certain amount of money. This amount was the result of seven cases of goods shipped by them. The defendants effected a marine insurance policy as insurance brokers at the request **of the Marine**

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[5] *Ibid.*
[6] *Ibid.*
[7] For more details see: Hill Christopher. Maritime Law. (1998). Lloyd's Practical Shipping Guides. 5th edition. Pages 121- 129.
[8] Bennett Howard. (1996). The Law of Marine Insurance. Clarendon Press, Oxford. Page 102.
[9] *Ibid.*
[10] (1930) 2 K.B. 40,46.

and General Insurance Agency, acting on behalf of the plaintiffs, **the Argonaut Marine Insurance Company**. The claim from the plaintiffs was that the defendants effected the insurance on their behalf and as a result, it was their property. On the other hand, the defendants based their claim on the argument that they had a lien on the policy in relation to the premiums that were owing to them. Wright J. was quite analytical in his reasoning for the decision. The first point he focused on was the fact that in respect of a particular lien that could arise for a certain amount of money – 41.9s. -, the claim could not be established, because the debt has been paid off. The precedent for this conclusion was in the case of **Levy v Barnard** [11], in which payments had been made and although there was no appropriation, a running account was considered to have been paid off. However, the main issue was *"whether or not there is a general lien of which the defendants can avail themselves against the plaintiffs?"* [12]. The question is directly relevant to section 53(2) of **the MIA 1906**. It must be noted, that the language that is used in the statute is not very straightforward and as a result the crucial question is whether or not the brokers had reason to believe that their employers were only agents and not principals. In the case of **Maans v Henderson** [13], it was held that this question could be answered by inference. Anyway, in respect of that question and after the reviewing of the evidence, Wright J. decided that the Marine and General Insurance Agency were only agents and as a result the defendants were not entitled to a lien.

The second question deals with the fact that the defendants sent the insurance policy to the Argonaut Marine insurance Company, which after a couple of months returned the policy to them. According to the judge, this event makes it clear that the defendants were positive that the Marine and General Insurance Agency were agents and not principals. This argument was actually raised by the plaintiffs and was based on the general fact that *"if after possession is parted with, before possession is resumed, the lien cannot revive if the person that claims his entitlement to a lien is aware that the person he is directly dealing with is only an agent"* [14]. It can be inferred by that principle that when there is a sub-agent, if possession, which he voluntarily parted, returns to him again, he will not be entitled to a lien, if he knew

[11] (1818) 8 Taunt. 149, 2 Moo. 34
[12] (1930) 2 K.B. 40, 46. Page 42.
[13] (1801) 1 East 335.
[14] (1930) 2 K.B. 40, 46. Page 44.

that his employer was an agent. Emphasis must be given to the fact that there is no express decision upholding that principle and reference is made only in Arnould on Marine Insurance, 11th edition, section 134 and in **Levy v Barnard** [15]. According to all these, it was held in our case that this was also an element for the defendants not to be entitled to a lien.

Finally, a last point was raised, as I mentioned above that the whole amount has already been paid off. The court also upheld this and it was held that the defendants did not have a lien.

The next case I will analyse is **Fisher v Smith** [16]. This case is about the situation when the assured has an intermediate agent, who has failed to pay the broker. In the introductory part of the case it is mentioned that it is possible for a lien that a broker has to be superseded by a special arrangement or a particular contract. Fisher was a shipowner. Mr. Smith was an insurance broker who worked at Liverpool in connection with a Mr. Brand. On the other hand, Mr. Skinner and Co. of Barrow – in- Furness were employed by Fisher. So, in 1974 Fisher instructed Skinner to get for him insurance cover and this took place through Smith. The course of business was the following: Skinner always used an account in respect of charges, such as premiums and brokerage, and Fisher settled this account every month. Smith knew that Fisher was principal in this transaction, but when the loss occurred in respect of cargo on the vessel *Eliza S. Milligan*, Skinner could not comply with the demand of Fisher, because Smith had possession of the insurance policies. It must be noted here that Fisher had no idea about the arrangements between Skinner and Smith. So, he brought an action against the right of Smith to keep the policies. According to Lord Chancellor, these were three questions that had to be answered: *(1) was there a lien in the Respondent from the nature of the transactions? (2) Did any contract or course of business inconsistent with it supersede that lien? (3) Was it discharged by any payment, which was a payment to the Respondent* [17]?

In respect of the first question, he decided that there could be no serious doubt that a lien really could be claimed, because the Respondent was the person, who

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[15] (1818) 8 Taunt. 149, 2 Moo. 34.
[16] (1878) 4 App. Cas. 1.
[17] *Ibid.* Page 5.

effected the insurance policies and paid the premiums for them. The second question was certainly more complicated. As his Lordships concluded, the answer was a question of fact. Everything depended on the course of dealing. In a similar case a person who received payment at the end of every six months or at the end of every year for receiving goods was held not to have a lien [18]. But, the circumstances in our case were quite different, since there was no necessity to deliver the policies immediately when they were effected, the court held that the lien could not be superseded. Thirdly, in relation to payments, again the lien could not be discharged, because their Lordships agreed that it was impossible for the appellant to find out that Skinner were the agents of the Respondent. If Skinner had not paid the premium because of fraud on his part, the situation would be different. No imputation of knowledge would be established because of the fact that Fisher knew nothing about the arrangements between Skinner and Smith and Skinner would be guilty of fraud.

I will refer now to a quite more recent case where section 53(2) and the exact rights that it confers to those who claim under it are being examined, **Eide U.K v Lowndes Lambert** [19]. The facts of the case are as follows. The first plaintiffs were actually the owners of the vessel in question- *the Sun Tender*- and the second plaintiffs were the bank where the vessel was mortgaged. This vessel was chartered to Colne Standby Ltd. for whom the defendant brokers had obtained two hull and machinery policies for a period of twelve months. The charter-party provided that *"during the charter period the vessel shall be kept insured by the charterers at their expense...insurances shall be arranged by charterers to protect the interests of both the Owners and the Charterers and mortgagees (if any)...All insurances shall be in the joint names of the Owners and the Charterers as their interests may appear"* [20]. Something else that needs to be mentioned is that this was a *demise charter*, which meant that the charterer had full possession and control of the ship. As a result of the negotiations, the *Sun Tender* had been added to the policies and a month later there was an assignment by the owners of their interests to the bank. After a few months, the vessel had sustained damage and there were claims by both Colne Standby and the bank as an assignee of the owners in respect of this damage. The broker collected from the underwriters a sum of money in respect of the insurance policy but Colne

[18] Crawshay v Hompray 4 Band A. 50.
[19] (1998) 1 Lloyd's Law Rep. 389.
[20] *Ibid.* Page 389.

Standby owed to the brokers a large sum of money, which was related to other insurance policies. Relying on **section 53(2) of the Marine Insurance Act 1906**, the brokers argued that they were entitled to a general lien because of the amount owed to them. Hence, the main issue for decision was whether the brokers were entitled to retain the claims proceeds as part satisfaction of Colne Standby's liabilities under the insurance account. It was held by the court of first instance that the right to lien under section 53(2) applied only to the policy itself and not generally. Another aspect of the decision was that the right of the brokers to use claims proceeds arose by virtue of the principles of set-off and not by statute and also the brokers could not exercise a lien against one co-assured for the liability of another. There was however an appeal by the brokers. The Court of Appeal decided that the brokers were entitled to retain the claims proceeds as a result of their lien as long as far as it was necessary to secure the debt under the lien. According to the court, the meaning of section 53(2) was simply to create a type of security under which somebody could retain possession of physical property until the debt to him is paid. If the decision of the judge would be considered as correct, this would destroy the security afforded by a lien. It was also held that section 53(2) did not apply to composite insurance and that no one can create a lien beyond his own interests. The appeal was allowed although it was submitted that the brokers were not entitled to proceeds collected by the bank just because Colne Standby owed to them under other insurance policies. This would be contrary to principle and it could not be supported by authority[21]. It would be interesting to look at the exact words of Lord Justice Phillips: *"where as is usual a broker collects under the policy which is procured for the assured the broker will normally have a right to set off moneys received for a particular assured against any indebtedness of the assured. To this extent, if earlier market practice or contractual agreement places the broker in a position to insist on collecting under a policy, the broker will enjoy a degree of security. This case demonstrates, however, that in a case of composite insurance such security falls short of that which would be provided by a general lien over policy and proceeds"* [22].

[21] See: Eide U.K. v Lowndes Lambert (1998) 1 Lloyd's Rep. 389.
[22] *Ibid.* Page 402. Per Lord Phillips.

3.3.4 Conclusion

In conclusion, it is submitted that the operation of a lien is interrelated with the duties and rights of brokers. Section 53(2) creates difficulties quite often and most of the times it is up to the courts to examine the course of dealing and business together with other factors in order to ascertain whether or not a broker is entitled to a lien [23].

[23] For a view of how entitlement to a lien for brokerage or marine insurance is confronted in the U.S see: Daingle Paul N. & Jerome C. Scowcroft. (1987). Payment for Services and Supplies Furnished in Maritime Commerce. Journal of Maritime Law and Commerce, Vol. 18, No. 2, April.

CHAPTER

4 *Duties Of Insurance Brokers*

4.1 Introduction

The duties that are imposed upon insurance brokers are to a substantial extent those imposed by the law relating to agency. It is generally accepted that the broker acts as the agent of the assured. However, this does not mean that it is impossible for a broker to owe a duty of care to other parties. There can be circumstances where he acts as the agent of the insurer under a binding authority or where he even owes a duty of care to third parties.[1] The other thing that needs to be mentioned is that the same principle applies to both reinsurance and original insurance. For example, the broker acts as the agent of the reinsurer when he operates in order to obtain a retrocession cover.

A case where it was held that a broker is primarily the agent of the assured is **McNealy v Pennine Insurance Co. Ltd.** [2].The facts of the case were as follows: the plaintiff was a property repairer and also a part-time musician. He decided to go to Italy together with a singer to join a band there and go for a six-week tour. Where insurance comes in is that he had a car and he wanted to place insurance cover, so that he travelled in it when he returned back. The problem was that when he had his insurance cover, there was an exclusion clause, which excluded quite a big class of persons. This class included part-time musicians, jockeys and journalists, press photographers and others. The broker, of course, who consulted the plaintiff, knew about all these categories but he did not inform the plaintiff. The reason for this was that when he asked about the plaintiff's occupation, he answered simply "property repairer". Hence, an accident happened when he returned home and the insured brought an action both against the insurance company and brokers. The claim was for damages in the car and for the injuries of the singer, who travelled with him. It was established that the broker was the agent of the assured. Lord Denning stated that no liability could be incurred by the insurance company because the broker is only the agent of the assured: *"at the trial of the case, it was accepted by both sides that the insurance company was not liable. The reason for their non-liability was because the broker is the agent of the assured and the assured only"* [3]. The other

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[1] See below to this chapter.
[2] (1978) 2 Lloyd's Rep. 18.
[3] *Ibid.* Page 20, per Lord Denning.

important aspect of the case related as to whether the insurance broker, in failing to disclose the existence of the exclusion clause which included part-time musicians, had used reasonable care and skill. In respect of that, Lord Denning said: *"it is clearly the duty of the broker to use all reasonable care to see that the assured, Mr. McNealy was properly covered...I am afraid that the broker did not do his duty. He did not go through that list with Mr McNealy at all"* [4]. Lord Denning's argument was that the broker should have asked the plaintiff about all these categories, which were excluded, in order to satisfy the requirement of reasonable care and skill [5]. In the end the broker was held liable for the whole amount of the claim.

The rule that the broker is primarily the agent of the insured has its routes at common law. I will refer now to the case of **Manufacturers Mutual Insurance v Boardman Insurance Brokers.** [6]. This is an Australian case and I will deal with its result as this was put by an Australian writer[7]. It must be mentioned at this point that the outcome of this case was quite important as to the balance of the Australian insurance market. The reason is that in the past decade, the Australian government had passed a number of statutes and regulations with the aim that the imbalance in the bargaining power between the insurer and the insured would be redressed [8]. However, there was a tendency among international and domestic insurers that with the application of these regulations commercial reality was not followed and the balance was too far in favour of the insured [9]. The facts of the case were the following. Metrot Pty Ltd. was the insured and through its broker – John H. Boardman Insurance Brokers Pty Ltd. – insured its Newcastle premises with Manufacturers Mutual Insurance Ltd. When the existing policy was about to be renewed, the insurer sent a renewal notice to the broker, who forwarded it to the insured. The insured on his part agreed with the renewal and sent to the broker a cheque for the payment of the broker and the commission. So, the broker was properly paid, but afterwards he failed either to communicate the insured's decision for renewal or

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[4] *Ibid.*
[5] *Ibid.*
[6] 1 (1994) 120 ALR 121.
[7] Alroe Simon. Insurance Brokers, Agents, Australia . International Law Review 3 (3). 1995. Pages 98-99.
[8] *Ibid.* Page 98.
[9] *Ibid.*

to forward the cheque for the premium to the insurer [10]. This case dealt specifically with **section 14(2)** of **the Insurance (Agents and Brokers) Act 1984**. This section provides that *"payment to an insurance intermediary by or on behalf of an intending insured of moneys in respect of a contract of insurance to be arranged or effected by the intermediary, whether the payment is in respect of a premium or otherwise, is a discharge, as between the insured and the insurer, of any liability of the insured under or in respect of the contract, to the extent of the amount of the payment"* [11]. In the court of first instance the argument of the insured was actually upheld. It was held that section 14 (2) of the Act should be interpreted as to mean that that the payment of the premium to the broker gave effect to the renewal of the policy in question [12]. The Court of Appeal disagreed with the interpretation given by the judge but the decision was again in favour of the insured. The reasoning was that there was a manifestation of an intention by the parties that acceptance could be effected by payment of premium to the broker. As a result the insurer appealed to the High Court of Australia. As a starting point the High Court observed that the broker is deemed to be the agent of the insured and not of the insurer. This can change under two special circumstances. Namely, where there is an express agency agreement like a binder between the parties or when there is really a manifestation of intention as stated above [13]. It was beyond doubt that there was no binder in effect. As to the second aspect, the majority of the court decided that the policy was impossible to be renewed without express notification to the insurer. Since, the payment of the premium was never done to the insurer; the renewal of the policy never came into effect, so no actual contract came into existence. The result of all these was that no liability could be discharged under section 14(2) if no contract was concluded. On the other hand, the minority of the court took a much narrower approach and held that renewal was effected through payment of the premium to the broker[14]. The practical significance, according to the writer was that there must be, as a result of that decision, an encouragement of the insurers, who believe that legislation imposes such a heavy burden

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[10] Manufacturers Mutual Insurance v Birdman Insurance Brokers. 1 (1994) 120 ALR 121.
[11] Alroe Simon. Insurance Brokers, Agents, Australia . International Law Review 3 (3). 1995. Page 98.
[12] Manufacturers Mutual Insurance v Birdman Insurance Brokers. 1 (1994) 120 ALR 121.
[13] *Ibid.*
[14] *Ibid.*

on them, because it seems like there are circumstances where courts will not adopt a narrow approach, which seems to follow the purpose of legislation, if this is not upholding commercial fairness and reality [15].

4.2 Avoidance of Conflicts of Interest

The duties that a broker owes to the assured include also a duty to avoid conflicts of interest. A case, which deals with this, is **Anglo African Merchants Ltd. v Bayley** [16]. The case was about a quantity of 20-year old army leather jerkins. The intention of the plaintiffs was to insure these clothes against "all risks". An important part of the case was that the plaintiffs – the insured - did not mention that the jerkins were 20 years old and that they were to be used for army purposes. They described them simply as new and they submitted that they were the government's property. Part of them was lost from the warehouse storage and as result an action was brought. The underwriters actually denied liability on the ground that there was a material non-disclosure. The argument on behalf of the plaintiffs was that there was a waiver of more information about the exact nature of the goods. The decision of the court in respect of these two arguments was: *(1) "that the use of the word **new** did not, on the evidence, amount to a misdescription of the clothing, but the fact that it was 20 years old was a material fact and since they had not been disclosed the underwriters were entitled to disclaim liability. (2) The failure to make further inquiry as to the precise nature of the goods did not give the plaintiffs ground for a successful plea of waiver"* [17]. But these were not the only issues of the case. The questions that arose in relation with the rights and the duties of the brokers came up because of the following fact: the brokers during the case had shown crucial information to underwriters and also had obtained a report, because the underwriters asked to do so. The problem was that when the assured asked him to have a look and inspect these documents the brokers refused. Hence, it was argued that the brokers did not have the right to do this. The decision of the court was the following. *"An agent who has accepted employment from one principal cannot in law accept any engagement inconsistent with*

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[15] Allure Simon. Insurance Brokers Agents Australia . International Law Review 3 (3). 1995. Page 99.
[16] (1970) 1 Q.B 311.
[17] *Ibid.* Page 311-312.

his duty to the first principal, unless he makes the fullest disclosure of all he material facts to both principals and obtains their informed consent to his so acting" [18]. Hence, the behaviour of the brokers was proved to be wholly unjustifiable. It derives from all that that the vital concept is that of consent.

4.3 Inspection of documents

A case, which was related to that, is **North and South Trust Co. v Berkeley** [19]. The Lloyd's brokers in question acted for the plaintiffs, in respect of the transit of goods, which was arranged by Lloyd's underwriters. However, the quantity of goods was quite short, when the cargo arrived and as a result there was a claim by the plaintiffs against the underwriters. One member of the underwriters' syndicate, who was the actual defendant in order to avoid liability, asked the brokers to obtain an assessor's report. This was done but this report was never shown to the plaintiffs. Also, when the plaintiff asked the brokers to inspect the report and other relevant documents they refused. Their argument was that when obtaining the report, they acted as agents of the underwriter, therefore, the plaintiffs did not have a right to look at the documents. The underwriters denied liability under the insurance policy. The result was that an action was brought against the member of the syndicate of the underwriters both in a personal basis and in a representative way, in order to include the other members in the action and against the brokers submitting that they were entitled to the possession and the inspection of the documents. Moreover, an action was brought against the insurance brokers and by the defendants in order for an injunction to be granted. The result would be that the brokers would be restrained from delivering the documents [20]. The decision of the court was that *"although the practice of Lloyd's underwriters to use Lloyd's insurance brokers, who placed business with them...was a practice which was wholly unreasonable and incapable of being a legal usage or custom, nevertheless, since the insurance brokers, in acting for the defendant, had not acted in the discharge of their duty towards the plaintiffs, the plaintiffs were not entitled to possession and inspection of the documents, which the insurance brokers had*

[18] *Ibid.*
[19] (1971) 1 W.L.R 470.
[20] *Ibid.* Pages 470-471.

obtained in a confidential capacity" [21]. But, part of the judgement and the reasoning of the court was dedicated to the matter of consent: *"fully informed consent apart, an agent cannot lawfully place himself in a position in which he owes a duty to another, which is inconsistent with his duty to this principal"* [22].

Moving on to another case I am going to mention **Kelly v Cooper** [23]. This case concerned a firm of estate agents. The facts of the case are mentioned in the chapter dealing with dual capacity of brokers, so, I will mention here only what was the basic issue for the court and what was the outcome. The action was brought by the plaintiff against his estate agents for breach of their duty towards him, because they did not inform that the buyer who bought his house has made actually a double offer to buy the adjacent premises at the same time. In the court of first instance, it was held that the plaintiff was entitled to an amount of damages and that the estate agents could not get their commission. On appeal, it was decided that the appeal should be allowed and the commission was lawful [24]. Finally, the Judicial Committee held that *"since it was the business of estate agents to act for numerous principals, several of whom might be competing and whose interests would conflict...and since the plaintiffs knew that the defendants would be acting for other vendors of comparable properties and would receive confidential information from them...the defendants were not in breach of their duty in failing to inform the plaintiff of the agreement to buy the adjacent house"* [25]. But, how was the **North and South** case [26] dealt with? It was said by the court that the principle which was recognised in the above case was that *"an agent for principal A who has chosen to act for principal B on whose behalf he acquires information cannot be forced to divulge such information to principal A but can be held liable to principal A for breach of duty"* [27]. Then, the judge continued by saying that everything depends on the type of the contract between the principal and the agent. For example, the terms of the

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[21] *Ibid.*
[22] *Ibid.*
[23] (1993) A.C 205.
[24] *Ibid.*
[25] *Ibid.* Page 206.
[26] (1971) 1 W.L.R 470.
[27] *Ibid.* Pages 213-214.

contract must be different between those who deal with general agency business and those who do something more specific [28].

Finally, I am going to refer to one more recent case, which dealt with inspection of documents. The case is **FAI General Insurance Company v Godfrey. 21/12/98. (Unreported)** [29]. FAI General Insurance Company Limited made an application to inspect copies and take copies of a number of documents, which were referred in an open court at a trial to which FAI was not a party. Despite this, they were really interested in these documents and the reason was the following. They were defendants in action brought by Ocean Marine Mutual Protection & Indemnity Association and Ocean Marine Mutual Association Europe OV – OMM- in respect of reinsurance contracts, which were concluded in 1993, 1994 and 1995. In that case, FAI tried to avoid liability on the ground of non-disclosure and misrepresentation. The contracts were concluded actually through a chain of brokers in London and Australia. The common thing with the trial from which they asked for the inspection and the copying of the documents was that the chain of brokers was the same. In this trial the situation was that an Australian reinsurer, GIO, tried to avoid reinsurance contracts where the reinsurer was Liverpool & London Steamship Protection and Indemnity Association – Liverpool & London. There was a settlement between these parties before the trial and London & Liverpool also tried to settle against the Third Party – GMR -. So, in the present action the plaintiff was GMR and an action was brought against sub-brokers Chapman & Co and GAK Re. As the trial proceeded, GMR and GAK Re settled and proceedings continued only against Chapman & Co who did not appear. On their part, FAI, before the opening of the proceedings, asked GMR for the copies of (a) the skeleton arguments lodged by counsel, (b) the trial bundles and (c) daily transcripts as they become available [30]. FAI tried to uphold their application on the basis that they were "a member of the public" and they needed the documents in order to follow the case. Walker J. rejected the application because he submitted that the motive of FAI was completely different from that mentioned in the application. It must be noted that the application was done pursuant to RSC Order Rule

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[28] *Ibid.*
[29] http://www.casetrack.com.
[30] FAI General Insurance Company v Godfrey. 21/12/98. (Unreported). Page 1. Per Lord Justice Potter.

38 2A(12) [31]. On appeal, FAI made an application to inspect only documents referred to witness statements and any written opening skeleton argument or submissions. As to the first ones access was denied. The reason was paragraph (11) of Rule 2A, which states that access must be denied unless there is consent by the party serving it, by the leave of the court or lastly if it has been put on evidence. None of the above applied in this case [32]. As to the second ones, the appeal was allowed. It was found by Lord Justice Potter that the judge of the court of first instance was wrong in declining FAI access to them on the ground that *"the appropriate judicial approach to an application of this kind in a complicated case is to regard any member of the public who for legitimate reasons applies for a copy of counsel's written opening or skeleton argument, when it has been accepted by the judge in lieu of an oral opening, as prima facie entitled to it"* [33].

4.4 Duty of Care of the Broker towards the Assured and Other Parties

I will firstly refer to the reinsurance case of **the Zephyr, General Accident Fire and Life Assurance Corporation and Others, Peter William Tanter and Other** [34]. This case is very significant in respect of a lot of topics. Again, I have referred to its facts in a very detailed way in the chapter, which deals with the liability of insurance brokers. So, now I will only make a summary of them. The whole matter was about the insurance of a vessel called Zephyr. The problem was that a broker gave a signing indication, which proved to be completely wrong and also the reinsurance contract was placed before the original insurance. The claim that arose was whether the broker was liable for a breach of a duty of care and what was the exact legal effect of signing indication. The whole aspect of the case was a possible tortious or contractual liability. At this point, I will deal only with the position of brokers in relation to their potential principals: they are considered to be the agents of the reinsured and not of the reinsurer. As it was mentioned in the Zephyr case: *"it was held that the broker was the agent of the reinsured, not the reinsuring insurance company... all risks underwriters and total loss underwriters... it is in my view*

[31] Supreme Court Practice 1999. Vol. 1. Paragraph 38/2A/8.
[32] FAI General Insurance Company v Godfrey. 21/12/98. Page 5. Per Lord Justice Porter.
[33] *Ibid.* Page 13. Per Lord Justice Porter.
[34] (1984) 1 Lloyd's Rep. 58.

very impractical and mistaken that with regard to a single reinsurance slip he was acting partly as the contracting agent of the reassured and partly as the contracting agent of the reinsurer. He is the contracting agent only of the reassured" [35].

Of course the above principles do not mean that this is always the case. There may be circumstances under which the brokers owe a duty of care to other parties of a certain transaction other than the assured. An example is the case of **Punjab National Bank v de Boinville** [36].Again, the facts are mentioned in the chapter of liability, so, I will try to focus on the parts of the judgement which deal with the topic of where the agent owes a duty of care. Actually, what happened is that four insurance policies had been carried out in respect of gas oil. The insurance brokers, who were involved changed firm during the transaction. Also, some other important changes were incorporated into the policies. The case was quite complicated and quite a few issues were resolved as preliminary issues. It was decided that *"it was a justifiable increment to an existing category to hold that an insurance broker owed a duty of care to a specific person, not being a client, who he knew was to become an assignee of an insurance policy, at least where to the broker's knowledge, that person had actively participated in giving instructions for the insurance"* [37]. It must be noted that everything depends on the circumstances. It does not mean that insurance brokers always owe a duty of care to third parties; everything starts from the relationship between the broker and the third party. This is shown in the case of **MacMillan v A.W Knott Becker Scott Ltd.** [38]. The facts were as follows. Knott Becker Scott were insurance brokers at Lloyd's but they were in liquidation. There were certain allegations that they were negligent towards quite a few of their clients, but the problem was that since they were liquidated, it was impossible for them to discharge their liabilities. The solution for the claimants and a syndicate that was involved was to claim under the Errors and Omissions Insurance. This insurance cover was obtained by another firm called Nelson Hirst and March Ltd. (NHM). These were also defendants in the claim. The insurers that undertook that E and O insurance denied liability on the basis that the insurance was invalid and that the notifiction of the claim

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[35] *Ibid.*
[36] (1992) 1 W.L.R 1138.
[37] *Ibid.* Page 1139.
[38] (1990) 1 Lloyd's Rep. 98.

was too late. The issue that arose was: **whether the E and O brokers (NHM) were liable for their negligence not only to their clients, the insured brokers, but also towards the clients of the insured brokers (KBS) and other persons (Syndicate 420) to whom the insured brokers were liable for their own negligence** [39]. The claim on behalf of the claimants had to do with the fact that that they could recover loss, because it was foreseeable and logical to happen, as a result of the broker's negligence. The decision had three parts. (1) The first part had to do with what is the purpose of an E and O insurance. Hence, the purpose is to indemnify the broker against his liability for claims, which are like the plaintiff's claim. (2) According to the second part, an E and O insurance policy actually protects the claimants in case where the broker is financially unsound and the necessary degree of proximity is established. (3) Finally, the third part of the decision was about the relationship between the defendant broker and their client. The court held that the liquidator represented their client now and there was a contractual relationship between the brokers and the liquidator, while there was no element of liability towards the plaintiffs. It must be understood that the real basis for the decision was the doctrine of privity of contract, because tortious liability could not overcome privity of contract. The plaintiffs could not be allowed to have a direct claim in tort [40].

4.5 Duty of the broker to obtain cover.

A broker must, according to his duties, undertake the obligation to obtain cover. This undertaking is important as to the fact to understand the nature of the duty of a broker. A case, which deals with this point, is **Hood v West End Motor Packing Co.** [41]. This case involved a car, which was carried on a ship. According to the bill of lading, the car was carried on shipper's risk. Also, it was carried on the deck. However, this was not notified to the underwriters. They learned it only after the loss had occurred. It was submitted that if the underwriters knew about it, the cargo might have been insured but certainly with an unusual high premium. It was held that the assured was not protected,

[39] *Ibid.* Page 98.
[40] *Ibid.*
[41] (1917) 2 K.B 38.

because *"it was an implied term that notice should be given to the underwriters within a reasonable time after the assured knew that the car was being carried on the deck; that such notice was not given; and that, therefore, the risk was not covered by the policy"* [42]. It is obvious that no proper cover was obtained by the broker. Of course, the court recognised that an undertaking to obtain cover was recognised on the part of the broker. This duty is really so important that it is considered to be the broker's primary function. It was analysed in the case of **Eagle Star Insurance Company Ltd. V National Westminster Finance Australia Ltd.** [43]. According to this analysis *"their duty was to use all reasonable care and skill in seeking to obtain the cover in London which had been sought by their principals, and if for any reason, notwithstanding that they had used that reasonable care and skill, their efforts failed, it was then their further duty to report their failure, and if necessary, to seek further instructions. But they did not undertake that cover would be procured"* [44]. It is obvious from the above definition that that a broker must use his reasonable care and skill in order to fulfil his duty of care. The degree of care that is owed is generally thought to be that of an average competent broker. In **section 13 of the Supply of Goods and Services Act 1982** provides that *"the supplier will carry out a service with reasonable care and skill"* [46]. Of course, the content of this provision is not specifically directed to the obligations and duties of the brokers but it shows what is usually the standard of care that is required by a professional [45]. Another way of putting the matter is that the degree of which is expected is the specialist knowledge that a broker has in respect of a particular risk. The case that needs to be mentioned is **Sharp v Sphere Drake Insurance p.l.c (the Moonacre)** [47]. The facts of the case are analysed in the part where I am talking about the effectiveness of exclusion clauses. However, in a part of a judgement brief reference was made to the degree of care that is required by a broker. It was decided there that *"...it is rather the standard of the broker who has general knowledge of the yacht insurance market and the cover available*

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[42] *Ibid.* Page 38.
[43] (1985) 58 A.L.R 165.
[44] O'Neil P.T & Woloniecki J.W.(1998). The law of Reinsurance. Sweet & Maxwell, 1st edition. Page 381.
[45] For more details see: Davies Iwan. Sale and Supply of Goods. Pearson Professional Limited. 1996. 2nd edition. Page 67.
[46] Bolam v Frien Barnet Hospital Management Committee (1957) 1 W.L.R. 582.
[47] (1992) 2 Lloyd's Rep. 501.

in it as to be able to advise his client on all matters on which a lay client would in the ordinary course of events need advice, in particular in the course of the selection of the market and the completion of the proposal" [48]. This statement generally shows what the market most of the times expects from a broker.

4.6 Ambiguous Terms

The next issue I am going to deal with is that of "ambiguous terms". This as it is logical makes the job of a broker more difficult, because there is always a possibility that although the broker will use his best endeavours to obtain the appropriate cover, his client will not explain to him the exact kind of cover he needs. In that case, the general rule is that he is more or less free from liability. A case where a broker used his best endeavours is **United Mills Agencies Ltd. v Harvey, Bray and Co.** [49]. There, the insured were the plaintiffs in the action and the defendants were the insurance brokers. The brokers obtained an insurance cover in respect of the insured's goods. It must be noted that there was no clause at all to provide for the attachment of any risk, while the goods were out at packers. Part of the goods was destroyed by fire while they were at packers. The insured's allegation was that *"the brokers were negligent in failing to effect an insurance of the goods while at packers when so instructed, or, alternatively in failing to advise the insured that the insurance cover goods in the hands of packers at insured's risk after having clear notice that the insured had goods in that situation"* [50]. The other argument that they used was that *"the brokers were negligent in that they delayed in sending them a copy of the cover for some days after the insurance had been placed, thereby, depriving the insured of the opportunity of examining it and seeing whether it complied with their requirements"* [51].

On behalf of the brokers, it was submitted that *"if the cover note had been sent in due time, they would have had the opportunity of ascertaining that it did not cover the*

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[48] *Ibid.* Page 523.
[49] (1952) 1 All.E.R 225n.
[50] *Ibid.* Page 225.
[51] *Ibid.*

goods in circumstances that existed" [52]. The reason that this argument was used was because perhaps they would be able, if this fact was notified, to examine if the appropriate cover was obtained. The court held *"that the insurance brokers had no knowledge that the goods...were uninsured and that they were not negligent in not insuring them or in not informing the insured that they had not so insured them"* [53]. The basis for the decision was that a duty on the part of the broker existed to notify legal information about the cover, but legal liability could not be involved. It can be a factor, which can show the practice of a prudent broker but nothing more than that.

One of the basic rights that the broker has in respect of all that is that he can ask his assured for clarification if he notices any kind of ambiguity. In the case of **European Asian Bank v Punjab and Sind Bank (No 2)** [54] this was the main point. The example of a banker who has received strange instructions was used in this case. He could either follow them or ignore them but always at his own risk. In relation with agency agreements, it was submitted that *"it is understandable that he should expect to act under those instructions without more; but if for example, the ambiguity is patent on the face of the document it may well be right to have his instructions clarified by his principal if time permits, before acting upon them"* [55].

I am going to make a reference to reinsurance. The principles that are applied are essentially the same. The only thing that changes is that sometimes a broker may have some additional duties in respect of the placement of the reinsurance. Most of the times, the position is that a broker may have to effect reinsurance that will have exactly the same terms at the original insurance. However, this is not always the case. When the courts have to deal with clauses, which simply do not make sense, the approach that is usually followed is to try to figure out what is the commercial purpose of the reinsurance. This is the reason why sometimes terms have not been held not to have a legal effect at all. However, when a broker undertakes to arrange a back-to-back cover in the same terms as the original insurance- if he fails to do so, then, it is almost certain that he will be in breach of a duty of care to his principal.

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[52] *Ibid.*
[53] *Ibid.*
[54] (1983) 1 W.L.R 642
[55] *Ibid.*

In **Icarom Plc. v Peek Puckle (International) Ltd.** [56], a broker was asked to place reinsurance after the loss had occurred. According to the court, this reason was enough in order to decide that the broker could not be held liable. Another possibility is that the broker may undertake to place reinsurance in any event. This undertaking means that, whatever the circumstances, he has put himself in the position to find the appropriate cover. This, as it is logical, imposes quite a heavy burden upon the broker. This was examined in **the Zephyr case** to which I have referred several times. It was held that in respect of that, since the broker had undertaken such an obligation, he is under a duty to obtain the appropriate cover [57]. Finally, I am going to refer to the case of **Youell v Bland Welch and Co. Ltd. (No 2)** [58]. Again, this case is mentioned in a detailed way in the liability chapter, so, I will try to focus on the points that are related to the duties of a broker. The policy contained a 48-months clause, which meant that any cover in respect of the vessel was terminated 48 months after its construction. It was submitted that no prudent insurer would have agreed to the insurance if they knew about the existence of the clause. It was held in the end that the broker were in breach of their duty for failing to inform the insurers about the exact cover and failed to take any reasonable precautions after the 48 months had expired [59]. The reasoning of the judge was that the brokers should have been proactive when obtaining the cover, so a duty of care was recognised on the part of the brokers. The other thing that was said about the duties of the brokers was that they were not absolute duties: *"the general duty will normally require a broker to perform a number of different activities on behalf of the client, but the performance of those activities constitutes no more than discharge of the duty to exercise reasonable care and skill. Failure to perform one of the activities will normally constitute a breach of that duty of care, not a breach of absolute obligations"*[60].

[56] (1992) 2 Lloyd's Rep. 600.
[57] The Zephyr, General Accident Fire and Life Assurance Corporation and Others, Peter William Tanter and Other, (1984) 1 Lloyd's Rep. 58.
[58] (1990) 2 Lloyd's Rep. 431.
[59] *Ibid.*
[60] *Ibid.* Page 458.

4.7 The broker's duty to investigate the risk and advise upon the cover.

This duty is equally important to that of obtaining the cover. It has a lot of similarities as well, since again the exercise of reasonable care and skill is required. The first case I am going to refer to is a Canadian one. Hence, in **Fine's Flowers Ltd. v General Accident Assurance of Canada** [61], a distinction was made between the duty of the broker to obtain a specific cover, when his instructions are putting him in that position and the situation where he just has to exercise his general degree of a duty of care: *"in many instances, an insurance agent will be asked to obtain a specific cover of coverage and his duty in those circumstances will be to use a reasonable degree of care and skill in doing so...where* the *client gives no such specific instructions but rather relies on his agent...then he cannot afterwards when an uninsured loss arises, shrug off the responsibility he has assumed"* [62]. So, according to this case, whether a broker is under a duty to advise his principal and figure out whether the risk is high or not, depends on the circumstances of each case and the instructions that he has received.

In **Mitor Investments Pty Ltd. v General Accident Fire and Life Assurance Corp. Ltd.** [63], an Australian case, the plaintiff invited on his premises an insurance broker and asked him to arrange an insurance cover. Actually, the plaintiff owned a hotel that was adjoining the sea. The cover that was obtained by the broker was a common form policy that excluded *"damage caused directly or indirectly by the sea"*. Damage occurred when because of a cyclone seawater entered the premises. As a result, the owner sued the broker on the ground that he could not rely on his insurance cover. It was held that the broker was liable *"because the exclusion contained therein introduced a qualification to the cover inconsistent with the instructions given"* [64]. And secondly, *"a broker who is brought on site to assess the risks and to advice his client upon appropriate cover must...take reasonable care in assessing the particular risks to which the property*

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[61] (1977) 81 D.L.R (3d) 139.
[62] *Ibid.* Page 149. Per Wilson J.A.
[63] (1984) W.A.R 365.
[64] *Ibid.* Page 374.

to be covered was exposed" [65]. It is obvious from the above that the fact that the broker went to see the premises increased the extent of his obligations. Perhaps if the cover was arranged without seeing the premises, the result would be different.

The next case I am going to refer to is really very significant and has application in quite a few aspects that are related with the operation of insurance broking: **Aneco Reinsurance Underwriting Ltd (in liquidation) v Johnson & Higgins Ltd. 30/7/1999. (Unreported)** [66]. The reason why I have put this case primarily under this heading was that the negligent advice given by the brokers in the first place was the reason that all the issues were raised. It is true that large sums of money were really involved in this case. I am going to deal in detail with the decision of the Court of Appeal. In the Court of first instance, there was a judgement for the plaintiffs – the insured - for a sum of around U.S.$ 10.000.0 00 with interest. On appeal, they made a claim of around $30.000.000. This very large amount actually reflected the losses that the appellants had suffered because of entering in a reinsurance contract with a syndicate of Lloyd's underwriters known as Bullen Syndicate. One of the vital facts of the case is that the appellants had entered into the reinsurance contracts with the Bullen Syndicate on the basis that the respondents would obtain reinsurance for the liabilities undertaken by them as reinsurers under the treaty. This kind of cover is what is called retrocession, which simply means further insurance of reinsured risks. And the type is known as "excess of loss on excess of loss"- XL on XL-. The underwriters had the right to avoid the policies, according to the arbitration tribunal. But, on appeal the major issue was, as I said above, the amount of damages. The submission of the respondents was that the amount of damages would be the value of the cover when the cover was avoided. On the other hand, the appellants' argument was that the reinsurance that they were looking for was not available in the London insurance market, so, if there was full disclosure about the implications of entering the Bullen treaty, they would decline to enter it. As a result, according to the argument, the respondents were entitled, as I already mentioned above, to the whole loss suffered by them [67]. The Court of Appeal said that the risk was impossible to be

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[65] *Ibid.*
[66] http://www.casetrack.com.
[67] Aneco Reinsurance Underwriting Ltd (in liquidation) v Johnson & Higgins Ltd. 30/7/1999. (Unreported). Page 2. Per Lord Justice Evans.

reinsured. It will be very interesting at this point to look at the law, which was applied to the case. One of the most important cases cited by the court was **Banque Brusselles S.A. v Eagle Star Co.** [68]. The correct measure of damages was the main point for decision. The first thing that was mentioned in the Court of Appeal was that there was a different test applied in case of negligence and a different one in case of fraud. When there is negligence, the damages are restricted not only by remoteness but also by the meaning of legal cause. What this means is that compensation must be awarded on the basis of the loss effectively caused by the breach. Also, considerations of common sense are taken into account. When fraud, on the other hand, exists, the fraudulent person is liable for all the loss directly caused by the fraudulent conduct [69]. In the House of Lords, a slightly different approach was followed. It was held that for damages to be awarded, it should be that a duty existed *"in respect of a kind of loss in respect of which a duty was owed"* [70]. Hence, the outcome of the case was that the defendant – a valuer who had given a false valuation – was not liable for consequences, which would have happened even if the advice given had been correct [71]. The legal position arising out of this case as it was summarised by Lord Justice Evans was that *"the fact that the claimant would not have entered into a contract, under which the loss has been suffered, if the information or advice he received from the defendant and acted upon had not been negligent, does not mean that the defendant is liable for the whole of that loss. He is only liable for this part of the loss, which is regarded as a consequence of the information or advice being wrong. The link is only established if there is a sufficient factual connection between the loss in question and the wrongness of the information or advice"* [72]. It is also worth noting a distinction that was drawn from Mr. Hunter who appeared for the appellants in **the Aneco case**. Thus *"the principle stated distinguishes between a duty to **provide information** for the purpose of enabling someone else to decide upon a course of action and a duty to **advise** someone as to what course of action he should take. If the duty is to advice whether or not a course of action should be taken, the adviser must take*

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[68] (1995) Q.B. 375; (1995) 2 All. E. R. 769; (1995) 2 W.L.R 607.
[69] *Ibid.*
[70] *Ibid.*
[71] *Ibid.*
[72] Aneco Reinsurance Underwriting Ltd (in liquidation) v Johnson & Higgins Ltd. 30/7/1999. (Unreported). Page 7. Per Lord Justice Evans.

reasonable care to consider all the potential consequences of that cause of action. If he is negligent, he will therefore be responsible for all the foreseeable loss, which is a consequence of that course of action having been taken. If his duty is to supply information, he must take reasonable care to ensure that the information is correct and if he is negligent, will be responsible for all the foreseeable consequences of the information being wrong" [73]. I will make now a quite brief analysis to the facts of the case where the above legal background was applied. As I said above the appellants – Aneco - were approached by a number of syndicates called Bullen to conclude a number of reinsurance contracts. This was done through a firm of brokers called J & H. In the decision of the court of first instance, J & H were not parties. The nature of the reinsurance contracts was facultative obligatory. This meant that Bullen could decide which risks to declare under the treaty and the appellants were bound to accept them, if they were within the limits. It must be said that this kind of contracts is not very attractive in the insurance market for the insurer. The reason is that the insurer is obliged to insure good or bad risks, because he does not have a real choice. This is the reason why Aneco asked for retrocession cover. Another factor, which made the attitude of the insurance market towards facultative obligatory treaties even more complicated, was that the Piper Alpha disaster had occurred earlier that year. This made the reaction of the market quite difficult to be assessed. The fact that J & H submitted that retrocession cover would be obtained for Aneco was the reason, which actually induced them to conclude the contracts. The issue on appeal was *"whether J & H could have obtained reinsurance for Aneco if they had made full disclosure of all the material facts"* [74]. The judge in the court of first instance had found that that even if full disclosure was made, cover would still be available[75]. On appeal, the burden of proof was put on the appellants to prove that alternative security was not available. It was held that *"the evidence is clearly sufficient to discharge the burden of proving that on the balance of probabilities, alternative security, meaning reinsurance cover of the kind which Aneco required, could not be*

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[73] *Ibid.* Page 6. Per Mr. Hunter for the appellants.
[74] *Ibid.* Paragraph 42.
[75] See above.

found in the London market" [76]. The risk, as I said above, was said to be uninsurable. As to the measure of damages the decision was the following. As to the losses it was decided that *"the losses would not have been incurred, if the respondents had acted with reasonable skill and care"* [77]. The problem, however, was how the principle of the **Banque Brusselles case** would be applied in this case. It was held by the Court of Appeal that *"that Aneco is entitled to recover damages for the whole of the losses, which it suffered in consequence of entering into the Bullen treaty, acting on J & H advice with regard to the availability of reinsurance (retrocession) and therefore on the current market assessment of the risk"* [78]. Conclusively, the principle of the **BBL case** was not applied in this case. The reason was primarily that the broker who had been instructed by J & H to effect the insurance had took it upon himself to advise Aneco in respect of the reinsurance contracts [79]. Since causal connection could be justified liability could be imposed. The Court of Appeal actually approached the matter on the basis that facultative obligatory nature of the treaty was a material fact and this is what affected its decision most [80].

Another case that can be mentioned and that is related with the duty to advise is **Jones and Marsh McLennan v Crawley Colosso** [81]. J – the insured - had acquired two islands in Bahamas and he wanted to develop them into holiday resorts. As a result, he instructed his United States brokers, MM, to obtain cover. However, it was not possible for MM to obtain the appropriate cover in the United States, so, they approached CC, who were London brokers to obtain the cover. They managed to do so, but the policies contained an exclusion clause, which disclaimed the insurers' liability for loss of or damage to any part of permanent works *"for which a certificate of completion had been issued"* [82]. When MM checked the policies, they did not object to these clauses. Afterwards, when the marina was complete and a document of substantial completion

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[76] *Ibid.* Paragraph 71.
[77] *Ibid.* Paragraph 74.
[78] *Ibid.* Paragraph 84.
[79] *Ibid.* Paragraph 83.
[80] Deighton Andrew & Peter Gregoire. (2000). Broker's negligence and measure of damages. Barlow Lyde & Gilbert. Pages 18-20.
[81] (1996) Lloyd's List, 1 August, Insurance Law Monthly. Volume 8. Issue 12.
[82] *Ibid.*

had been issued, it was destroyed by Hurricane Andrew. J brought an action against CC and assigned to MM his rights. The court held that the combined negligence of both firms of brokers caused J's loss. The responsibility for the loss was apportioned two-thirds to CC and one-third to MM. It is obvious that the main issue of this case was the relationship between the principal, its brokers and the sub-brokers. It is submitted that if the brokers and sub-brokers are solvent, there are two possibilities. (1) The assured can sue his own broker alone for the whole amount of the loss and the broker subsequently or in joined proceedings recovers contribution from the sub-broker [83]. (2) The assured sues his own broker and the sub-broker for their respective breaches of duty [84]. If, on the other hand, either broker is insolvent, the assured is still entitled to recover his loss under joint and several liability rules [85].

The general duty to advise also exists in the reinsurance field. For example, it was held in **Youell and Others v Bland Welch & Co. Ltd. and Others (The Superhulls Cover No 2 case)** [86] that it is the duty of the broker to read the reinsurance contract and tell him whether his cover is appropriate or not. The materiality issue here is also at stake. I have dealt with it when talking about the ***utmost good faith requirement***, so I will make a very brief reference at this point. Generally, subject to the issue of inducement, as to what is regarded, as material, no subjective opinion would be accepted. What a prudent and reasonable underwriter sees as material is usually that which would be considered to be material. The only thing that needs to be mentioned is that an average broker is not required to have the knowledge of a lawyer. If for example, a legal issue is deemed to be very complicated, the broker has the right to refuse to give advice or to give it but say that it is doubtful whether this piece of information is correct or not [87]. A case, which is quite illustrative about all that, is **Sarginson Brothers v Keith Moulton and Co. Ltd** [88]. This case took place during the Second World War and the issue was whether a stock of timber could be insured against war risks under the War Risks Insurance Act 1939. The

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[83] *Ibid.*
[84] *Ibid.*
[85] *Ibid.*
[86] (1990) 2 Lloyd's Rep. 431.
[87] O'Neil P.T & Woloniecki J.W.(1998). The law of Reinsurance. Sweet & Maxwell, 1st edition. Page 395.
[88] (1942) 73 Ll.L.R 104.

information that was given by the brokers was that they could not but this was proved to be wrong. It was cited down in the judgement that *"one has a great deal of sympathy, I suppose, with every professional man nowadays...emergency legislation, regulations and rules...pour out in an unceasing flow...there is always a danger of being caught out by something. I do not for one moment say that they are bound to be* acquainted *with everything"* [89]. In a brief analysis of the degree of care, according to the court, the vital point is that there is an effort by the courts to try and modify the application of legal principles according to the needs of the present market. This simply means that perhaps before the development of such a balanced insurance system, the standard of care and knowledge, which would be required by a broker, would be higher, because the market was more complex. In addition, the persons with expert knowledge were only quite a few and as a result the clients relied much more on their opinion.

4.8 Proper Presentation of the Risk

Another duty that needs to be mentioned is that proper presentation of the risk by the brokers must be achieved. Since, the chapter of utmost good faith deals with this duty, because of its importance, I am going to refer to it quite briefly and not in detail. The duty of the utmost good faith is very significant, because it is what the whole transaction is based on. If for example, a broker does not disclose to the insurer material facts, then the insurer has the right to avoid the insurance policy for non-disclosure. And this is logical, because where there is non-disclosure, it is impossible for an insurer to ascertain whether a risk is high or not. More illustrative are the cases and the relevant sections of **MIA 1906** but these are mentioned in the utmost good faith chapter [90].

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[89] *Ibid.*

[90] Bennett Howard. The Law of Marine Insurance. Clarendon Press, Oxford.

4.9 Duty of the broker in placing the cover

In respect of reinsurance, some aspects of placing the cover were mentioned in the part that is related with obtaining it. So, I will refer only to the cases, which deal with original insurance. The issue is one relating as to whether the broker acted with sufficient speed to place the cover. For example, in the case of **Cock, Russell and Co. v Bray, Gibb and Co. Ltd.** [91], instructions were received to obtain insurance of a cargo of wine. There were actually great difficulties in obtaining the cover and since the instructions were received on Friday afternoon, nothing could really be done. On Saturday, there was an effort for the cover to be placed, but there was no success at all. On Monday, it was discovered that much of the cargo was lost. It was held that the brokers were not liable and the reason for this was that they did not delay in any of their activities in an unreasonable way [92]. One more case that needs to be mentioned is that of **Lewis v Tressider Andrews Associates Pty Ltd.** [93]. The outcome of the case was that a broker was held liable for not using his best endeavours to find out through the financial statements he had, what was the exact financial position of an insurer who was new in the field [94].

I will refer in quite a more detailed way to the case of **Osman v J. Ralph Moss Ltd.**[95]. The case related to motor insurance. When the plaintiff, who was the owner of the car, wanted to obtain insurance for his vehicle, the insurance company, which was recommended by the brokers who were instructed by the plaintiff, was known to be in financial difficulties. The first claim against the brokers was for ***damages for breach of contract or negligence.*** The second one was related with the breach of the brokers of the duty ***to inform their client that he was in fact uninsured.*** The next allegation against the brokers was that the brokers actually incurred liability for the costs and the fines that the plaintiff had to bear and also ***liability to third parties.*** Finally, there was a claim in relation to the recommendation by the brokers to insure with this particular insurance company. In the court of first instance, it was decided that *"the defendants were liable,*

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[91] (1920) 3 Ll.L.Rep.71.
[92] *Ibid.*
[93] (1987) 2 Qd.R 533.
[94] *Ibid.*
[95] (1970) 1 Lloyd's Rep. 313.

but the plaintiff was entitled only to the amount of the premium, which he paid, and that any further damage suffered by the plaintiff was too remote" [96]. There was an appeal by the plaintiff, which was in fact allowed. The Court of Appeal held that it could be found that the brokers were negligent in recommending this particular insurance company to the plaintiff. The same thing was decided in respect of the letter, which was sent to the plaintiff. In this letter the broker simply advised the plaintiff to obtain insurance from another insurance company. Also, as to the aspect of remoteness, the decision was that all the amount of damage that was suffered by the plaintiff was not too remote in relation to the activities of the brokers. The result was that the plaintiff was entitled to recover all the money he has spent as a result of the negligence of the brokers [97].

I will now concentrate on the case of **FNCB Ltd. (Formerly First National Commercial Bank plc.) v Barnet Devanney (Harrow) Ltd. (formerly Barnet Devanney & Co Ltd.) 1/7/1999** [98]. The facts of the case were as follows. In 1989 Barnet Devanney & Co. Ltd, a firm of insurance brokers, arranged a cover on behalf of First National Commercial Bank plc for the insurance with General Accident Fire and Life Association Corporation plc and others, who were the insurers of the case, for a property. This property was charged to the bank as a security for a loan, which was given to the owner. The policy was effected on the name of the owner and the bank. When the property was damaged by fire, the insurers denied liability to both on the ground of non-disclosure and misrepresentation. The bank brought an action against the insurers and although it had recovered some money under a Contigency policy, it had still suffered quite a loss [99]. Hence, the bank in this case brought the proceedings against the brokers for negligence and breach of contract. In the court of first instance, the bank's claim was unsatisfactory because the judge believed that negligence and breach of contract were not proved. Also, he decided that even if damages were awarded to the bank, the amount recovered by the bank under the Contigency policy would not be brought into account in

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[96] *Ibid.*
[97] *Ibid.*
[98] http://www.casetrack.com.
[99] *Ibid.* Paragraph 1. Per Lord Justice Morritt.

the calculation of damages [100]. The bank appealed in respect of this decision. The brokers submitted that if the appeal of the bank was successful, then, the Contigency policy recoveries should be brought into account when assessing the damages. Hence, the issues for the court were three: (1) whether the brokers were negligent in arranging the appropriate insurance cover? (2) Whether the loss of the bank was caused by the negligence? (3) Whether the proceeds of the Contigency policy should be brought into account [101]? The Contigency policy actually covered direct losses in respect of mortgage loans if the mortgagor had failed to maintain proper insurance. And the policy did not contain any mortgagee protection clause or a non-invalidation clause. It was argued that the brokers were negligent in not including these clauses in the policy. The duty that they owed was either contractual or tortious. When dealing with this, Lord Justice Morritt analysed the sources from which the judge came to his conclusion. These sources consisted of textbooks, precedent and the tendencies of the market. However, Lord Justice Morritt did not come up to the same conclusion. He submitted, first of all, that there was no evidence of a responsible market practice not to ask for a mortgage protection clause. Also he observed that it was not the function of an insurance broker to take a view on undetermined matters of law. Finally, he thought that the existence of the Contigency policy did not absolve the brokers from their duty to obtain primary protection. Therefore, the brokers were held liable for not including the clauses mentioned above in the insurance cover [102]. One very important aspect of the case was that in this kind of clauses, no additional premium is required; hence, the brokers should not include it in the policy. It must be said at this point that one of the main issues of the case was the difference between a composite and a joint insurance. As to the first one, Lord Justice Morritt challenged the judge's decision. His argument was based on the fact that although he was right to decide that a reasonable insurance broker would have known as a matter of law that no breach of condition, misrepresentation or non-disclosure would affect the claim of a mortgagee, as a result of **New Hampshire Insurance Co. v**

[100] *Ibid.* Paragraph 2.
[101] *Ibid.* Paragraph 3.
[102] *Ibid.* Paragraphs 20-24.

MGN Ltd. [103], this was not the case in 1989 [104]. The next big issue of the **FNCB case** was that of causation. The judge's conclusion in relation to this was that even if the brokers were negligent, the loss to the bank was not the result of this negligence. He also submitted that the right of legal recovery was not dependent upon the inclusion of the clause. On appeal, it was decided that if the clause was included, the insurers would have to pay the bank in full [105]. The last issue was that of the Contigency policy. The brokers claimed in the court of first instance that credit should be given to them because the amount of the bank's loss was reduced by the amount recovered under the Contigency policy. In the court of first instance, this argument was not accepted. On appeal, Lord Justice Morritt agreed with the judge. He held that there was no possibility of double recovery for the bank. The loss suffered by the bank was not reduced by the amount recovered under the policy [106].

In case where there is a placement of illegal insurance, the broker is liable if he chooses an authorised insurer [107].

4.10 Cancellation and Renewals of Policies

Another possibility that need to be examined is what is the position when a policy is cancelled by any of the parties. A relevant case is that of **London Borough of Bromley v Ellis** [108]. A purchase of a car took place between D and E who was the person who purchased the car. Also, an agreement was made to the effect that the car's insurance would be transferred to E. As a result, the insurance brokers that were instructed by E issued a cover note. However, the insurers did not accept the proposal of the brokers and the cover had to be cancelled. The problem was that E was not informed. When an

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[103] (1997) L.R.L.R 24.
[104] *Ibid.* Paragraph 20.
[105] *Ibid.* Paragraphs 25-32.
[106] *Ibid.* Paragraph 38.
[107] Insurance Law Monthly. Insurance Brokers Breach Defences Duty of Care Measure of Damages Risk Assessment. 7 (3) 1995. Pages 5-7.
[108] (1971) 1 Lloyd's Rep. 97.

accident happened, there was an action against E and E on his part made a claim against his insurance brokers for indemnity. His claim was successful. On appeal the Court of Appeal held that *"although the brokers were not E's agents, they were under a duty to use reasonable care in arranging the transfer; they were in breach of their duty, and therefore E was entitled to indemnity from them"* [109].

The next case I am going to talk about relates to the situation where there is a renewal of the policy. In **Mint Security Ltd. v Blair** [110] the facts of the case were as follows: the plaintiffs carried on a security business in Birmingham. The third defendants were instructed by the plaintiffs to obtain cash in transit with a limit of £50.000. They asked afterwards the second defendants to deal with it. When a slip was given to the first defendants, a proposal form was completed by the plaintiffs on 1975 and was renewed in 1976. When the plaintiffs decided that they wanted to expand their business in London and Manchester a new slip was prepared at 1977, which included the proposal of 1975. Hence, practically the underwriters in this instance were the defendants. On 1977, money that was delivered by the plaintiffs was stolen and as a result they indemnified the owner and tried to recover the money from the first defendants. The argument of the first defendants was that *"that they were entitled to limit their liability to £20.000"* [111]. This was according to the limits of liability as these were put in the policy. The next aspect of the argument was that *"they were entitled to avoid liability in that the plaintiffs were in breach of the warranty contained in the proposal form since no member of the crew had been in the plaintiffs' employment for at least a* year, *at least one member had not been trained before embarking on operations"* [112]. On the other hand, the allegations on the part of the plaintiffs' were *"a like sum of damages for breach of contract or duty from the third defendants or from the second defendants and further applied for rectification of the policy by deleting the reference to the proposal form"* [113]. The decision was quite complicated and the reason was that three defendants were involved, however, the general conclusion was that the limitation clause applied and the plaintiffs were entitled to recover £20.000 from the second defendants. The claims against the first and the third

[109] *Ibid.*
[110] (1982) 1 Lloyd's Rep. 188.
[111] *Ibid.* Pages 188-189.
[112] *Ibid.*

defendants failed [114]. Also, I will make a reference to the part of the decision that is dedicated to the renewal of the policy. The problem in this particular case was whether a piece of vital information, the inclusion of the 1975 proposal in the 1977 policy, was passed in such a way in order to discharge the defendants of their duty. In the actual judgement, Staughton J said: *"it is not suggested that the vital information was passed directly to the plaintiffs. However, the second defendant avers but the third defendants deny that the second defendants sent a copy of the slip to the third defendants. That is the crucial issue if a copy of a slip was so sent, then the second defendants discharged their duty, although they might have done so more conspicuously; if it was not sent, then the second defendants were in breach of their duty"* [115]. All this means that the vital issue seems to be whether a copy was sent or not.

4. 11 Standard of the Duty of Care

I am going to focus on what is the exact standard of a duty of care that is required by a broker, when he has to discuss with his client the type of cover that he has to obtain. Also, what happens in the case where this kind of insurance that is wanted cannot be obtained and it is the broker who must notify the client that an alteration has to be made? As we shall see a broker is generally required to secure his client's interests and quite a lot depends on the particular circumstances of each case. In the case of **Harvest Trucking Co .Ltd. v P.B Davis T/A P.B Davies Insurance Services** [116], thieves entered a warehouse which belonged to the plaintiffs' company and stole a lorry with a quantity of goods. After the theft took place, the company was liable to its customers for the loss. The plaintiffs tried to recover the money they spent under their insurance policy. The vital point was a clause that was included in the policy: ***"no claim will be admitted for the theft of or from any vehicle, which is not individually attended"*** [117]. According to this clause, there was no substance in trying to allege that the insurer had to pay. It was a fact that was beyond doubt. So, the only solution that the plaintiffs had was to bring an

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[113] *Ibid.*
[114] *Ibid.*
[115] *Ibid.* Page 99.
[116] (1991) 2 Lloyd's Rep. 638.
[117] *Ibid.* Pages 638-639.

action against the defendant broker. Their argument was based on the fact that he actually failed to obtain proper cover and inform the plaintiff company which was the exact effect of the "individually attended clause". It was held that *"on the facts and the evidence the defendant was in breach of this duty and his failure to do either of these things"*- to obtain the appropriate cover or to use his best endeavours to bring the insurer's terms to the company's attention – *"and his further failure to obtain his client's consent to any further action amounted to negligence on his part"* [118]. Also, the second aspect of the decision had to do with the fact that *"the plaintiffs were entitled to succeed on the basis that if the defendant had performed his duty as an intermediary, they would have recovered from the insurers the amount of loss they had in fact suffered"* [119]. Finally, the argument of the defendant that the plaintiffs were deemed to mitigate their losses by not pursuing their remedies was rejected [120]. What can be concluded from the above is that because of a broker's expected knowledge, there may be instances, where he will be considered to owe a duty of care simply because there will be no other person, on whom his client could possibly rely on.

4.12 Duty to assist in making the claims.

The broker is obliged for one more time to exercise his reasonable care and skill in order to fulfil his duty to assist in making a claim. As the situation is, this duty is most of the time related to the duty to ensure the proper preservation of documents and also sometimes the collection of claims. The reason behind this is that when for example a broker fails to retain documents, the result is that when a claim takes place, it is not then possible to track down who are the parties in an insurance contract. This happens because a number of years may pass before a claim comes into question. Then all the parties, whether they are at fault or not, are faced with a potential loss. Details about all these will be mentioned in the next unit of this chapter. For now I will refer to a very old case. This case is **Comber v Anderson** [121]. Here, the assured put on a ship a cargo of wheat. The

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[118] *Ibid.*
[119] *Ibid.*
[120] *Ibid.*
[121] (1808) 1 Comp. 523.

event, which damaged the cargo, took place on 28 January. Although most of the cargo was saved, its commercial value was more or less lost. On 2 February, there was a letter to the broker by the assured, which asked him ***"to do the needful"*** about the cover and also saying ***"I should wish to abandon, if it be admitted of"***. The reply of the broker took place on the 4th of the same month and its meaning was that he could not discuss substantially with any underwriters if he was not aware of more details. When the assured again replied, he did not say anything about abandonment. The assured after all these brought an action against the broker, when he served a notice of abandonment. The allegation was that there was a lapse of time and the court upheld this. Of course, the assured could not make any claim under his insurance cover and this was the cause of action. It was decided that the broker could not be held liable because he was not given clear instructions [122]. At this point, it must be said that this decision can be seen to be quite controversial and perhaps in our days a broker would be in a more difficult position because he would be expected to understand his principal's instructions [123]. This case just shows that a broker can be very important under certain circumstances in order to make a recovery possible. As I said above, more will be said below in relation to retention of documents and collection of claims.

4.13 Preservation of Documents and Collection of claims

A fundamental case that is concentrated on this matter is **Grace v Leslie & Godwin Financial Services Ltd**.[124]. The contracts in question were retrocession contracts. Actually what happened is that in 1956 the defendants were the brokers who placed the retrocession cover for the plaintiffs. Almost thirty years later, in 1984 the plaintiffs tried to claim under the retrocession contracts but this was proved not to be possible. This happened because the retrocessionaires were mentioned in the cover notes just as "companies" or "London Companies". This simply meant that they could not be traced. The question that arose was whether the brokers were under a duty in contract or in tort to keep the relevant documents in order to "make" the action possible. Clarke J.

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[122] *Ibid.*
[123] Benett Howard.(1996). The Law of Marine Insurance. Clarendon Press. Pages 93-94.
[124] (1995) L.R.L.R 472.

said: *"in my opinion, the evidence shows that it is and was the universal of Lloyd's brokers to collect claims when called upon to do so...in consideration of the insured (or reinsured as the case might be) agreeing to pay the broker's commission, the broker agree inter alia to* collect *the claims...his duty is to exercise all reasonable care and skill in collecting claims when asking to do so"* [125]. The effect of the opinion of the judge was that the broker was under a duty to keep the records as long as he would regard a claim possible. This principle as the judge stated it is quite controversial as it imposes such a heavy burden on the broker. Finally, an allegation that the plaintiffs were contributorily negligent, on the ground when the cover was originally obtained, they did not ask for the names of the retrocessionaires was rejected because it was held that the market practice in the 1950's did not impose such a duty on the plaintiffs [126]. Another issue was that of time bar. The argument on the part of the brokers was that the cause of action had occurred when the documents were actually lost, so, the six- year limitation period had passed. The judge did not agree with that and stated that the six-year time-bar period started when the brokers were called to collect the claims [127]. It is interesting to look at the implications of this decision. There is a possibility that it can lead the courts to the tendency to create a much more extensive duty for collection of claims. This duty actually consists of the assessment on the part of the broker when it is the same time for destruction of documents. Also, a broker must advise his client when it is the right time for destruction and obtain his principal consent for it [128].

The same principle more or less applies when the broker holds the documents of his principal at his property. A case, which is about what happens when the principal asks for documents that are in the possession of the broker, is **Yasuda Fire and Marine Insurance Co. of Europe v Orion Marine Insurance Underwriting Agency Ltd.** [129]. This case is very significant in the context of European law, since it deals with the right of inspection and there are a number of directives, which are dedicated to this. The defendants entered into three underwriting agency agreements with the plaintiffs. They

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[125] *Ibid.* Page 477.
[126] *Ibid.*
[127] Mattick Richard. Insurance Brokers Documents Duty of Care Insurance Claims. International Law Review 3 (9) 1995. Pages 329-331.
[128] *Ibid.*
[129] (1995) 3 All.E.R 211.

acted as their underwriting agents. Two parts of the agreement were of particular significance. The first one is that the defendants were entitled ***"to maintain all necessary books accounts records and other usual documentation appertaining to the insurance business transacted"*** [130]. And the other is that the plaintiffs were entitled ***"to inspect the same at any reasonable time following a written request to do so"*** [131]. It must be cited at this point that all these documents were deemed to be the property of the brokers. In 1993, the plaintiffs asked the defendants to give them access to their computer records. On their part, the defendants refused to give them access because according to them *(1) they had already permitted detailed inspection and copying of the defendants' written records under the agreements. (2) The computer records contained confidential information relating to other pool members' participation. (3) The defendants were not obliged under the agreements to create new documents for the plaintiffs' benefit"* [132]. The plaintiffs, after terminating the agreement with the defendants, asked for the inspection of the records, which would enable them to carry on their business. Again, the defendants refused and submitted that the termination amounted to the repudiatory breach of the agreements. The court decided that the agent's duty to provide his principal this kind of information *"arose from the fact that the principal entrusted to the agent the making of transactions binding on the principal. He was entitled to know what his personal contractual rights and duties were"* [133]. In respect of what was the effect of the termination of agency, it was held that *"on the proper construction of the inspection clause the inspection facility under the agreements was not discharged by the termination of the agency agreements for repudiatory breach"* [134]. Again, it is shown in this case that the burden that can be imposed on a broker is quite heavy.

4.14 Remedies

Everything in respect of remedies depends on whether the action is brought under contract or under tort. There is a difference in the limitation period according to **section**

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[130] *Ibid.*
[131] *Ibid.*
[132] *Ibid.*
[133] *Ibid.*
[134] *Ibid.*

14A of the **Limitation Act 1980** in respect of hidden losses. More about this is mentioned in the unit that is concerned with the liability of the brokers both in contract and tort.

4.15 Defences

In **Youell and Others v Bland Welch & Co. Ltd. and Others (The Superhulls Cover No 2 case)** [135] – which I mentioned above – a number of defences were raised. This case concerned a professional principal. These defences were that first of all the broker did not understand that the reinsurance contract was not back-to-back and also that because the reinsured did not make any further investigation when he was provided with a copy of the policy, this gave rise to an estoppel. These arguments were really based on two older precedents. The first one is the case of **General Accident Fire and Life Assurance Corporation v J.H Minet and Co. Ltd.** [136]. The whole case was about an excess reinsurance contract, which was issued by the plaintiff company. After a number of accidents, the plaintiff brought an action against the defendant brokers for failure to obtain the appropriate cover. The brokers argued that since they sent the cover note to the plaintiffs, the policy, which was obtained, was clearly shown. The court held that *"there was a breach of contract by the defendants in that they have failed to effect a reinsurance cover according to the plaintiffs' instructions; that in the particular circumstances no negligence could be imputed to the plaintiffs' underwriter in failing to appreciate that full cover was not provided by the cover note; and that therefore the defendants were liable in damages"* [137]. What the judges said was that the defendants had to prove ratification of their action by the plaintiffs in order for them to avoid liability because they could not be held liable for something that the plaintiffs had already accepted. However, ratification on the particular case was rejected.

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[135] (1990) 2 Lloyd's Rep. 431.
[136] (1942) Ll.L.R. 1.
[137] *Ibid.* Page 1.

The other precedent I would like to refer to is that of **Dickson v Devitt** [138]. Lord Atkin gave a quite influential speech. The following is an extract about the possible reliance of each client on his broker: *"when a broker is employed to effect an insurance, especially when a broker is a person of repute and experience, the client is entitled to rely upon the broker carrying out his instructions and is not bound to examine the documents drawn up in performance of these instructions"* [139]. These are authorities according to which an insured or a reinsured has the right to rely on his broker to obtain the appropriate cover or to inform him about the details of the policy. So, the result in **the Superhulls case** [140] was, as I mentioned above, that the brokers were liable. In respect of the defence of contributory negligence that was alleged, the court decided that the reinsured was 20 per cent blameworthy. It was also submitted that the cases of **Dickson v Devitt** [141] and **General Accident Fire and Life Assurance Corporation v J.H Minet and Co. Ltd.** [142] were decided on their own facts and did not create any kind of rigid rule.

I am going to refer now to two other cases. The first one is that of **Vesta v Butcher** [143]. This case was about the insurance of a fish farm. As to the matter of contributory negligence, it was held that this defence would be allowed. The plaintiffs' allegation that the blame between the parties could not be apportioned was rejected. Hence, it was decided that the plaintiffs were three quarters to blame and the brokers were just one quarter blameworthy. The Court of Appeal accepted this and in the House of Lords the point was not raised [144]. In contrast, I am going to refer to the case of **Pryke v Gibbs Hartley Cooper Ltd.** [145]. Here, the vital issue was that a financial guarantee policy was issued but it was outside the scope of a binding authority under which a firm of underwriters was acting on behalf of the plaintiffs. The defendants were actually the brokers acting in respect of a binding authority. The insurer was actually based in the U.S

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[138] (1916) 86 L.J.K.B 315.
[139] O'Neil P.T & Woloniecki J.W. (1998). The law of Reinsurance. Sweet & Maxwell, 1st edition. Pages 384-385.
[140] (1990) 2 Lloyd's Rep. 431.
[141] (1916) 86 L.J.K.B 315.
[142] (1942) Ll.L.R. 1.
[143] (1986) 2 Lloyd's Rep. 179.
[144] *Ibid.*
[145] (1991) 1 Lloyd's Rep. 602.

and when the broker was sent there to check whether his client- the U.S insurer- is conducting his business properly- he returned with quite an inadequate report. One of the arguments was that the broker takes commission, hence he owes a duty of care, but this failed. Also, the defence of contributory negligence was not established according to the particular facts of the case [146]. However, this case was very difficult to be decided because the broker was in conflict of interest with his principal.

Another defence that needs to be mentioned is that of causative breach. This defence sometimes is related to the defence of contributory negligence. In simple words, this defence is based on the question whether the alleged "illegal" conduct on the part of the defendant has caused in any way, the damage that the cause of action is based on. It can be possible that there is no connection between the two and as a result no liability can be inferred. In the case of **Standard Chartered Bank v Pakistan National Shipping Corporation (No 2)** [147] there was a claim for damages for deceit. There was an allegation that the defendant had made false statements to the issuing bank in respect of a bill of lading. In the words of Lord Justice Aldous *"the plaintiff's attempted deceit of the issuing bank was not causative of any part of the damage suffered by reason of the defendant's deceit"*[148]. The reason was that the bank had refused the payment anyway because of discrepancies in its documents. Another aspect of causation in this sense was developed in Vesta v Butcher where under English law, the 24-hour watch condition, which was breached, would render the policy null and void, although that the loss that took place was irrelevant to this condition [149]. Hence, it is quite clear that the defence of causative breach is something that has to be examined by the courts according to the particular aspects and facts of each case.

Finally, one more important case is that of **National Insurance and Guarantee Corporation plc v Imperio Reinsurance Co. (U.K) Ltd. and Rusell Tudor-Price Co.**

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[146] *Ibid*
[147] 27 July 2000, www.lawreport.co.uk. Page 1.
[148] *Ibid.*
[149] See above.
[150] (1998) 3 I.R.L.N 2.

Ltd. [150]. In this case, three defences were raised: waiver, estoppel and ratification. The outcome was that a client had not waived his right against his broker merely because the client has expressed the mistaken opinion that the policy has satisfied his instructions [151]. In relation to the defence of waiver, it was decided that for waiver to be established, the waiving party must not only know the fact on which his right to elect is founded but also that he has a right to elect...there could be no waiver or estoppel in the absence of unequivocal representation by a party that he will not rely or abandon his right [152]. About ratification it was held that when there was ratification by a principal contract, although the desired cover was not obtained, the effect was the contract that was binding as between the principal and the third party, but did not deprive the principal of any of the rights he may had against his agent [153]. This is how, more or less, defences are used in the insurance field.

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[151] National Insurance and Guarantee Corporation plc v Imperio Reinsurance Co. (U.K) Ltd. and Rusell Tudor-Price Co. Ltd. (1998) 3 I.R.L.N 2 / O'Neil P.T & Woloniecki J.W. (1998). The law of Reinsurance. Sweet & Maxwell, 1st edition.

[152] National Insurance and Guarantee Corporation plc v Imperio Reinsurance Co. (U.K) Ltd. and Rusell Tudor-Price Co. Ltd. (1998) 3 I.R.L.N 2.

[153] *Ibid.*

4.16 Codes of Conduct [154]

The first thing that needs to be said is that the Code of Conduct is very much the consequence of **the Insurance Brokers (Registration) Act 1977**. Lloyd's established it and its importance is beyond doubt. Before I start analysing each section, I will state the three fundamental principles under which the Code was created: **(1) Insurance Brokers shall at all times conduct their business with utmost good faith and integrity. (2) Insurance brokers shall do everything possible to satisfy the insurance requirements of their clients and shall place the interests of those clients before all other considerations. Subject to these requirements and interests, insurance brokers shall have proper regard to others. (3) Statements made by or on behalf of insurance brokers when advertising shall not be misleading or extravagant**[155].

I will know make a very brief reference to what these sections are about:

7.17 Sections

➢ Section 1

I will know make a very brief reference to what these sections are. This is about the relationship with the client. He must make sure that the client knows what is the role of a Lloyd's broker and also what is his knowledge towards the risks he will face or the dealings he will be a part into.

➢ Section 2 / Remuneration

Section 2 is about remuneration. It is submitted that if the client asks the broker, he has to disclose the amount of brokerage they will take. The same applies in respect of any payment during the transaction.

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[154] For further details see: Wright Jonathan. (1999) Insurance Brokers Codes of Practice Professional Conduct. International Insurance Law Review 3 (3). Pages 100-101.

[155] Shaw Richard. A Lloyd's Broker. (1995). Lloyd's London Press. Pages 271-272.

➢ **Section 3 / Confidentiality**

This is about the confidentiality of the client's information. The information that the client tells to his broker cannot be used or disclosed. The only situation when this can happen is when he does it in the ordinary of negotiating an insurance contract. Another one is when the client gives his consent or when a court requires the information.

➢ **Section 4 / Choice of Insurers**

It is the duty of the broker to try and find a certain number of insurers, in order to be able to obtain the adequate insurance cover. The broker must also understand that whatever connection he has must not prejudice his affairs. Finally, I will refer briefly to the situation where a possible insurer is outside U.K or an EEC country. The broker is actually allowed to suggest to his client three things: ***(a) the insurer is not supervised by the regulations of an EEC country. (b) Even if the client is an individual he will not find protection in the*** **Policyholders Protection Act 1975.** ***(c) The client may face problems to bring an action against such an insurer.***

If however, the client ignores the instructions of his broker, the broker must inform him that he disagrees and ask his client to put his acknowledgement in writing.

➢ **Section 5 / Disclosure**

This is one of the vital duties of the broker and is fully analysed in the chapter, which is about the duty of the utmost good faith. Generally, the broker is obliged to disclose all the information, which is considered as material. Also, a broker should not, at least in the normal course of business complete his proposal form for his client. In the occasion when he does not believe that the statements of the client are true, he must ask him, in order to be positive that he possesses the correct information.

- **Section 6 / Documentation**

The broker is under a duty to have written confirmation of any insurance policy and its terms. This should happen in respect of the names of the insurers and also in relation with other pieces of information. In the case of a lien exercised by a broker, he must inform his client that he is withholding the relevant documents.

- **Section 7 / Accounting**

The whole accounting function is the responsibility of the broker. All the monies have to be kept in **an Insurance Broking Account.** More details will be mentioned in the unit that is about the accounts of a broker.

- **Section 8 / Binding authorities**

This section is related to binding authorities. What is the Code focused on is that the broker must avoid a potential conflict of interest. He must always place business in order to achieve the best result for his client. For more, see the chapter of binding authorities.

- **Section 9 / Claims**

In relation with claims the broker must make sure that all the information, which has been acquired in respect of any claim is correct. Again, the avoidance of conflicts of interest is important.

- **Section 10 / Renewal**

The broker is simply under a duty when his client's insurance expires to seek for certain instructions and remind him of his duties.

- **Section 11 / Transfer of client**

On the occasion when the client decides to change broker, the old one has to provide the new Lloyd's broker with any documentation that will make his business easier.

- **Section 12 / Servicing**

In respect of servicing, even when the relationship between a broker and a client has been terminated, the broker is still under a duty to provide for his client any services, which are related with the particular insurance. The only reason according to which he does not have to do all that is if he has evidence that the client has instructed a new broker to perform all the activities he has been asked to do.

- **Section 13 / Complaints**

When there is a complaint, the broker must inform his client about the complaints' procedure. The client has actually the right to write his complaint to the Council of Lloyd's.

- **Section 14 / Supervision of Staff**

A registered insurance broker must supervise the work that is done by a broker. He should also try to inform his employees about the legal consequences of their actions and the legal framework that they have to move around

- **Section 15 / Competence**

A requirement for a broker to deal with a particular class of business is that he is competent in it.

➢ **Section 16 / Lloyd's Name**

Finally, a broker must be aware that of the regulatory status of the parties in an insurance transaction and be careful to use correctly the name of Lloyd's.

4.17 Conclusion

In conclusion I can say that the duties a broker can undertake are very significant for the proper performance of his job. As we can see from the Code of Conduct, efforts are made to try and regulate their duties and their rights. However, sometimes codes and rules are not enough because the market itself is faced with obscure problems under strange circumstances. But, it is the only way by which brokers have something to follow, so, that they do not act completely without a guide.

The other important aspect that needs to be mentioned is that there have been a number of new cases – some of them are mentioned here – which may prove to be very influential in the future. Moreover, it is an area, which can be described as a changing environment [156]. It will be very interesting how the concept of the duties of insurance brokers will be affected by the **General Insurance Standards Council** reform. The major issue is not that there will be new regulatory bodies but how the market will react to these changes. I will deal with this point more thoroughly in my conclusive thoughts as to what the position of insurance brokers will be in the future.

Hence, as we examined above, the duties of insurance brokers are very wide. It seems like a broker is not the person who will just obtain the cover for his client and this will be it. There can be instances where hid duty will continue to exist much after the completion of the insurance contract or before that. For example, the broker has to investigate the risk and also advise his client as to appropriate cover. This is, of course, very logical since it is something that goes together with a broker's expertise. And as we saw in the very recent **Aneco case** [157] it can be the basis for very complicated and important claims. Also, it would be useful to make a reference to the duty of the broker as

[156] Part of this research is dedicated to the latest developments in respect of the regulation around insurance brokers.
[157] 30/7/1999.

to the inspection of documents. It is again a duty that can take place much after the conclusion of the insurance contract and yet it can be very significant. Finally, I need to say that perhaps the most common duty of a broker is that of disclosure and misrepresentation. The number of case that had to be decided on this ground is very large. The most recent I have mentioned is **the FNCB case** [158]. It is very clearly shown in this case that non-disclosure will continue to be a very common ground for proceedings to be brought because it can be very difficult for a broker in practice not to be in breach of his duty of disclosure and in the same time to be able to obtain the adequate cover he needs. The reason for this is that there certain kind of risks that are very unattractive and there can be insured only on a very high premium. So, the broker has no real choice but not to reveal everything. The chapter that follows and deals with the liability of brokers will make the nature of the duties of insurance brokers even more clear.

[158] 1/7/1999.

CHAPTER

5 *Utmost Good Faith –Imputation of Knowledge - Fraud of Agents*

5.1 UTMOST GOOD FAITH

5.1.1 Introduction

General English contract law does not impose a duty on the parties to volunteer information during the contractual negotiations. Of course, this does not mean that the law will protect someone who has been induced into a contract by a misrepresentation, but just that a party has the right not to share information, even if it is highly relevant to the contract. However, this is not the position in insurance law. Insurance law contracts are considered to be *uberrimae fidei* – of the utmost good faith- and this simply means that there is a duty on the parties to disclose certain kind of information. Section 17 of **the Marine Insurance Act 1906** makes it obvious: *"A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not be observed by either party, the contract may be avoided by the other party"* [1]. Something that needs to be mentioned is that this duty is very significant in relation to brokers, because during the negotiations for the conclusion of the contract, it can affect the whole procedure. An obvious example is the case of **Pan Atlantic v Pine Top** [2], but this case will be analysed below, because of the implications that it has had. I intend to refer to a number of opinions, as to the actual result that this case had in relation to the operation of the insurance market.

5.1.2 Goof Faith in Contract Law.

First of all I intend to make a general reference to the concept of good faith in contract law. The reason for this is that it will be much easier afterwards to understand the difference between contract and insurance law and also what is the whole philosophy under which insurance operates. As it was cited in the introductory paragraph, a general duty of good faith is not recognised in English law. But, the situation is much more complex than such an explicit explanation and in the same time aphorism of good faith. The concept of deceit at common law recognises a duty of good faith in negotiation and performance as well as the enforcement of contracts.

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[1] Ivamy E.R Hardy Ivamy. Chalmers Marine Insurance 1906. London, (1966). Butterworths. Page 25.
[2] (1993) 1 Lloyd's Rep. 496, (1995) 1 A.C 501 (H.L)

The problem is that for deceit to be established fraud has to be proved. As it is put in an article: *"this duty is no more than a duty not to engage in fraudulent contracts"* [3], which as a result makes the duty less onerous and more difficult to be applied. So, the vital question is whether the law requires anything more than a duty not to act fraudulently. It must be said at this point that every country or more specifically every legal system has developed its own approach towards the issue of good faith. I am going to look at quite a few countries but English law will be the starting point. The refusal of the courts to recognise a duty of good faith was developed in respect of two kinds of arguments. First we have the **pragmatic thesis**[4]. This was a theory, which was developed, in the famous case of **Interfoto Picture Library Ltd v Stiletto Usual Programmes Ltd.** [5]. It holds that *"although English law has not committed itself to an explicit principle of good faith, it nevertheless succeeds in acting against cases of unfair dealing by one means or another"*. And as Sir Thomas put it *"it has developed- the English law- piecemeal solutions in response to demonstrated problems of unfairness"* [6]. It can be assumed from this kind of response that the requirement of good faith is not vital, simply because English law can do nicely even without one. The other approach is called **the repugnatory thesis** and it was developed in **Walford v Miles** [7], where it was held that it was not possible *"to recognise an agreement to negotiate in good faith as a legally enforceable contract"* [8]. The reasoning behind this approach is that – in the words of Lord Ackner – *"the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations"*[9]. The consequence of this opinion is that a general duty of good faith will actually unsettle the practical commercial position, and as a result problems will be created between the parties of the bargain. However, although it seems to be quite justified, there may be some space for a duty of good faith, even if the adversarial position of the parties is adopted. This does not necessarily mean that good faith has to be accepted in theory, but rather that it can be accepted in the exercise of the law. This is **the preservation function of**

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[3] Carter J.W & M.P Furmston.. Good Faith and Fairness in the Negotiations of Contracts. (1994). 8 Journal of Contract Law. Part I. Page 1.
[4] See: Brownsword Roger. Two Concepts of Good Faith. (1994) 7 Journal of Contract Law. Page 198.
[5] (1989) Q.B 433.
[6] *Ibid.* Page 439.
[7] (1992) 1 All E.R 453.
[8] *Ibid.* Page 460. Per Lord Ackner..
[9] *Ibid.*

good faith[10]. This is reflected by the courts in that they are often influenced by the reliance that a party may wish to show that a particular way to negotiate is not permitted, in order to preserve justice and ensure the economic fairness of a contract. On the other hand, in the United States of America the concept of good faith is treated in a different way. In the words of Mr. Farnsworth, *"if the English have difficulty to attaching any meaning to good faith, the difficulty in my country is quite the opposite: the Americans have...too many meanings of good faith"*[11]. One of them is the prospect of good faith need to be mentioned. The first one is called **the excluder analysis** and it was developed by Professor Summers[12]. According to it, it would be better in cases of doubt for a court to define good faith by excluding what it cannot be- bad faith -. The second one is **the forgone opportunity analysis**[13]. Professor Steven Burton developed this analysis and it states that a standard can be created by the expectation of the parties. The sources where a concept of good faith can be found in United States law is **the Uniform Commercial Code, the American Law Institute's Reinstatement (2nd) of Contracts and the United Nations Convention** on contracts for the **International Sale of Goods** [14].

In Italy and Germany, a duty to negotiate in good faith is imposed in some cases. In the **Italian Civil Code,** this is expressly provided. In the **German Civil Code,** there is an express provision for good faith in the performance but not in the negotiation of a contract. I left France for the end because the duty of disclosure in the negotiations of a contract is much wider and it is more similar to the duty of the utmost good faith in English insurance law. It exists not only in the areas of sale and insurance, but also in money lending and franchising. And it arises both through legislation and case law[15].

Finally, in Greece the situation is as follows[16]. The main article is **article 288** of the Civil Code. According to it *"the debtor is obliged to fulfill the giving-* his part

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[10] See: Carter J.W & M.P Furmston. Good Faith and Fairness in the Negotiations of Contracts. (1994). 8 Journal of Contract Law. Part I.
[11] Beatson & Friedman. (1995). Good Faith and Fault in Contract Law. Clarendon Press. Article by Farnsworth. Page 160.
[12] *Ibid.*
[13] *Ibid.*
[14] *Ibid.*
[15] *Ibid.*
[16] See: Aggelopoulou Penelope. (1997). Civil Code and Introductory Law. Sakkoulas Publications. Stathopoulos Mihalis. (1993). General Culpability Law. Sakkoulas Publications. 2nd edition.

of the bargain - *as he is obliged by good faith taking into account also the customs prevailing in legal relations".* Something else that needs to be mentioned is that in case there is a breach of duty the only remedy that can be awarded is avoidance of contract.

5.1.3 Utmost Good Faith

It is time to move on to the duty of the utmost good faith. This is the area, which is related to brokers because as I submitted in the introductory part, this is a duty that is recognised in the insurance field. The most usual remedies for breach of duty of the utmost good faith are avoidance or rescission- retrospective avoidance- of the contract. As a starting point, I need to say that even the common law recognised a duty of disclosure[17]. In the very old case of **Carter v Boehm** [18] Lord Mansfield made a statement that remains influential until today: *"Insurance is a contract upon speculation...the keeping back of such circumstance is a fraud and therefore the policy is void"*[19]. In relation with misrepresentation, Lord Mansfield again held in **Macdowell v Fraser** [20] that a contract could be avoided by an underwriter because of a non-fraudulent misrepresentation. Finally, in **Ionides v Pacific Fire and Marine Insurance Co.** [21] a cargo policy was held to be void although the misrepresentation was made in an innocent way[22].

5.1.3.1 Marine Insurance Act 1906 – Relevant Sections

Section 17 of the Marine Insurance Act 1906 – it is cited above – is the most explicit one in relation to the duty of utmost good faith. Also relevant are sections 18-20. Section 18 of the same statute is about disclosure on the part of the assured and it provides that *"subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known to him. If the assured fails to*

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[17] See: Bennett Howard. The Law of Marine Insurance . Clarendon Press. Page 45.
[18] (1766) 3 Burr. 1905, 1909 1 W. Bl. 593.
[19] *Ibid.* Pages 593-594. Per Lord Mansfield.
[20] (1779) 1 Dougl. 260.
[21] (1871) L.R. 6 Q.B 674.

make such disclosure, the insurer may avoid the contract" [23]. Very important is subsection 2 as well: *"every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk"*[24]. Section 19 is about the knowledge of an agent effecting the insurance. According to it *"subject to the provisions of the preceding section as to circumstances which need not to be disclosed where an insurance is effected for an assured by an agent, the agent must disclose to the insurer (a) every material circumstance which is known to himself, and an* agent *to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to him* and *(b) every material circumstance which the assured is bound to disclose, unless it comes to his knowledge too late to communicate it to the agent"* [25]. Finally, there is section 20, which is related to misrepresentations that may happen during the negotiations. This section is quite relevant as to what is considered a misrepresentation. Hence, *"(1) every material made by the assured or his agent to the insurer during the negotiations of the contract, and before the contract is concluded, must be true. If it is untrue the insurer may avoid the contract. (2) A representation is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk"*[26]. This part of the section has been subject to a great extent of analysis both by courts and academics.

Relevant Cases – Prior to the CTI and the Pan Atlantic Cases

Two of the most significant cases in relation to the duty of the utmost good faith, namely **the CTI case** and **the Pan Atlantic case** [27] dealt extensively with this point. However, I will refer to them further on. Going back to **the Marine Insurance Act 1906** section 20 also provides that *"(3) a representation must be either a representation as to a matter of fact or to a matter of expectation or belief. (4) A*

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[22] *Ibid.* Page 683.
[23] Ivamy E.R Hardy Ivamy. Chalmers Marine Insurance 1906. London, (1966). Butterworths. Pages 25-32.
[24] *Ibid.*
[25] *Ibid.*
[26] *Ibid.*
[27] Proper reference is cited below.

representation as to a matter of fact is true, if it be substantially correct, that is to say, if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer. (5) A representation as to a matter of expectation or belief is true if it be made in good faith. (6) A representation may be withdrawn or corrected before the contract is concluded. (7) Whether a particular representation be material or not is, in each case a question of fact"[28]. At this point two elements of good faith must be mentioned: firstly, although the duty of utmost good faith is deemed, in most of the cases, to be owed by the assured, in reality, all the parties of the contract are under this obligation. And secondly, the duty of the utmost good faith is a continuous one. Before the MIA 1906, the duty of utmost good faith was recognised as a duty existing in contexts other than a context of pre-contractual negotiations. For example, in **Shepherd v Chewter**[29], Lord Ellerborough held that an adjustment would not be binding, unless there was a full disclosure of the circumstances of the case. Also, a post-contractual duty was recognised but there was no discussion about the remedies of a possible breach.

After the MIA 1906, not a lot of cases have been decided on the ground of section 17. The first case that needs to be mentioned is **Berger v Light Diffusers**[30]. In this case Kerr J. decided that in order for a marine insurance to be void, the situation should be that the non-disclosure had to be material not to the objective underwriter but to the particular underwriter who deals with the transaction in question. This was also the main issue of the questions that were addressed in the **Pan Atlantic case.** Hence, if we want to summarise them the basic issues were **(1) when is a non-disclosure regarded as material – in other words what impact should it have on the mind of a prudent underwriter-? (2) Is materiality an objective concept as section 18(2) and 20(2) of the MIA 1906 show or a subjective element as well?** In **the Berger case** it is obvious that a subjective element was recognised and this was an

[28] Ivamy E.R Hardy Ivamy. Chalmers Marine Insurance 1906. London, (1966). Butterworths. Pages 25-32.
[29] (1808) 1 Comp. 274.
[30] (1973) 2 Lloyd's Rep. 442.

advantage for the assured, because the underwriters would have to prove that they were actually induced in the contract[31].

The CTI and the Pan Atlantic Cases

I am going now to move on to two cases, which are very closely related with each other. The reason for this is not that they have any kind of contractual relationship but rather in the second one what had to be done was actually the assessment and the examination of the first one's results. Hence, the first one of these cases is **Container Transport International Inc. v Oceanus Mutual Underwriting Association (Bermuda)** [32]. The case was about non-disclosure of a previous claims history. And it was held that in order for a particular circumstance to be material, it should, if it was disclosed, make a prudent underwriter, either to cancel the policy or charge an additional premium. In the words of the court, *"since the English law is so favourable to the underwriter in this respect, the least that should normally be expected of the underwriter is to show that a prudent insurer would have charged an increased rate"* [33] . However, the decision did not remain the same on appeal [34]. The Court of Appeal decided that in respect of sections 18(2) and 20(2) of MIA 1906, there was no subjective element on materiality and even more importantly, that the influence on the mind of the underwriter did not necessarily mean that he should change his mind but rather that it would have an impact on his mind. According to Stephenson J. *"everything is material to which a prudent insurer, if he were in the proposed insurer's place, would wish to direct his mind in the course of considering the proposed insurance with a view to deciding whether to take it up and on what terms, including premium. His mind would, I think be influenced in the process of judging whether to do so, either temporarily where he can say that he would ultimately have reached the same decision without it, or permanently where it would*

[31] For more details see the judgment.
[32] (1982) 2 Lloyd's Rep. 178.
[33] *Ibid.* Pages 188-189.
[34] (1984) 1 Lloyd's Rep. 476.

have led him to reach a different decision" [35]. *Hence*, what are in effect the implications of **the CTI case**? Cameron Marky Hewitt concluded that this decision has been under great condemnation. And his reasoning seems to be quite convincing... *"It was pointed out by numerous writers that the test of materiality was generous in the extreme to insurers"* [36]. Also, he argued that *"there was a particular fear that the parties to international insurance and reinsurance contracts would disregard English law in favour of a more rational law"* [37]. And it is not really difficult for someone to understand that this would have a very bad impact on the English insurance market. Finally, he referred to the fact that **the Insurance Ombudsman Bureau,** *"which adjudicates on consumer insurance disputes and which is not bound by the strict law, refused to apply the CTI and began to adopt a proportionality approach"* [38].

It is quite clear from the above that the decision in **the CTI case** could not last long and this is what really happened. Its findings were examined in the case of **Pan Atlantic v Pine Top Insurance Co. Ltd** [39]. There were actually two different tests that had to be examined by the court. These were related to the aspects of materiality and inducement. Before I concentrate in the actual decision, it is significant to emphasise the fact that the findings were in accordance with **the CTI case** on the subjective element test and on the different decision test. The plaintiffs in the case were the reassured and the defendants were the insurers. The contract in question covered losses occurred in 1982 and similar contracts also existed for the periods 1977-1979 and 1980. The plaintiffs claimed payment of damages in respect of

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[35] *Ibid.* Page 529. Per Lord Stephenson.
[36] See: Hewitt Marky Cameron. Reinsurance Disclosure Insurance Contracts Misrepresentation Underwriters. In House L. May 1993. Page 59.
[37] *Ibid.*
[38] *Ibid.*
[39] (1993) 1 Lloyd's Rep. 496 (C.A), (1995) 1 A.C 501

outstanding losses due to them and they also sought indemnification under the reinsurance contract. On the other hand, the defendants raised the argument that they did not have to pay on the basis of a non-disclosure of a material fact. The court held that in respect of the period 1980-81 the non-disclosure was immaterial and as a result the underwriters were not entitled to avoid the policy. For a period 1977-1979, it was decided that there was a waiver of disclosure by the brokers of the defendants. And for 1981, in contrast, it was held that there was a material non-disclosure, so the defendants were entitled to uphold their defence. This was the practical outcome of the case. But, there was a theoretical background that had to be applied in the case. The Court of Appeal upheld actually the objective materiality test that was adopted by **the CTI case** and decided that inducement was not an essential requirement. In the House of Lords the decision remained the same in respect of materiality, but changed about inducement[40]. However, this case has been discussed extensively among writers. I am going to refer now to some of the views that have been expressed in respect of this case. Hence, according to Harold Caplam[41], the decision did not make any serious difference in the operation of the insurance market. The fact that, according to this case, the test for materiality is an objective one and the test for inducement is subjective did not have such an important practical effect. It is worth citing down an influential part of his article: *"Is anything changed by Pan Atlantic? Very little. The commercial buyer is still at the risk of discovering, years later, that insurers* ***who have never written his business*** *will find fault with the broker's presentation, saying that they would have liked more of this or that, or that the omission of the other is something which, with hindsight, they would have dearly loved to be told about; and that his own insurer was undeniably induced to grant the cover in blissful ignorance of misrepresentation or non-disclosure- how could it be otherwise* [42]*?*

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[40] More analytical views about this decision are discussed below. However, the main issues were that of materiality and inducement.

[41] Caplam Harold. (1994) . Reinsurance Contracts Disclosure Fraud, Illegality, Letters of Credit. Int. I.L.R. 2(12). Pages 433-437.

[42] Ibid. Page 435.

5.3.1.2 Types of Material Information

Another interesting view is the one by Malcolm Clark[43]. He made an effort to analyse different types of information and accordingly decide whether it is considered material. Type (A) *"is information such that, if the insurer had known about it, after due consideration he would have refused to make a contract at all"*. Type (B) *"is information such that, if the insurer had known of it, he would have made the contract of insurance but only on terms especially as to premium, different from those which he did agree"*. Type (C) *"is information such that, if the insurer had known it, he would have considered it relevant, but unlike Type (A), so relevant that he would have refused to contract and, unlike type (B), not so relevant that he would have insisted on different terms"*. Finally there is type (D) *"which appears to be information between type (B) and (C)* [44]. Hence, according to this analysis, the main point that needs to be discussed is actually the purpose of disclosure. The reason for this is that it directly affects which type of information is the one that needs to be disclosed. If the test is for the insurer to decide whether he will take the risk or not, then is type (B) that needs to be revealed. On the other hand, if the test concentrates on the fact to enable the insurer decide whether he will make further inquiries in order to undertake the risk or not, type (C) is the information that ought to be disclosed. And this is where two very important cases- **the CTI and the Pan Atlantic cases** – focused on. According to Clarke, the effect of **the CTI case** was that disclosure of type (C) was required. However, this approach was reviewed in **the Pan Atlantic case.** The problem of **the CTI case** was that there were two alternatives, which were not examined. The first one is *"the awareness"* test. According to this, the insurer would want to be aware of

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[43] See: Clarke Malcolm. (1993). Reinsurance Disclosure Insurance Contracts Misrepresentation Underwriters. L.M.C.L.Q. August. Pages 297-300.
[44] *Ibid.*

this kind of information when taking the risk. However, this kind of solution was not the one that was chosen. Steyn L.J. believed that it was the second alternative, which was intended to be considered correct by **the CTI case**. This approach was *"the different and increased risk"*. The result of this is that if this kind of information was disclosed, it would make the insurer believe that the risk in question had been increased in relation always with the original disclosure. However, according again to Malcolme Clarke this approach does not solve any problems. And there were quite a few reasons for his doubts to be taken seriously. One of the most important ones is that many times in the London market, risks are taken on because of commercial reasons and with very high speed, so that there can be no real difference between the "awareness" and "the increased risk" test. Another reason is that the remedy for non-disclosure is based on the vitiation of the consent of the insurer, but this cannot be upheld, since there is always the possibility that the insurer will eventually take the risk. These kinds of problems make sometimes non-disclosure nothing more than a technical defence, which causes confusion among lawyers and their clients. It is worth noting that as doubts were expressed about the outcome of the case, as I cited above, another suggestion that was mentioned was that when the non-disclosure came into light, the adjustment of the premium would be enough [45].

I am going to refer now to another case, where the duty of the utmost good faith was one of the central issues. This case is **The Litsion Pride**[46]. The problem here was the broker's own knowledge and this was the factor that made this case so difficult to be decided. The facts were as follows. The first plaintiffs of the case were the owners of the vessel Litsion Pride. The defendants were the underwriters with which the vessel was insured against war risks. The second plaintiffs were those to whom the vessel was mortgaged. It would be very interesting to look at the warranties, which were incorporated in the policy. These were: *(a) this coverage shall extend worldwide, but in the event of a vessel...insured hereunder sailing for...or being with the Territorial Waters of any of the Countries or places described in the*

[45] See: Hall John & Justin Tivey. Reinsurance Disclosure Insurance Contracts Misrepresentation Underwriters. Int. I.L.R. (1993). Pages 181-184.
[46] (1985) 1 Lloyd's Rep. 437.

Current Exclusions...additional premium shall be paid at the discretion of Insurers...(b) Information of such voyage...shall be given to the Insurers as soon as practicable and the absence of prior advice shall not affect the cover..." [47]. Hence, the Litsion Pride was chartered to make a voyage in one of the most dangerous ports in the Gulf. As a result, the first plaintiffs wrote a letter to the brokers stating that they have to proceed with the war insurance and advise the underwriters accordingly. The brokers received the letter ten days later. While the vessel was in this dangerous area, it was struck by a missile and it was abandoned. On a claim by the plaintiffs the argument on the part of the defendants was that they were not liable on the basis that the requirements, which were contained in the warranty, were a condition precedent for liability to be established in an additional premium area. Also, the underwriters submitted that the owners and the brokers were in breach of the duty of utmost good faith[48]. The first part was concentrated on the construction of the warranties. Namely, it was held that if clause *(b)* – mentioned above – was a normal "held-covered clause", then, a condition precedent would be implied. However, this was a quite more extensive and detailed clause and nothing for condition precedent was mentioned. Conclusively, if the underwriters wanted to impose a condition precedent, they had to do that in very clear terms. Secondly, it was decided that the phrase "the absence of prior advice shall not affect the cover" meant that a duty still existed even if the information on the particular voyage was not passed. Moreover, the fact that information on the voyage should be given as soon as practicable was not a condition precedent [49]. The second part of the decision had to do with the issues of fraud and bad faith. First of all, the court submitted that that it was made clear that the owners would not pay the additional premium required. . Also, the duty of the utmost good faith could very clearly apply under the circumstances. The insured was simply required to notify all the relevant information to the underwriters. But, this did not happen, because the brokers made a number of fraudulent statements, which were

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[47] *Ibid.*
[48] *Ibid.*
[49] *Ibid*

directly relevant with the claim. Finally, the meaning of avoidance under section 17 of MIA 1906 was discussed. It was decided that it meant avoidance *"ab initio"*. This meant that the policy might be avoided or not. If the underwriters wanted to defend the claim instead of avoiding it, it was up to them[50]. Hence, the defence of the underwriters was upheld both against the owners and the brokers. It is obvious from the above that the fact that the brokers were aware of circumstances that they did not communicate to the underwriters was the controversial issue as to whether their principals should be held liable for their agents' fraudulent claims. However, this case would not be decided now on the same grounds on the basis that there is no actual fraud on the part of the principal.

Moral Hazard

Next, I want to refer to the aspect of moral hazard. It is one of the grounds that are used by insurers in order to avoid liability. In the quite old case of **Locker & Wolf Ltd. v Western Australian Insurance Co.** [51] it was recognised that the moral integrity of the parties in a contractual relationship is one vital factor. Hence, when a state of moral hazard occurred, the avoidance of the policy would be justified per se. For example, factors, which would create moral hazard, are the insurance history or the criminal record of the parties[52]. As I cited above, the duty of the utmost good faith is applied to all the parties to a contract. This means that the insurer is also under a duty of the utmost good faith. However, one of the first cases where an assured decided to preserve his rights under the duty of disclosure is the **Banque Financiere v Westgate Ins Co. Ltd.** [53]. The case involved the non-disclosure by the insurers of certain facts that concerned the dishonesty of the plaintiff's broker. The plaintiffs granted a number of loans, but they could not either recover the amount that was owed to them or sought indemnity in respect of the debtor's fraud under the terms of the policy. More specifically, the firm of insurance brokers that arranged the cover issued cover notes about the first loan, which were proved to be fraudulent. In the end,

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[50] *Ibid.*
[51] (1936) 1 K.B 408.
[52] See: Brown Vanessa. Reinsurance Contracts, Disclosure, Fraud, Illegality, Letters of Credit. (1994). Legal Times, 30 November. Page 10.
[53] (1991) 2 A.C 249.

the whole scheme was proved to be the result of fraud. An action was brought both against brokers-which was settled- and on the insurance contracts. However, in the court of first instance, the claim was not upheld because of the existence of an "insurers' liability exclusion clause". Also, an action was brought against the insurers for the non-disclosure of the broker's fraud. In the court of first instance, the claim was successful but the Court of Appeal decided that even if a breach for non-disclosure was recognised only avoidance of the contract and return of the premiums could be established but no damages. Finally, in the House of Lords, it was held that the losses that the banks were faced with had nothing to do with the duty of disclosure on the part of the insurers. Hence, there was lack of causation. However, it was again established that damages could not be awarded. It is true that this approach had created quite a few problems in the development of the utmost good faith issue, since the party, which tried to rely on it, did not have an extensive reward. The strange thing is that the court seemed to be influenced by section 17 of **MIA 1906**, although so many years had passed and it should try to make the rules more flexible towards the needs of the modern insurance market[54].

Open Cover Arrangement

But what happens in the case of an open cover arrangement? I am going to refer to the unreported case of **Societe Anonyme d'Intermediaries Luxembouregois (SAIL) v Farex Gie** [55] where quite a few related issues were discussed[56]. The facts were as follows. According to the report, an open cover is divided in two stages: the formation of an open cover, which is considered as a separate contract and the making of individual declarations, which are individual contracts as well. So, in this particular case, SAIL was an in-house broker acting for a group of insurers and reinsurers called AIG, and it entered into a reinsurance agreement with FG. Under the agreement, SAIL had to reinsure with FG a number of risks accepted by AIG. The nature of the agreement was a non-obligatory facultative, which simply meant that SAIL did not have to make declarations and on the other hand, FG had the right to accept or reject

[54] See: Birds John. (1997). Modern Insurance Law. Sweet & Maxwell. 4th edition. Pages 123-127.
[55] December 1993.
[56] See: Reinsurance Contracts Disclosure. Ins. L. M. 6 (5) 1994 pages 11-12

any kind of declarations. The agreement, as a slip, took place for 1988-1989 and was renewed for 1989-1990, when the disputes arose. Very important in the whole operation of the slip was the inclusion of "held-covered" provisions, in respect of which, SAIL could treat new declarations as covered for seven days and renewals were held covered for thirty days. The court held that the existence of held-covered clauses was not directly relevant to the duty of disclosure. Hence, a duty of disclosure was not recognised on the part of SAIL. Some of the reasons by Mr. Justice Tuckey were that it would be impractical for such a duty to be recognised and that a duty of disclosure in respect of open covers would create bizarre results. A duty of disclosure was also denied in relation to each particular declaration.

5.3.1.3 Development of the law of the Utmost Good Faith

All the cases I have mentioned already are cases, which have been very influential in respect of the development of the duty of the utmost good faith. I am going to refer now to some cases that are of equal importance for the reason that they show how the law has reacted to the above development. The first case I am going to mention is that of **The Star Sea** [57]. A family who lived in England was the beneficial owners of a number of vessels that were travelling under a Cypriot flag and the managers were a Greek company based on Piraeus. The plaintiffs in the case were a Cypriot company. Before a journey of one the vessels, when the ship was inspected, a problem with a cut pipe was discovered, but there was a failure to fix it. Near the Panama Canal a fire occurred in the engineroom. The result was that the vessel became a constructive total loss. The plaintiffs relied on the insurance, which had been effected and made a claim. The underwriters however denied liability by arguing that the vessel was unseaworthy because of the technical problem that was never fixed. Also, the second argument of the underwriters was related to the fact that the plaintiffs were in breach of their duty of utmost good faith. The court accepted that the vessel was beyond doubt unseaworthy and that the captain was completely unaware of the safety mechanism of the ship in the case of fire. However it was not accepted that the underwriters were entitled to avoid liability because of breach of the duty of utmost good faith. The reason for the decision was that since the insurers had

[57] (1997) 1 Lloyd's Rep. 360.

rejected a particular claim, the duty of the utmost good faith in relation with that claim comes to an end at commencement of litigation. There was an appeal by the underwriters in respect of the breach of duty and a cross-appeal by the plaintiffs in relation to the amount of damages. The argument on the part of the defendants was that they could avoid the whole contract retrospectively. The appeal of the underwriters was dismissed whereas the cross-appeal was allowed and the assured was entitled to indemnity according to the fact that the vessel had become constructive total loss. The case went on to the House of Lords[58]. The appeal was dismissed but it is worth noting that one of the reasons that was given was the fact that other jurisdictions trying to discard English law in respect of the fact that an insurer can avoid liability on the basis of factors that are completely irrelevant with the occurrence of the loss[59]. This I submit shows clearly the problems with the English approach.

I am going to deal with a number of recent non-marine cases where the duty of the utmost good faith is involved. The first case is that of **Economides v Commercial Union Asse Co. plc.** [60]. Mr. Economides was insured under a household policy but the problem was that when he was asked to give a value for the contents of the house he said that it would be 16.000 pounds, whereas the true value was 40.000 pounds. When there was a burglary in the property, the insurers sought to avoid liability on the ground that the insured was under a duty to make further enquiries as to the true value of the contents and also on the ground of non-disclosure. At the court of first instance, it was held that he was not entitled to recover anything under the policy. However, the appeal was allowed. The reasoning of the court was related to the fact that the plaintiff was just under an obligation to act in an honest way and this was something that was established. Also, a duty to make any further enquiries was not recognised unless it was something that was mentioned in the proposal form. In the words of Simon Brown LJ *"if insurers wish to place upon their assured an obligation to carry out specific enquiries or otherwise take steps to provide objective justification for their valuations, they must spell out these requirements in the proposal form"* [61]. Another

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[58] http://www. publications.parliament.uk/pa/ld200001/ldjudgmt/jd010118/manife-4.htm.
[59] *Ibid.* Paragraph 79.
[60] Lloyd's Law Reports Insurance and Reinsurance 9.
[61] *Ibid.* Page 16. Per Lord Simon Brown.

case is that of **Galloway v Guardian Royal Exchange (U.K)** [62]. The similarity with the previous case is that again the insurance policy in question was a household contents one. The main issue of dispute was related with question Q6, which simply asked if the assured or his spouse were at any time subject to any conviction of arson, fraud or a number of other offences? The plaintiff answered "no" but this was proved to be false. The other issue of the case took place after the burglary, which resulted, in the claim. In addition with all the other things that were claimed by the plaintiff, he also wanted compensation for the loss of the computer. However, it was proved that this computer did not exist and that the receipt for it has been forged. The questions for the court were two: the first one was if the plaintiff irrespective of the fraud was entitled to the recovery of any genuine loss. The second one was if the supply of false information in respect of question Q6 could be considered to be an offence of obtaining property by deception. The first question was answered negatively and the second one positively. The appeal was dismissed and the court held that although there was no express provision citing that in case of fraud, the policy would be void, this made no difference at all. The principle behind this decision was in the words of Lord Woolf MR that *"the policy of the law in this area must be to discourage the making of fraudulent claims"* [63]. In the case of **ICCI v Royal Hotel** [64] the policy in question was about fire insurance in respect of a hotel. The importance of the case lies on the fact that the principles, which were established by **the Pan Atlantic** decision were in question. The facts were as follows. Royal Hotel was closed since June 1992 because of a number of fires. The insurance, of course, covered fire among other perils. However, the correct legal process was not followed, since the insured had created through his director and his secretary false invoices that were submitted to bankers. These invoices were the result of fraud and one of the main issues for the court was if the activities of the insured's director and his secretary could be considered as his actions. The action was brought by a company called ICCI and was one of the insurers. They also tried to avoid liability under the policy on the grounds of non-disclosure. In the court of first instance it was held that Royal Hotel had

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[62] (1999) Lloyd's Rep. 209.
[63] *Ibid.* Page 16. Per Lord Woolf MR.
[64] (1998) Lloyd's Rep. 151.

forfeited all its rights because of the fraud. On appeal, the decision of the court was, in respect of the first issue, that the actions of the director could be regarded as the insured's. The result of the fraud was, according to the court, that material facts were not disclosed to ICCI and Royal Insurance- a parent company- when the policy was renewed. And they were facts that a prudent underwriter would take very much into account when dealing with the policy. As to the second part of the test that was used in **the Pan Atlantic case**- inducement- it was held that ICCI was induced to enter the contract because of the non-disclosure. Therefore, it is clear that the principle established in **Pan Atlantic** applied. In addition, the questions of affirmation and estoppel were raised, but they are of no specific relevance in respect of utmost good faith[65]. Another case where inducement was one of the main issues is that of **Kausar v Eagle Star Insurance Co. Ltd.** [66]. The insurance here was in respect of a shop. The insurers argued that they were not under any obligations in respect of the insurance policy effected because Mrs. Kapuar failed to disclose to them material facts such as that part of the premises were used as a Turkish social club and that she had serious problems with her tenant. Very important was Condition 3 of the policy, which cited that the insured would not be covered if there was a change in the circumstances and the insurers did not agree to that. The change had to do with the suspicion of the insured that the tenant had destroyed a window. The judge in the first hearing held that the insurance company was induced to the contract and that there was no material non-disclosure. This was reversed on appeal[67]. Finally, I would like to refer to one reinsurance case, where the central question was that of non-disclosure, **Hill v Citadel Insce.** [68]. This case was about excess of loss reinsurance business. The plaintiffs were underwriters for XL cover from 1983 to 1991. The first and the second defendants subscribed for the year 1989 – the first- and for the year 1990- the second- under the reinsurance contracts. The plaintiffs claimed sums under these contracts from both the defendants and for both years as well. On their part, the defendants tried to avoid liability on the ground of non-disclosure and misrepresentation. As to 1989, it was held by the court of first instance that there was a material non-disclosure since it was

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[65] *Ibid.*
[66] (2000) Lloyd's Law Rep. 154.
[67] *Ibid.*
[68] Lloyd's Reinsurance Rep. 167.

not disclosed to them what were the costs of recent years. The same applied for the renewal in 1990; so, the defendants could treat the contracts as void. The decision was upheld on appeal[69].

Finally, I would like to make a reference to the operation of a binder in relation with the duty of the utmost good faith. Of course, further analysis would be done in later chapters of this research dealing with reinsurance, so, I will try to be brief. Hence, a binder is *"a contract between an insurer and a broker delegating certain underwriting powers on brokers"*[70]. If the binder is granted directly by the insurer to the assured, the situation is not so complex, because the assured owes a duty of disclosure of all material facts, but not of individual declarations. The problem starts with whose agent is the broker during the operation of a binder. For example, in the case of a non-obligatory binder- the insurer has the right to avoid the declaration- if a broker does not communicate properly the information that he has to, to an insurer, whose agent is he [71]

It is obvious from the above that the duty of the utmost good faith has a vital role in the operation of insurance law. It can affect the role of brokers, because as it is shown from the cases I mentioned they are under a duty of disclosure as well. Whether they are directly liable or not is a complex matter and quite a few aspects come into play such as imputation of knowledge. Also, the duty of the utmost good faith is a factor that can make a policy void or on the other hand uphold it. And this is the reason why it is treated with so much caution by the courts.

5.1.4 Conclusion

As a conclusion, I submit that **Pan Atlantic** is the most influential case in relation to the duty of the utmost good faith, but someone cannot be positive whether the subjective- the actual underwriter's- or the objective approach is better, because both create problems in their justification. It seems however that in recent cases like **the ICCI case** the principles established there remain very effective. Anyway, it is something that will always be an available and is quite a "technical" defence, so,

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[69] *Ibid.*
[70] Merkin R.M. (1996). The Duties of Marine Insurance Brokers, in Thomas D.R. The Modern Law of Marine Insurance, LLP. Page 288.
[71] *Ibid*

brokers and other parties must be very careful in how they conduct their business. Perhaps the solution would be a proportionality approach as in the rest of the Continent[72]. This approach simply means that the parties are considered to be responsible according to their involvement in the cause of action. For example, in a particular case both the plaintiff and the respondent can be held to be liable for the same cause of action and the discretion of the court is in accordance with this proportion. However, how the duty of the utmost good faith is applied may vary in relation with the circumstances of each case. Hence, it is up to the courts to try and make an adjustment between law and the balance of the insurance market.

[72] O'Neill P.T & J.W Woloniescki. The Law of Reinsurance in England and Bermuda. Sweet & Maxwell. 1998. Paragraphs 10-10 – 10-24.

5.2 IMPUTATION OF KNOWLEDGE

Imputation of knowledge is very much related to agency law. However, it is very significant in the insurance and reinsurance field because in relation to whether an imputation of knowledge can be assumed, many of the relations of the parties are determined. The meaning of imputation of knowledge is that any knowledge, which is known to an agent during the course of the particular transaction, that he is appointed for, is deemed to be known to the principal. The case that examined the above is **Blackburn Low v Vigors** [1].This case was about communication of knowledge. Briefly, the facts were the following. A reinsurance contract, which was instructed by the plaintiffs, who were the assured in this particular instance, took place through their Glasgow brokers. Actually, the reinsurance was obtained through the London agents of the Glasgow brokers. The crucial point of this case was that the Glasgow brokers knew a material fact to the risk of the ship, but it was not communicated to the plaintiffs. Immediately after that a different Lloyd's broker put through different reinsurance and the defendant Lloyd's underwriter reinsured the ship on a "lost or not lost basis". However, when the second policy was actually issued, the ship was lost. The argument on the part of the defendant underwriter was that the second policy should be void because the plaintiffs were imputed with knowledge, which was known to the Glasgow brokers but which – the letter – had failed to disclose.

In the court of first instance it was decided by Day J. that judgement should be given for the plaintiffs, because the material information was not communicated. The Court of Appeal reversed this judgement and held that non-disclosure of the fact was fatal to the action of the plaintiffs. The plaintiffs appealed in respect of this. The appeal was allowed. According to Lord Halsbury *"the judgement of the Court of Appeal is intended to lay down a principle that would not be contested, but applying that principle to a state of facts to which I think it is inapplicable"* [2]. According to him again, it all depends on the type of the broker. The second policy was actually issued on instructions of the other broker who did not have the knowledge of the Glasgow broker. Generally, if *"the person*

[1] (1887) 12 App. Cas. 531.
[2] *Ibid.* Page 535. Per Lord Halsbury L.C

is an agent to know, his knowledge does bind the principal" [3]. It is up to the principal to give to his agent such authority, in order for him to know if the agent's actions can be deemed to be his actions. The same principle was actually followed by Lord Machaghten[4]. According to him a legal duty existed for the Glasgow brokers to make to the underwriter of the first policy **full disclosure of certain material facts,** but also a moral duty existed as well for them to communicate all material information to their principals. The case where the legal duty or the moral obligation of communication was distinguished is **Banque Financiere v Westgate Insurance**[5]. I am not going to deal with the facts in a detailed way since I have already analysed this case in the previous part of this chapter[6].

Another case that was interrelated with **Blackburn Low v Vigors** was **Blackburn Low v Haslam** [7]. In this case there was a cause of action in respect of the first reinsurance policy, which took place by the London agents of the Glasgow brokers. It was held by the court that he policy was void, because of concealment of material facts. The Divisional Court did not change the decision. It is worth noting the exact wording of Baron Pollock: *"the judgement in no way conflicts with the decision in **Blackburn Low v Vigors.** Although the opinion was expressed in that case it was not the duty of the agents to communicate to the principals the decision, which they had received, we take that opinion as applying to the particular facts before the House"* [8].

A more recent case is that of **Kingscroft Insurance Co. Ltd. v Nissan Fire and Marine Insurance Co. Ltd. (Unreported)** [9]. The plaintiffs here were the reinsureds and their claim was actually for an indemnity against the defendant reinsurers. The treaties were arranged through a company, which acted as the plaintiffs' agent. The argument on the part of the defendants was that they should avoid treaties on the basis of non-disclosure in respect of illegal procedures followed by three directors. Moreover, they

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[3] *Ibid.* Pages 537-538. Per Lord Halsbury L.C.
[4] *Ibid.* Pages 542-543. Per Lord Macnaghten.
[5] (1991) 2 A.C 249.
[6] For more details see part about Utmost Good Faith.
[7] (1888) 21 Q.B.D 144.
[8] *Ibid.* Page 153. Per Baron Pollock.
[9] Mitchell Charles. English Insurance Decisions. 1996. Lloyd's Maritime and Commercial Law Quarterly. Page 296.

submitted that they could not make any connection between the plaintiffs and the knowledge of the guilty directors, but they could do that in relation to the innocent directors, who, although they were not aware, of course, of the fraud of the guilty directors, knew that a certain amount of money was not paid to the plaintiffs. The **PCW Syndicates v PCW Reinsurers** case [10] was used to support this argument. In the court of first instance, it was decided that the defence could not be upheld. The *ratio decidendi* was that the transmission of information from his agent to the insured could not take place when the nature of the type of information is such that it cannot be inferred that the agent would reveal it to his principal. The defendants appealed but their appeal was dismissed because it could not be established that the innocent directors knew that the "guilty" ones did not intend to pay the plaintiffs but keep the money for themselves. This kind of knowledge either could not be deemed to be known under section 18 of MIA 1916.

The relevant sections of the Marine Insurance Act 1906 are sections 18, 19, 20 as I have already mentioned[11]. Generally they are the codification of common law as this is established in **Blackburn Low v Vigors.** Section 18 states that the circumstances under which the assured owes a duty of disclosure of all the material facts to the insurer. More specifically, it states that *"the assured is deemed to know every circumstance, which in the ordinary course of business ought to be known to him"*[12]. It also states the remedy for failure to disclose. The insurer has the right to avoid the contract. Section 19 is very similar to section 18, but it deals with the knowledge of the agent effecting insurance. Similarly, it provides that *"an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by or to have been communicated to him"*[13]. The only defence that is recognised by section 19(b) is when the information that needed to be disclosed came to the knowledge of the assured too late, that it would be impossible to communicate it to his agent. The difference between the two sections is that section 19 does not provide for the remedy that should be awarded.

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[10] (1996) 1 Lloyd's Rep. 241.
[11] These sections are also analysed in the chapter, which is about the duty of the utmost good faith.
[12] Ivamy E.R. Hardy. Chalmers, Marine Insurance Act 1906. 6th edition, London, Butterworths. Page 26.
[13] *Ibid.* Page 31.

The only remedy that is allowed by section 19 is that of the insured against the broker for failure to obtain effective insurance. Therefore, it is very strange that although the statute imposes more or less a direct duty of the agent towards the insurer, the insurer has a right of action not against the agent but only against the principal and the only available remedy is that of avoidance. This is confirmed by section 20 to which I will refer later. Before I continue with sections 20 and 84, it would be very interesting to look how other countries deal with this duty of disclosure. However, the last thing I want to say for now about English law is that it does not accept forgetfulness as an excuse. As Malcolm Clarke puts it in his book: *"no allowance is made for forgetfulness or age: the person with a bad memory is expected to have a good notepad or a good organisation"*[14].

Hence, in Australia there is a rule according to which disclosure is required to everything that would seem material to a reasonable insured. Also, in Switzerland there is quite a similar rule [15]. What it says is that there must be a limitation of the duty of disclosure to an accurate response to the insurer's questions. This principle can be addressed in English law only if it is said that for things that the insurer did not ask, he waived the duty of disclosure towards him. We can now move on to France. There the situation is quite simple. Where there is a wilful misrepresentation or a non-disclosure, the contract is nullified. On the other hand, if the misrepresentation is not wilful, then the insurer has to pay a proportion of the claim as if the misrepresentation was not done. Finally, I will make a reference to America. There, avoidance of a contract because of non- disclosure can be achieved only under two conditions. The first one is that *"the information was not discoverable by the insurer's own investigation of the risk"*. The second condition is that *"the odds of discovery were tipped against the insurer by willful concealment, for example fraud, on the part of the proposer"* [16]. Every system of these that are mentioned had its advantages and disadvantages but I am not going to examine them in detail at this point [17].

Moreover, in respect of the **Marine Insurance Act 1906**, we have section 20. This is about the duties that may arise, when we have misrepresentation. Simply, the

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[14] Malcolm Clark. (1997). Policies and perceptions of insurance. Clarendon Law Press. Page 87.
[15] *Ibid.*
[16] *Ibid.* Page 104.
[17] *Ibid.* Page 99-106.

contract can be voidable only if the misrepresentation is material. However, the most complicated of the above sections is section 19. Its implications start from the fact that it refers to agents and most of the times the relationships between agents, principals and third parties are quite difficult to be understood. The major thing about this section is that it deals only with what must be disclosed on the part of the broker. There have been some cases, where this kind of knowledge has been examined. I will make an effort now to analyse these sections in relation with the doctrine of utmost good faith. The basic analysis about the utmost good faith is done in the relevant part of this chapter but I will focus on the relationship between the sections because this is interrelated with the concept of imputation of knowledge. First of all, it needs to be said that that there is both a pre-formation doctrine of the utmost good faith and the post-formation doctrine. But, what is the relationship between the sections? Hence, section 17 [18] actually is the one that imposes a general duty upon the parties of an insurance contract and sections 18-20 provide for the relevant details. It is also obvious that section 17 is much broader in respect of the pre-formation doctrine of the utmost good faith and that sections 18-20 deal actually with the assured's duty of the utmost good faith. As a result it can be inferred that only section 17 can be used in order to enforce the insurer's duty. Finally, it must be said that there is no aspect of materiality in relation to section 17[19].

In **PCW Syndicates v PCW Reinsurers** [20] quite a few aspects of sections 18 and 19 were analysed. The facts of the case were as follows. PCW Underwriting Agencies Ltd. were actually the managing agents for a number of Lloyd's underwriters. According to a DTI report there were some individuals in this agency scheme, who were committing fraud by diversion of a premium income, which was for the benefit of the syndicates. The result was that a number of reinsurers submitted that they were entitled to repudiate liability on the basis that the existence of the fraud was not disclosed to them. The parties of the action decided to arbitrate. Hence, Mr. Justice Waller as a Judge-Arbitrator held that the insurers could not be deemed to be aware of the dishonest conduct of the PCW

[18] I have referred to it in the part that is about utmost good faith. It is the section, which renders a contract of marine insurance one of *uberrimae fidei.*

[19] Bennett Howard N. Mapping the doctrine of utmost good faith in insurance contract law. Lloyd's Maritime and Commercial Law Quarterly. Page 165.

[20] (1996) 1 Lloyd's Rep. 241.

agents. Secondly, the agents in question could not be thought to be *"agents to insure"*. Thirdly, these agents were not in any direct relationship with the insurers and fourthly the knowledge of PCW Ltd. in respect of their dishonesty was not held by them in their capacity as agents to insure, therefore, there was no obligation on them to disclose anything about their dishonest conduct. The reinsurers appealed. The Court of Appeal decided that first of all, according to section 18, a person who wants to be insured must disclose what is known to him. However, it was held that an assured could not be deemed to know his agent's own dishonesty. Conclusively, it was submitted that in this particular case the PCW insurers could not be deemed to know about the dishonesty of some of the PCW agents. Also, simply because an agent is *"an agent to insure"*, this does not necessarily mean that his knowledge is deemed to be his principal's knowledge[21]. I will refer to some parts of Lord Justice Staughton's judgement. The first thing I am going to deal with is how he approached sections 18 and 19. He cited that *"it seems to me that sections 18 and 19 are carefully framed so as to describe what must be disclosed. By section 18 the person seeking insurance must first disclose what is known to him. If he is a natural person, that means to him personally; if a company, known to a director or employee at an appropriate level. Secondly, a person must disclose everything, which in the ordinary course of business ought to be known to him. This is a quite sufficient test to deal with the knowledge of agents"* [22]. Finally, I will quote his words as to what is the position of an agent to insure. He said that *"I do not find in the authorities any decision that an agent to insure is required by section 19 to disclose information which he has received otherwise than in the character of agent for the assured"* [23].

In the case of **Simner v New India Assurance Co Ltd** [24] three categories of agents were recognised, where the knowledge of the agent is deemed to be the knowledge of the principal. These categories are the following. *"There is a class of agent on whom an assured relies for information concerning the proposed matter of the proposed insurance"*. Secondly, *"the assured will be deemed to know circumstances within the knowledge of his agent, where the agent can be regarded as being in such a predominant*

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[21] *Ibid.*
[22] *Ibid.* Page 254. Per Justice Staughton.
[23] *Ibid.* Page 257. Per Justice Staughton.
[24] (1995) L.R.L.R. 240.

position in a relation to the assured that his knowledge can be regarded as the knowledge of the assured". Thirdly, "*where the agent has effected the relevant insurance*"[25].

5.2.1 Conclusion

It is not very simple to state whether a duty of disclosure applies in relation to a particular agent or when a piece of material information is communicated to another person. The reason for this is that there can be a lot of things according to which this can be decided. For example, what is the exact nature of the agent in the particular contract and whether he can be considered as an agent to insure? Everything actually depends on the circumstances and on the relationship between the parties.

[25] Blackburn Low v Vigors (1887) 12 App. Cas. 531. Page 539. Per Lord Halsbury L.C.

5.3 FRAUD OF AGENTS

5.3.1 Introduction

It is quite common in the business world for agents to commit fraud. In the context of insurance law, cases about fraud arise both in the insurance and the reinsurance field. The problem that usually arises is whether the knowledge of the agent that commits the fraud is considered to be the knowledge of the company he works for – this simply means his principal.

5.3.2 Fraud of Agents

The first thing that needs to be said is that the available remedy for innocent misrepresentation and non-disclosure is avoidance. When there is fraud the difference is that damages are also available [1]. The case that states the principles for the fraud of agents is **Re Hampshire Land Company**[2]. Briefly, the facts were as follows: two sister-companies were involved. This close relationship was created from the fact that four of the directors of the Hampshire Land Company- this was the first company - were also the directors of the Portsea Island Building Society and both companies had the same secretary. The important person was Mr Wills, an agent of both companies. What actually happened was that the Portsea Company lent some money to the Hampshire Company. But, there were some regulations that needed to be observed in order for the borrowing of the money to be within the rules. The relevant section was clause 82 of the association agreement. It provided that *"the directors may borrow, in the name or otherwise on behalf of the company, such sums of money, as they may from time to time think expedient... provided nevertheless that the aggregate of the principal money so borrowed shall not at any time exceed the amount they paid- in capital, unless the borrowing of the larger amount shall have been previously authorised by a general meeting, in which case the directors may borrow to such extent as is authorised"* [3]. The details of the action were as follows. J.J Saffery was the liquidator of the company and he took out a summons to

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[1] O'Neill P.T. & J.W Woloniecki. (1998). The Law of Reinsurance. Sweet & Maxwell. Page 361. Paragraph 9-35.
[2] (1986) 2 Ch. 743.
[3] *Ibid.* Page 743.

which the society and Mr. Edmonds, who was one of the liquidators of the society, were respondents. The main question was whether the society could be considered to be a creditor of the company[4]. Vaughan Williams J. held that there was no proper authority for the borrowing of the money. This was because article 38 of the association agreement provided that *"seven days notice at the least, specifying the place, the day and the hour of the meeting, and in case of special business the general nature of such business, shall be given by a circular letter addressed to each member and sent to his address in the company's register"* [5]. In our case, this was not done properly, so; there was no real authorisation. However, the basic question, according to Vaughan Williams J., which arose, was whether there was an imputation of knowledge upon the company in respect of its agent's actions in relation to the formalities of the borrowing. The authoritative case, to which the case was referred, was **Royal British Bank v Turquand**[6]. The principle that this case upheld is that a company –when borrowing of money was involved- had a right to make an assumption that all the formalities are being observed by the borrowing company. The only situation where this cannot be accepted is when there is an imputation of knowledge. This principle was relevant to the Hampshire case. It was argued in **the Hampshire Land Company** that since Mr Wills was an agent of both companies, it would just be fair and reasonable to assume that the knowledge he had as an agent of one company could be imputed to be the knowledge of the other company. Vaugham William J. did not accept this argument. He cited the case of **Re Marseilles Extension Ry. Co**[7]. He said that in his opinion from the judgements in this case, it became clear that there may be circumstances, where the personal knowledge of someone cannot affect the knowledge of the company. The only circumstance, where knowledge would be imputed would be when the common agent had a duty to communicate his knowledge to the other company. So, he concluded that in the case of Mr Wills, it could

[4] *Ibid.* Page 744.
[5] *Ibid.*
[6] 6 E&B. 327.
[7] L.R 7.Ch. 161.

not be accepted that his knowledge was the company's knowledge. In contrast, although Mr Wills had been guilty of fraud, the company was innocent[8].

An example would make the whole situation easier to understand. Also, it will show that sometimes in practice it is not obvious how legal principles can be "enforced". The example I am going to focus on is that of an underwriter, who is dealing with a reinsurance to close. This is the procedure where the underwriter is actually setting the premium, which the old year syndicate should pay to the next year in order to be free from any liabilities[9]. But, in the same time he is the underwriter of both his old and his new syndicate at Lloyd's. This of course can create difficulties, because the underwriter will have a duty towards his old syndicate to effect the reinsurance and towards his new syndicate to make a full disclosure and not to overlook anything for the benefit of his old syndicate. Under these circumstances, it would be very difficult to follow **the Hampshire Land principle** and be positive about the imputation of knowledge of the agent[10]. Something else that needs to be addressed is whether the agent is fraudulent or just negligent is a vital factor or just another element for liability to be imposed.

The next two cases I am going to refer to are mentioned in previous parts of this chapter, so I am going to make a brief reference just to the outcome of them. The first one is **Societe Anonyme D' Intermediaries Luxembourgeois (SAIL) v Farex Gie, et al**[11]. In this case, there was a firm of London brokers – Health Fielding – which was acting for both the reinsured – SAIL – for the original reinsurance – and for the reinsurer – Farex – for the placement of retrocession[12]. The action against the brokers was based on the argument that Health Fielding knew that the retrocession cover was not effective and that

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[8] For more details see judgement.
[9] O'Neill P.T. & J.W Woloniecki. (1998). The Law of Reinsurance. Sweet & Maxwell. Pages 362-363. Paragraph 9-36.
[10] *Ibid.*
[11] (1995) L.R.L.R 126.
[12] This is the procedure where cover is obtained for reinsurance contract. A more detailed definition is given in other parts of my thesis.

there was an imputation of knowledge to the reinsured. The outcome of the case was that no imputation of knowledge could be inferred[13].

The second case is **PCW Syndicates v PCW reinsurers**[14]. The cause of action was an alleged dishonest contact by agents. The sections of Marine Insurance Act 1906, around which the whole case was revolved, were sections 18 and 19.It was decided by the court that the agents did not have a duty of disclosure. The reason for the decision was that, according to Walller J., the knowledge of the agents was not acquired in respect of their duties towards the reinsured[15].

The other important aspect of the case has to do with the fact that the court decided that the agents were not "agents to insure". This meant in practical terms that the case had to be decided according to section 18 of the **Marine Insurance Act 1906**, since section 19 was not applicable. The major idea, which was upheld by the judge was that in section 18 what matters is what was ought to be known by the principal of the agent. This, as it is logical, gives emphasis to the standard duty of care that an ordinary agent owes to his principal. However, the main issue, which is not so straightforward, is whether there is any difference of the duties of someone that is judged under section 18 and an agent who is deemed to be "an agent to insure". In this case it was held that there could be no different standards because the opposite would be absurd[16].

In the case of **Group Josi Re v Walbrook Insurance Co Ltd** [17] the main issue that arose related to whether an agent was considered to be "an agent to insure". The answer that was given was that "an agent to insure" was an agent that simply played that most significant role in effecting the insurance contracts in question. This was actually the difference that was noted between the **Group Josi** case and the **PCW Syndicates** case. In the first one, the agent had played only a small role in concluding the contracts, whereas in the second one, he had a much more significant role.

The application of the principles that were established in the **Group Josi** case and the **PCW Syndicates** was done in **Kingscroft v Nissan Fire and Marine, Commercial**

[13] Because of the nature of the open cover, see p. 54 supra.
[14] (1996) 1 Lloyd's Rep. 241.
[15] The case is analysed in a more detailed way in the part about imputation of knowledge.
[16] *Ibid.*
[17] (1996) 1 Lloyd's Rep 345.

City (unreported) [18]. There were two principles which were held to be inferred from the two above cases: *(a) Where an agent is defrauding an insurer, the agent's principal (the reinsured) is not fixed with the fraudulent agent's own knowledge of the fraud, either because he has no deemed knowledge under section 18 of the Marine Insurance Act or because under the principle in Hampshire Land, he does not know of the fraud. (b) Underwriting agents in the position of the Weavers are not agents to insure under section 19 of the Marine Insurance Act* – Weavers were the defendants in the Group Josi case[19]. The impact of these two principles is that in case there is a fraudulent conduct by an agent, it is quite difficult to prove that the principal was considered to have the knowledge of his agent. The further test, which was upheld by the court in relation to imputation of knowledge was the following: *(a) Whether the information in question is of a kind which it is the agent's duty to acquire for his principal, (b) Whether having regard to the particular information in question, it can be inferred that the agent will have performed a duty by communicating to the principal*[20]. Therefore, according to these principles everything depends on the kind of information and on the duties of the agent. What is quite significant is that it does not really matter whether an agent acts in a fraudulent or a non-fraudulent way. This is because the communication of information from the agent to the principal does not affect the agent's motives.

5.3.3 Conclusion

In conclusion, in relation to the fraud of agents, generally, it is very easy to assume when an agent commits fraud or when he is just negligent. Also, in most cases, it is quite easy to ascertain his degree of responsibility. However, in legal terms a fraud committed by an agent is a much more complicated issue. In relation to section 18 the problem is the position of the reinsured, because a broker under these circumstances is deemed to be the agent of the reinsured. Of course it is essential that the agent in question is not classified as an agent to insure, because then, his duty of disclosure would fall

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[18] 29.7.99 / Queen's Bench Division (Commercial Court). www.elbornes.com
[19] *Ibid.* Per Coleman J.
[20] *Ibid.*

within section 19. Hence, it has to be made clear that the duty of the reinsured to the reinsurer is completely separate to the duty of the broker to the reinsured. The other thing that needs to be stated as a closing point is that the dishonesty or not of an agent has nothing to do with his duties towards his principal, because what matters is the actual materiality of the information and what is the agent's role in the formation of contracts. The more he is involved the greater his duty will be.

CHAPTER

6 *Proposals – Slips –Policies - Renewals*

6.1 Inroduction

Much of this chapter will be dedicated to the procedure followed by Lloyd's in relation to the obtaining and the placement of the cover. This does not mean that this is the only way that exists. However, it is true that the history of Lloyd's and its role makes it very influential and if someone understands the exact way by which an insurance cover is obtained and placed properly, then, he will be in the position to say that he knows more or less how the insurance market works.

6.2 Proposal Form

The first thing I am going to deal with is the **proposal form** [1]. The reason for this is that everything starts from there. It must be said at this point that there is a difference in the terms, which are used in the United Kingdom and in U.S.A. In the U.K, the document that is used to express that there is a wish for an insurance cover to be obtained is called a proposal form, whereas, in U.S.A this is called application form [2]. The general rule is that brokers should not, except where certain circumstances exist, fill in proposal forms themselves. The danger that exists is that there is always a possibility that because the broker will not be aware of some facts that may be vital, the information that will be written on the proposal form can be wrong and this of course can create serious problems during the procedure of the formation of the insurance contract. What is generally required by a broker is described by example 14 of **the Insurance Brokers Registration Council Code of Conduct 1978:** it is provided that *"in the completion of the proposal form, claim form, or any other material document, insurance brokers shall make it clear that all the answers or statements are the client's own responsibility. The client should always be asked to check the details and told that the inclusion of incorrect information may result in a claim being repudiated"* [3]. It is shown from that statement that the burden, when a false piece of information is inserted, lies on the proposer and not on the broker. Of course, quite a lot depends on who is the proposer and who is the broker. For example, if the proposer is someone who cannot even read and the broker is one with

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[1] Shaw Gordon. The Insurance Broker. (1995). Lloyd's of London Press Ltd. Chapter 10.
[2] Ibid.
[3] Ibid. Page 285.

quite a good reputation, it would seem correct that a high degree of responsibility should be assumed on the part of the broker.

The cases that are related with this topic are mentioned in my research under either "the duty of utmost good faith or imputation of knowledge or liability of brokers". This is logical as these are usually the questions, which arise under these circumstances. Namely, when a court is faced with a problem that is related with what exactly happened during the procedure of the passing of the proposal forms or slips a number of allegations is made. The insurers in most instances deny liability on the basis of non-disclosure of material information. This is quite a common defence [4]. The insurer quite often alleges that his broker is liable, because simply he did not follow his instructions and the insurance cover, which was obtained, was not the appropriate one. And on their part the brokers either argue that the defence of non-disclosure should fail, because they passed all the correct information to the underwriters or they submit that it is the fault of the insured, because he did not reveal, either fraudulently or negligently all the relevant information to the broker.

I am going to start my analysis with an unreported case. It is quite illustrative about how things work in practice and how sometimes obscure situations may occur. This case is known as **the loss of an eye case** [5]. This case was so complicated, that even in the original source, to which I refer is divided into three parts. Because of lack of space, I do not intend to do the same thing. However, I will try to show its significance by referring to particular parts of the judgement. The proposer- the plaintiff – was a person from Europe, who had very little ability to speak English. Because of this, he used a friend as an interpreter when he wanted to have an insurance policy in case he had a personal accident. This is the point when things started to become a little bit more complicated. The cover the insured wanted was around two million pounds. But, the strange thing was the insured's life. Namely, he liked more or less to live on the edge. He had a very bad driving record and he was involved in a number of accidents. Although he told the broker – the defendant – with whom he was dealing with, that he was seriously injured on two occasions, he did not disclose to him the fact that as a result of these injuries he received a very substantial

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[4] See chapter about duties of insurance brokers.
[5] Shaw Gordon. The Insurance Broker . (1995). Lloyd's of London Press Ltd. page 72-74.

amount of money from his insurers. Finally, he was about to go hunting in the Amazon jungle and the possibility of returning alive from there was only fifty per cent. As is obvious from the above, the facts of the case were quite unusual and the court had to face a number of problems. The major problem actually was that there was great dispute as to what exactly happened when the broker met with his client. However, the judge rejected the allegations of the client that actually he has disclosed all the material information to the broker. Only nominal damages were awarded to the proposer of the insurance cover because the broker had failed to inform his client that there was a duty of disclosure imposed on him. After that, in the judgement there was a reference as to what was the exact job of the broker in relation to the information that should be put in the proposal form. It was said that the broker generally is not expected to act as the person, who must try really hard in order to examine and assess whether the information he acquires is true or not. The only thing that the broker is required to do is to provide his client with proper assistance in the completion of the proposal form [6].

Before I move on to some typical but yet very significant facts about proposal forms, I will concentrate for a while on the legal aspects that are involved in this topic. Of course, an analytical examination does not have to be done, because all these things are mentioned in the other parts of this research. Despite that, a reference will be made, since it will be much easier to understand why the process of obtaining an insurance cover can become so confusing sometimes. One very important aspect is that of **imputation of knowledge**. One very old case about imputation of knowledge is that of **Bawdev v London, Edinburgh and Glasgow Assurance Co.**[7]. This case has very unusual facts. The proposer had one eye only and he could not read. It was written in the proposal form that the proposer suffered from no disability, despite the fact that the broker knew about his disability. When an accident took place, the result was that he lost his other eye as well. The court decided that the proposer was entitled to recover for total loss of sight under the policy. The ratio decidendi in this case was that it should be accepted that since the agent knew about the special circumstances, which were related to the proposer, his knowledge could be said to have been imputed to the insurer. The case seems to be correctly decided but moreover it need to be cited

[6] For a more detailed analysis see in: Shaw Gordon. The Insurance Broker . (1995). Lloyd's of London Press Ltd. Chapter 10.
[7] (1892) 2 Q.B 534.

that by the cases that followed, nobody can be positive how influential this case really is. An example is the case of **Newsholme Bros v Road Transport and General Insurance Co.** [8]. This case is significant in relation to how the importance that the address can have in a proposal form, but I will refer to this later in this chapter. As far as imputation of knowledge is concerned, it was held in the arbitration stage that the agent's knowledge could be imputed the insurer, so, he could not avoid liability. However, this conclusion was not upheld in the court of first instance or in the Court of Appeal. The reasoning of the court was actually twofold: the first argument had to do with the fact that, according to the court, if a proposer asks an agent to act on his behalf in respect of the completion of a proposal form, this agent cannot afterwards be deemed to be the agent of the insurer. The second one was that since the proposer had signed the proposal, if some of the information that is contained in there is untrue, it could not be admitted that he can avoid liability on the ground that the agent, who filled the proposal form for him, is the agent of the insurer who will eventually receive the proposal form. Finally, another judge submitted that if he accepted evidence as to what the agent in question really knew would be against **the parol evidence rule**. The effect of this rule is that somebody cannot give oral evidence, which will contradict written evidence in a contract unless there is an allegation of fraud or mistake. So, the judge believed that this rule could not be overruled in order to protect the proposer. From these two cases, the conclusion that can be reached is that everything depends on the circumstances, in order to decide whether imputation of knowledge can be established. Agency law principles are involved and everything is more or less a matter of authority. The general rule is that an agent does not have actual authority to fill in a proposal form. But, things become more complicated, because it is not always easy to decide when ostensible authority is accepted to exist [9]. However, for the purposes of this chapter, I do not intend to go into depth about agency rules.

It is time now to deal with the actual information that can be contained in a proposal form [10]. There are a number of cases in which vital information, such as the name or the address of the proposer, is proved, either with or without intent, to be wrong. First of all, there are examples, where there is a mistake as to the name of the

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[8] (1929) 2 K.B. 256.
[9] Birds John. Modern Insurance Law. (1997). Sweet & Maxwell. 4th edition. Pages 145-150.
[10] Shaw Gordon. The Insurance Broker . (1995). Lloyd's of London Press Ltd. Pages 77-85.

proposer. In the case of **Home v Poland** [11], in the insurance policy a person used the name with which he was generally known and not his real name. The court held on this point that the insurers could avoid liability because there was a misrepresentation on the part of the proposer. Other facts, which can be important, are the address or the occupation of the proposer. In **McNealy v Pennine Insurance Co**.[12], the person who wanted to insure his car was a part-time musician and a building contractor on a regular basis. The problem really was that part-time were excluded from the insurance cover, but when the broker effecting the cover asked him what his job was, he simply answered that he was a building contractor. The decision of the court was that the broker was at fault in not informing the client what was the exact list of the occupations excluded. I have referred to this case more when talking about the duties of the brokers. Another case, which is related with all that, is **Roberts v Plaisted**[13]. The insured wanted to insure his premises. His broker visited the premises and when he asked what was the purpose that the premises were used for, the insured answered that they were used as a hotel. The cover that was obtained was for a year but fire damaged the premises a couple of weeks before the expiry of the policy. The insurers made an allegation that they could avoid liability on the ground that the premises were used as a discotheque as well, a fact, which was not disclosed to them. In the court of first instance, Hodgson J. held that the argument on the part of the insurers could not be justified because the insured actually answered honestly to the question of the insurers. He was not obliged by any means to disclose all the other purposes that the premises were used for. On appeal, the Court of Appeal upheld the decision of the judge. The reasoning was the following: (1) Even if it was a material fact that part of the premises was used as a discotheque, this was not something that had to be disclosed. (2) Moreover, only exceptional risks could be included in a supplementary question of the proposal form but this was not one. (3) It was correct to be concluded that the presentation of the proposal form meant that the insurers had waived any right to repudiate [14]. Finally, the case went to the House of Lords. Again, the decision was concentrated on the use of the premises and the decision remained the same: *"Mr.*

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[11] (1922) 2 K.B 364.
[12] (1978) 2 Lloyd's Rep. 18.
[13] (1989) 2 Lloyd's Rep. 341.
[14] Ibid.

Justice Hodson was justified in the conclusion that by presenting the proposal form, the insurers waived any right which they have had to repudiate on the basis that the assured failed to disclose that he was operating a discotheque at the motel and that, therefore, this appeal must be dismissed" [15]. It is obvious from the above cases that it is really very easy for a proposal form to be confusing.

6.3 The Slip

The slip is something that is used largely by Lloyd's brokers. It is very important to note at this point the similarities and the differences between proposal forms and slips [16]. The similarities relate to the fact that the information, which is contained in both documents, is more or less the same. The first thing that needs to be mentioned in the slip is the name and the address of the assured. After that, the period of the insurance cover, which is obtained in and the sum that is insured. Finally, the situation of the premises and any other conditions that can be contained in the policy. This of course is not directly relevant to Marine Insurance. However, although by this brief analysis, they seem exactly the same, they are quite different in some aspects. The first difference is that in the slip someone can see the shape of the policy if the cover is obtained. In contrast, in the proposal form of this kind is not contained. The second thing that is different is related to the precise details of the properties. During the process of the slip, generally there will be a survey by the broker to the premises that are to be insured. Again, in the proposal form in contrast, all the details about the property are mentioned by the proposer. Thirdly, the broker proffers the slip on its own slip. On the other hand, the proposer signs the proposal but this is prepared by the insurer. And finally, the main difference is that the slip, until a policy is issued, can constitute an insurance contract, which can be binding [17]. The proposal form is just an invitation to the insurer to make an offer. It is true that Lloyd's has quite a few rules in relation with slips. The Lloyd's Standard Slip was first established in the market in 1970 [18]. I am going now to refer to the progress of the slip. In the beginning, it is the broker who figures out the proposal sums, which are to be insured and the rate

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[15] Ibid.
[16] Shaw Gordon. The Insurance Broker . (1995). Lloyd's of London Press Ltd. Pages 87-99.
[17] Ibid.
[18] Ibid.

of premium that he expects to achieve. However, in the insurance market things are not always so simple and I will try to refer to some cases, which are about whether a binding contract can be deemed to exist. The first thing that needs to be said is that for a contract to be completed, the broker has to find, first of all, underwriters to cover 100 per cent of the risk. Of course, this is not always easy and everything depends on the nature of the risk. In **American Airlines v Hope** [19] the facts were as follows. The case was about an aircraft, which was destroyed on the ground at Beirut airport by Israeli forces. In the slip, war risks were included, but with an additional premium. Also, the other question was if the clause referring to *"unprovoked incidents arising during normal course of assured's operation"* was incorporated into the slip. And what was the exact meaning of the phrase *"as expiring"* that was mentioned in the slip. So, the problem was whether the insured, since he did not make any effort as for the insurance cover to be obtained at an additional premium, was entitled to recover anything in respect of the loss that took place. The main point of interest in this case was that in some other policies issued by the plaintiffs, there were two types of clauses included. The first one was an ***"over"*** clause. This simply meant that it should cover loss over Arab/Israeli territory. The second one was a ***"between"*** clause and its purpose was to cover loss between Arab and Israel. The House of Lords held that there was no way to change the ***"between"*** for the ***"over"*** wording. Hence, as a result, the plaintiffs were not covered for the loss, which took place on the ground of the airport. Finally, I am going to cite the case of **Bartlett and Partners v Meller** [20]. This was a typical case where there was a problem between the wording of the policy and the wording of the slip. However, the **contra proferentes** rule applied, therefore, since there was an ambiguity, it had to be construed against the plaintiffs.

[19] (1983) 2 Lloyd's Rep. 287.
[20] (1961) 1 Lloyd's Rep. 487.

6.4 Development of the Slip System

Before talking about case law, it would be very useful to talk about the relevant provisions of the Marine Insurance Act 1906. First, we can refer to section 21 of MIA. According to it, *"a contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not; and for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract, although it may be unstamped"* [21]. Also, section 22 provides that *"the policy may be executed and issued either at the time when the contract is concluded, or afterwards"* [22]. Hence every case has to be decided according to these sections.

There have been some very important cases, which were very influential in the whole slip procedure. The first case I am going to deal with is **Janglom v Excess Insurance Co.** [23] There, insurance was needed to cover jewellery. The premium was really high and the broker suggested that it would be reduced if it were kept in the custody of a bank. According to that, the cover was actually re-arranged and the jewellery was insured when it was in the bank or while it was taken out of the bank. The same day that the plaintiff – i.e. the insured – was informed about the new arrangement, the jewellery was stolen. So, the plaintiff brought an action against the leading insurers as first defendants and against the brokers as second defendants. The submission on the part of the insurers was that they were not liable, because the insurance covered only the period, when the jewellery was not in the custody of the bank, when it was stolen, they could avoid liability. Another question, which was raised and is much more related to what we are talking about here is whether the slip can constitute an offer that is accepted or rejected by an underwriter. The court held that: (1) when an underwriter takes a line on a slip, this simply means that he is making an offer on the terms of a slip. There is also a retention of right by him to modify his offer according to the particular terms of each agreement. (2) The fact that there should be a formal delivery in the custody of the bank could not constitute a formal requirement of the policy. This could happen only with a warranty that the

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[21] Bennett Howard. The law of Marine Insurance. 1996. Clarendon Press. Pages 30-31/ Stamp duty is no longer in force.
[22] *Ibid.* Page 31.
[23] (1971) 2 Lloyd's Rep. 271.

jewellery was in the custody of the bank in a certain date and time. (3) The requirement of *"prior advice to the brokers"* was satisfied since the second defendant knew that the jewellery was not in the bank. (4) If there are amendments to a slip, these can be construed contra proferentem against underwriters as a whole"[24]. Conclusively, the action by the plaintiff was successful against the first defendant. And it was established that the underwriter makes an offer when dealing with a slip.

Moving on swiftly, I am going to talk about the **Fennia cases.** In the case of **General Reinsurance Corporation and others v Forsakringsaktiebolaget Fennia Patria** [25] one of the points, which were discussed was the same, as the one I mentioned above, namely the making or accepting an offer by an underwriter in relation with a slip. The facts were as follows: the plaintiffs were a reinsurance company and the defendants were a Finish insurance company. They provided cover for the dispatch of linerboard, sackcraft and pulp paper. The company for which they provided cover was Eurocan and the paper was under its control while it was stored. Fennia actually obtained reinsurance for this cover- "the whole account cover"- and also "a specific cover" in respect of paper, which was kept in some named warehouses. After a while, the cover was increased. A fire took place in one of the warehouses and the paper stored in was destroyed. Some of this paper had already been agreed to be sold to customers. A couple of days after, Fennia's brokers prepared an amendment slip, by which only a small amount was to be covered by "the specific cover". As a result of all these things, the underwriter initiated the slip, but when Fennia asked them to cancel the amendment, they refused and they tried to rely on the amendment slip, in order to avoid liability. The decision of the court was focused on the following points. (1) The underwriter was bound by the slip. He could only write down a risk that was over-subscribed. (2) The initialisation of the slip by the underwriter could be considered to be an acceptance, so, the contract was binding upon the parties. (3) The custom and practice of Lloyd's insurance market meant that the right to cancel and time-on-risk was binding both on the underwriter and the assured. (4) Also, it was held that the custom, which was related with original slips, should not extend to amendment slips. (5) Finally, it was decided that the property did not pass to the customers [26]. As we can see, the rule in respect of the initialing a slip

[24] *Ibid.* Page 371.
[25] (1982) 1 Lloyd's Rep. 87.
[26] *Ibid.* Page 88.

was changed. It constituted an acceptance on the part of the underwriter. However, there was an appeal to this case. As to the fact of whether there was an acceptance of the underwriter, the decision remained the same. Also, *"it could not be established that there was a custom existed that the insured or reinsured had the right to cancel the contract. And it could not be concluded that the right of cancellation should arise by implication of law"* [27]. Therefore, the appeal was allowed. This series of the Fennia appeals were very important in relation with how the slip system worked.

Next, I am going to deal with some aspects of **the Zephyr case** [28]**.** I have mentioned this case in quite a few aspects. Here, I will concentrate on what is the legal effect of signing down. The court held that the whole matter was more or less a question of reliance. It was established that a duty existed on the part of the brokers to make sure that the signing down indication is achieved. I am not analysing the facts in a detailed way, since this is done in another part of my research. This question is very important about slips, because in reality a signing down is a very usual custom.

Finally, a reference will be made to **the regulatory aspects of the slip system at Lloyd's** [29]**.** There is a part, which is dedicated to this in **the Lloyd's Policy Signing Manual**. It starts by saying that the slip is actually the main document, according to which everything is controlled. There are Treaty Standard Form slips and non-treaty Standard Slips. The Treaty Standard Form Slip includes "all treaty and excess of loss reinsurance business". On the other hand, the non-treaty Standard Slip is about "all business both direct and reinsurance other than treaty scheme and excess of loss reinsurance business". There are also some rules, which are about alterations or renewals. In respect of alterations, it must be said that they must be done on the slip. However, if the slip is signed at the LPSO, the alterations have to be done on a separate attachment. And in relation to renewals, it has to be mentioned that renewals sheets are used only when a policy is renewed on almost the same terms as the previous policy". For more technical details, one can refer to the LPSO manual.

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[27] *Ibid.*
[28] (1985) 2 Lloyd's Rep. 529.
[29] Shaw Gordon. The Insurance Broker . (1995). Lloyd's of London Press Ltd. Chapter 10.

6.5 Rectification

This is actually the remedy that is provided by the courts for any mistakes that may happen between the progress of the slip and the issue of the formal policy. And the main thing is to try and follow the common intention of the parties [30]. There are four factors, which can establish common intention [31]. Hence, the basis for rectification is that when there is a difference between the slip and the policy, the difference must be disregarded and rectified [32].

6.6 Renewal of the Slip

This is a very significant aspect of the slip procedure. I am going to use the wording of Lord Diplock in **the Hope case**: *"when the time comes to renew the insurance with the same leading underwriter, the broker makes out a new slip and takes it to the leading underwriter, generally with a copy of the previous year's slip from which the expiring policy was prepared... to simplify the negotiations, the renewal slip uses the expression* ***as expiring*** *after the reference to a particular form of cover to indicate that the underwriter's liability under that head in the renewed insurance is to be no different from his corresponding liability under the expiring policy... on a renewal, the broker draws the leading underwriter's attention to any changes from the expiring slip, which have been made in the renewal slip and which affect the risks to be covered"* [33]. Of course, this whole procedure is not so simple in the insurance market. The duty of the utmost good faith is very significant in relation with all that. If the correct information is revealed, it is much easier for a policy without problems to arise.

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[30] Bennett Howard. The law of Marine Insurance. 1996. Clarendon Press. Page 38.
[31] Agip S.p.A v Navigazione Alta Italia S.p.A (The Nail Genova and Nail Superba) (1984) 1 Lloyd's Rep. 353. Page 359.
[32] See: Symington & Co. v Union Insurance Society of Canton Ltd. (No 2) (1928) 34 Com. Cas. 233. Wilson Holgate & Co. Ltd. v Lancanshire & Chesire Insurance Corp. Ltd. (1922) 13 Ll.L.Rep. 486.
[33] American Airlines v Hope (1983) 2 Lloyd's Rep. 287. Per Lord Diplock.

6.7 The Policy

This is a topic, which is very much related to the practice of Lloyd's. In the beginning, the way by which the actual policy was processed was very different from what is happening now. No particular office was involved and everything was done in the so-called Room. However, this practice created a few problems to a number of underwriters, especially when the amount of policies and slips started to increase. The result was that in 1916, there was a set-up of an office called **the Lloyd's Underwriters Signing Bureau.** The importance of this office was shown from the interest that the underwriters showed in it. But, its use remained on a voluntary basis until 1924. It was then decided that when the sum insured a policy was more than 200 pounds, it had to be signed by the Bureau, in order to be effective. Moreover, it was stated that if the official Bureau did not sign a policy, it would not be considered as an acceptance of liability. As it was proved through the years, the creation of this office influenced the whole functioning of Lloyd's. Its name to **Lloyd's Policy Signing Office** took place in 1927 [33].

I will refer to one case, in order to make it clear how significant can the role of LPSO be. In **Eagle Star v Insurance Co. Ltd v Spratt** [34], the plaintiffs were an insurance company, which reinsured some risks with Lloyd's underwriters, one of them was the defendant. The underwriters were not happy with the plaintiffs. Negotiations were done through a negotiating committee. During the negotiations, the defendants failed to attend a meeting and in the meanwhile one of the leading underwriters disagreed with some of the terms. In the end, the defendants argued that they were not bound by the policies, which were signed by the LPSO. The court held that the underwriters were bound by the policies. Lord Denning said: *"To my mind the answer is plain as can be: when LPSO put their stamp on a policy...they bind the underwriters as completely and effectively as if each underwriter had signed for himself"*. And according to Lord Justice Phillimore: *I entirely agree...that when underwriters set up this policy signing policy they entrusted to it to the task of signing policies, which will bind them"* [35]. This actual decision shows how things work and what is the role of LPSO.

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[34] (1971) 2 Lloyd's Rep. 116.

[35] Ibid. Page 128.

In conclusion, it can be said that slips and policies create a system under which the insurance market works and also the amount of work is controlled [36].

[36] Shaw Gordon. The Insurance Broker . (1995). Lloyd's of London. Chapter 13.

CHAPTER 7

Binding Authorities –Binding Authorities & Brokers – Umbrella Arrangements

7.1.1 BINDING AUTHORITIES

7.1.1 Introduction

Emphasis must be given to the feature of binding authorities that is one that is developed within the London marine insurance market. Before we start analysing what is the exact position and which are the duties that a broker has in respect of them, it would be very useful to mention quite briefly what are the binding authorities, which types we have and how they work. We can start by saying that a binding authority is actually a form of agency relationship.

7.1.2 Underwriting Agents

The first one is one the underwriting agent. The only thing that can be said at this point is that an underwriting agent is appointed by insurers and his duty is to deal with proposals and underwriting decisions. Their presence is more usual in the reinsurance field and it needs to be said that their role becomes more important when there is an overseas insurer, who does not have to be regulated under **the Insurance Companies Act 1982**[1].

7.1.3 Line Slips

The second form of agency relationship is based on the Lloyd's line slip. The line slip actually means the delegation of authority by other underwriters to the leading one[2]. Again it is a facility that was developed in the London market and its practical view means that the leading underwriter can accept risks on behalf of others and as a result it can save a broker quite a lot of time. So, a broker is helped to be more quick and efficient. A reference must be made here to what is called the line-slips. One of the most important questions in relation with line-slips is *"whether the leading underwriter owes a duty of care to those on whose behalf he is authorised to act"*? As Merkin put it *"the answer it is submitted must be yes, a result which can be properly by the implication of an equivalent implied term to the authority"*. Thomas

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[1] Merkin R.M. (1996).The Duties of Marine Insurance Brokers. , in Thomas D.R, The Modern Law of Marine Insurance , LLP. Pages 287-292.
[2] *Ibid.*

also asked two questions than can arise in the absence of a line-slip: ***(1) Does the leading underwriter operating under a leading underwriter clause owe a duty of care to the following market to reach settlements in good faith? (2) Does the leading underwriter owe a duty of care to the following market in accepting risks, given the likelihood that the decision will be a significant factor in the decisions of the following market?*** [3]. The last thing in respect of line-slips I want to focus on is their shape. Usually, the cover part of a line slip is on two A4 pages. The first sentence of the slip is the cover reference. Afterwards, somebody can find the name of the coverholder and the account. Next it is the type of contract. Most of the times the contract will be permanent and it will have a cancellation notice clause. Finally, there are four other clauses. The first is the insurable interest clause. The second one relates to the territorial limits. The third one is about the limits of liability and insured values and the last one is about conditions. After all these, there are eight more pages with underwriters' stamps and initials by the leader. It would very useful for someone to look for example at a Lloyd's line slip in order to understand how works in practice[4].

7.1.4 Binding Authorities

The third type of agency relationship is in terms of so-called binding authorities. As a definition one can say *"a binding authority is an agreement between underwriters and a coverholder authorising that coverholder to accept risks on behalf of the underwriting members on conditions set out in the contract, without specific prior approval of those underwriters either from a broker or any other intermediary or direct from an assured"* [5]. It is true that most of the times both the assured and the broker benefit from this procedure. An obvious example where the use of the binder has very satisfactory results is when the assured has a very poor claims record. The reason is the following. In an open market, it would be very easy for a certain kind

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[3] *Ibid.* Page 288.
[4] *Ibid.* Pages 287-292.
[5] Shaw Gordon. (1995) The Lloyd's Broker. Lloyd's of London Press. Page 181.

risk to be completely uninsurable. On the other hand, in case of a binder, it would be very much better for both of them because the assured can be allocated to the binder and as a result a lower premium can be paid. But of course, there are a few disadvantages as well. For example, there is always a chance that an insurer will not renew the binder at its renewal date. So, this will result in damage to the broker's market. It would be quite useful to summarise what is the broker's exact position in respect of the operation of a binder: *"a broker acts as an independent commercial entity in making such decisions, with a perfect entitlement to filter business to the binder in a manner which protects the broker's own interests".* [6] Also, we cannot forget that what is required by a broker to an assured is only reasonable conduct[7]. In relation with this, we can mention here that in Australia the position is quite different. Under **the Insurance (Agents and Brokers) Act 1984**, the coverholder of a binder is considered to be the agent of the insurer and secondly he has to disclose the fact that he is operating under a binder. If this does not happen, it is possible for the contract to become voidable. The disclosure is relevant with the doctrine of the utmost good faith. An analysis is made in another chapter, so I will be quite brief. If the binder is **obligatory** – the insurer does not have the right to refuse risks by the assured – the situation is the following: a duty of disclosure by the assured is recognised in respect of all the material facts. On the other hand, it is not recognised in respect of individual declarations. But, if the binder is **non-obligatory** then, the insurer has a right to refuse risks from the assured- a duty of disclosure cannot be implied, because the policy is only a framework contract and each declaration is a separate contract with the result that the insurer may either reject or accept the declarations[8].

I will give emphasis on a few more things in relation with obligatory and non-obligatory binders. Generally, as it is implied from the above obligatory binders are considered to be contracts of the utmost good faith and all the difficulties arise in respect of the individual declarations, which take place during the operation of a non-obligatory binder. The most crucial question is whether a broker owes a duty of care to the insurer. In **Empress Assurance Corporation Ltd v Bowring & Co Ltd**.[9], the problem was that the broker had made some false declarations in respect of an amount

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[6] Merkin R.M. (1996).The Duties of Marine Insurance Brokers. , in Thomas D.R, The Modern Law of Marine Insurance , LLP. Page 289.
[7] *Ibid.* Page 287-292.
[8] *Ibid.* Page 290.
[9] (1905). 1 Com. Cas. 107.

of premium paid to the reinsurer, although he acted in good faith. As a result, there was a claim by the reisurer that the broker had been in breach of duty. It was held that he did not [10]. Also, serious problems arise when the assured has made full disclosure to the broker, but the information is not communicated in the right way to the insurer. It was decided again in **the Empress Assurance** case that when a situation like that takes place the insurer has waived his right of disclosure and as a result it is submitted that the information has been received by him [11].

Very interesting about binding authorities is **the Fisher Report**[12]**.** This was published by Lloyd's and its original title was "Self Regulation at Lloyd's". It was actually a report by the Fisher Working Party in May 1980. Some parts have to be extracted in the exact words in order to look at the use of binding authorities and some other important aspects of them. In chapter 22 of the report it is written that *"the use of Binding Authorities clearly carries special risks for those Underwriters who give them, and no system of control would remove all possibilities of abuse...We are satisfied that the premium income currently generated by Binding Authorities is considerable and represents a significant proportion of the total business written"* [13]. Afterwards, emphasis is given to the fact that the brokers are the suitable persons in order for the selection of the coverholders to be quite secure and the unsatisfactory choices to be very rare. Finally, in chapter 22 we have a very significant reference to the role of the Council or the Committee. It is stated that the Council must have the power to make the appropriate rules in order to make binding authorities more useful and that it should have the right to impose obligations on the brokers, so that the coverholders are instructed correctly and all the requirements are satisfied. And the last thing that is mentioned in respect of binding authorities is that an authority must be conditional on registration by **the Lloyd's Policy Signing Office** and that the broker has to inform the coverholder.

But, what is the exact process of setting up a binder? Again, in the Fisher Report is mentioned: *"In every case, the binding authority will have been negotiated by a Lloyd's Broker, who most commonly will be instructed by a would-be coverholder to negotiate a binding authority for him with Lloyd's Underwriters*

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[10] For more details see the judgement.
[11] *Ibid.*
[12] Shaw Gordon. (1995) The Lloyd's Broker. Lloyd's of London Press. Chapter 20.
[13] *Ibid.* Page 181.

(though occasionally the initiative will come from Underwriters)" [14]. However, many times it is the broker, who will try his best in order to prepare the market to join the binder. It has to be stated here that the Fisher Report was very influential at Lloyd's in respect of the position of brokers and as a result **the Brokers Regulation Committee** was created. This Committee published a document. Its title was ***"Lloyd's: Consultative Document: The Regulation of Lloyd's Brokers"*** and it is known as the Green Book. And there was a paragraph in it that dealt with **the Lloyd's Code of Practice for Lloyd's Brokers.** There in paragraph 8, one can find very important statements about binding authorities. At 8.1, it is written that the actual purpose of the use of binding authorities is to make much easier the acceptance of business. The only requirement that is emphasised is that the broker should always act for his client's best interests. At 8.2, it is mentioned that if the broker acts under a binding authority, this fact should be disclosed to his client as well as the economical advantages that the Lloyd's broker will have as a result of the use of binding authorities. Finally, at 8.3 it is cited that it is the duty of the broker to inform the insurers that his priorities are focused on his clients and not on the insurers[15].

Now, it is time to write about the statutory instruments in respect of binding authorities[16]. The first one is **the Binding Authorities Byelaw (No. 9 of 1990).** It has quite a few provisions. The first one is about interpretation. There, in subsections (3) and (4), someone can find the definition of what is and what is not a binding authority. According to subsection (3), a binding authority is a limited binding authority or a marine open cargo cover. Also, there are some restrictions in case where the coverholder is not a Lloyd's person or entity. On the other hand, according to subsection (4), binding authority is not a Lloyd's broker marine line slip. I have to say at this point that this byelaw is actually the result of the consolidation of the Binding Authorities (Amendment) Byelaw (No 1 of 1988) and the Insurance Intermediaries Byelaw (No 8 of 1990)[17].

The second statutory instrument is **the Binding Authorities Regulation (No 5 of 1990).** The most significant provision is the one that deals with the delegation

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[14] *Ibid.* Page 182.
[15] *Ibid.* Appendix 15. Page 363.
[16] *Ibid.* Pages 183-186.
[17] *Ibid.*

under the binding authorities. Under this provision delegation by the coverholder can happen only with the presence of prior written agreement. Again, it is a consolidation of the Binding Authorities (Amendment) Regulation (No 1 of 1988), the Binding Authorities (Amendment No 2) Regulation (No 2 of 1989) and the Insurance Intermediaries Byelaw (No 8 of 1990)[18]. The third is **the Binding Authorities Registration Scheme.** This scheme is about the registration of binding authorities and some other important topics, such as the signing of the Lloyd's Policy Signing Office or the resubmission of registration documents. The fourth one is the **"the Operation of Binding Authorities Code of Practice"**, which was made under paragraph 6 of Regulation No. 5 of 1990. It included among others coverholders' compliance with laws, transmission of information and responsibility of operation[19].

The last part of the chapter will be dedicated to a brief explanation of the persons and how they can be involved during the operation of a binder[20]. First of all, the coverholder is recognised as the agent of the underwriter. Another fact is that *"where the employer is a Lloyd's broker direct as his agent, then the potential for conflict arises in the event of a claim".*[21] This is often the reason, which leads many coverholders to try to find other brokers, in order to avoid the conflict of interest is also the integrity of the coverholder, especially in cases where there are disputes that have to do with matters of disclosure or other problems. A measure, which can help to the correct operation of binding authorities – as much as this can happen – is the monitoring of the check – lists. These appeared for the first time in the Regulation No 5 of 1990. They are prescribed in some classes, which are prescribed by the Committee and when a leading underwriter subscribes in such a class under a binding authority, then he had to sign a document that is called a check list. The solution that this can provide is that in some instances, where there is damage, it will be found out quite soon.

This theoretical background will be very useful in order to move on now and analyse more what is the position of brokers towards binding authorities also in practical terms.

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[18] *Ibid.*
[19] *Ibid.*
[20] *Ibid.*
[21] *Ibid.* Page 187.

7.2 BINDING AUTHORITIES & BROKERS

7.2.1 Binding Authorities and Reinsurance

Binding authorities are quite a common concept in the field of reinsurance. I have already referred to the theoretical background of binding authorities, when I was talking about special arrangements, where brokers are involved. What I am going to analyse now is the binding authorities, which are effected through underwriting agents and what is the position of each party during the transaction. This area, although it does not directly concern a broker, is very important, because for example a broker is under a duty to make inquiries, in order to assess whether the underwriting agent he deals with has the authority to conclude the contract in question. In respect of the agent's position, everything depends on the authority that he has, whether this is actual or ostensible[1]. The opinion of the broker is vital. The reason for this is that most of the times, the principal of the broker will rely on him to ascertain the "quality" of the assured because it is he that will have the personal knowledge and experience about whom he is dealing with.

The first thing I am going to refer to is the position of the underwriting agent during the transaction. Is he always merely an agent or he is in the position to accept risks also as a principal? A case where this question was elaborated is **Trancontinental Underwriting Agency S.R.L v Grand Union Insurance Co. Ltd.** [2]. Briefly the facts were as follows: the case was about a retrocession cover. A retrocession agreement takes place when a reinsurer actually agrees to insure the liability of another insurer. The plaintiffs in this case were the managing agents of a retrocession pool in which the defendants were interested. Hence, the two questions that arose- in respect of the relationship between the retrocessionaire (the person who insures the liability of the other reinsurer) and the retrocedant (the original reinsurer) were: (a) *whether the plaintiffs were on the proper construction of the agreement parties thereto and* (b) *irrespective of answer to* (a) *whether the plaintiffs as brokers were in any event entitled to a claim under the agreements on behalf of their principals in the capacity of fiduciary agents* [3]. In the arbitration stage, it was decided by the arbitrators, that the plaintiffs did not have the right

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[1] Birds John. (1997). Modern Insurance Law. Sweet & Maxwell. 4th edition. Pages 178-180.
[2] (1987) 2 Lloyd's Rep. 409.
[3] *Ibid.* Page 409.

to sue the defendants and there was an appeal to that. I am going to refer to the judgement in quite some detail.

In relation to the first question, the argument of the plaintiffs was that the ratio decidendi of the arbitration is in conflict with an agency law principle. Someone can read in the authoritative textbook of Bowstead on Agency: *"an agent who makes a judgement on behalf of his principal is liable to or is entitled to sue the third party in accordance with the terms of any contractual engagement into which he has entered... the question whether an agent is deemed to have contracted personally depends on the intention of the parties"*[4]. The same principle was established as well in earlier cases. In **Cooke v Wilson**[5], it was said by Mr. Justice Creswell that *"prima facie, when a man signs a contract in his own name, he is a contracting party and there must be something very strong upon the face of the instrument to prevent that liability from attaching to him"* [6]. Also, in **Parker v Winlow**[7], Lord Campbell C.J said, *"I can see no doubt for myself that the defendant is personally liable. He makes the contract using apt words to show that he contracts. And the only ground suggested for rebutting his personal liability is that he says he is the agent for another: but he may well contract and pledge his personal liability, though he is the agent for another"*[8]. And Mr. Justice Crompton in upholding his argument expressed his opinion that *"mere words of description attached to the name of the contractor, such as used here, saying he is the agent for another, cannot limit his liability as contractor. A man, though agent, may very well intend to bind himself, and he does not bind himself if he contracts without restrictive words to show that he does not do so personally"* [9]. These were more or less the authorities used by the plaintiffs. Hence, in summary, Mr. Mance argued on behalf of the plaintiffs, that because the plaintiffs

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[4] *Ibid.* Page 412. / Bowstead William. (1996). Bowstead and Reynold on Agency. Sweet and Maxwell. 16th edition. Articles 115-116

[5] (1856) 1 C.B (N.S) 153.

[6] *Ibid.* Page 162. Per Mr. Justice Cresswell.

[7] (1857) 9 Exch. 942.

[8] *Ibid.* Page 947. Per Lord Campbell C.J.

[9] *Ibid.* Page 949. Per Mr. Justice Crompton.

themselves signed the contract in question and because there was no intention for this not to happen, they were parties to the contract.

On the other hand, the defendants argued that the decision of the arbitrators was correct and that because the plaintiffs acted only as brokers and managing agents, they could not be deemed to be the parties of the contract. They relied on a passage in Halsbury's Laws of England: *"extrinsic evidence generally cannot be received in order to prove that a person appearing, on the face of the document, to be the principal was in fact the agent...where a person contracts professedly as an agent, then in order to charge him on the contract, it may be shown by extrinsic evidence that he is in fact the principal"* [10].

The court accepted plaintiff's argument. Mr. Justice Hirst in justifying his decision said that it was clear from the retrocession agreements that the plaintiffs did not try to exonerate themselves from liability. It was beyond doubt that they intended to be parties of the contract. In addition, the judge said that because the plaintiffs were considered to be personally involved with the contract and personally contracted, they did not mean that the unnamed principals of the pool could not bring an action or be sued together with their agents[11].

The second question had to do with the right of the plaintiffs to sue in respect of their position as brokers. Again, the plaintiffs justified their position with a number of authorities. The first one that was used was from Arnould on Marine Insurance: *"an action on a policy may be brought in the name of broker or other agent who has effected it in his own name"* [12]. Quite a few cases were mentioned as well. In **Provisional Insurance Co. of Canada v Leduc**[13], it was upheld that *"it is clear that an agent who insures for another with his authority may sue in his own name"* [14]. Finally, Mr. Mance cited down the cases of **Lloyd's v Harper** [15] and the more recent one of **Woodar**

[10] Halsbury's Laws of England. (1983). Volume 12, paragraph 1479. 4th edition. This was mentioned in the judgement.
[11] For more details see the actual judgement.
[12] Arnould Marine Insurance. 16th edition, paragraph 1354.
[13] (1874) L.R 6 P.C 224.
[14] *Ibid.* Per Sir Barnes Peacock.
[15] (1880) 16 Ch. D 290.

Investment Development Ltd v Wimpey Construction U.K Ltd. [16]. Both cases actually upheld the principle that when a party – e.g. A- is a trustee for someone else- e.g. B- then, it is possible for A to claim everything under the contract to which B is entitled to. The **Woodar** case was even more specific, because it dealt with the position of an insurance broker. The defendants on their part stated that in the case of **The Albazero**[17], it was said that in order for someone to claim the interest of someone else under a contract, *"it must be shown that it appears from the terms of the policy that he intended to cover their interests"* [18]. Their other argument was that the authorities that were mentioned by the plaintiffs applied only to marine insurance. The court again accepted the plaintiffs' argument, by saying that it would not be logical for the brokers' capacity to be disputed, since it is in the nature of the brokers' business to act on behalf of their principals.

Another area of dispute in relation to the authority of agents is when we have a termination of an agency agreement, but at the same time the principal gives to his agent the right to continue to administer the run-off of the business. This administration of the run-off of the business by the agents means in simple words that the agent will deal only with business that has already been done by him on behalf of his principal in respect of the agency agreement that has been terminated[19]. It must be mentioned here that although this is quite a usual scenario in the insurance context, the principal has of course the right to cancel completely the agreement and discharge his agent. A very significant case that is related with all these aspects is **Yasuda Fire and Marine Insurance Company of Europe Ltd. v Orion Marine Insurance Underwriting Agency Ltd**[20]. The defendants-Orion - were actually the underwriting agents of the plaintiffs-Yasuda Fire-. The agreement contained clause 4.2 by which *"the plaintiff was entitled to inspect and take*

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[16] (1980) 1 W.L.R 277.
[17] (1976) 2 Lloyd's Rep. 467.
[18] *Ibid.* Page 474.
[19] For a more detailed definition see: O'Neill P.T. & J.W. Woloniescki. The Law of Reinsurance. (1998). Sweet & Maxwell. Paragraph 16-01
[20] (1995) Q.B. 174, (1995) 2 W.L.R. 49. (1995) 3 All E.R. 211, (1995) 1 Lloyd's Rep. 525, The Times, October 27, 1994, ChD.

extracts for or make copies of all the necessary books, accounts, records and other documentation, although the records were to be the property of the defendants" [21]. At first, the plaintiffs terminated the agreement, but let the defendants to continue to administer the run-off of the business. Later on, they decided to conduct the run-off themselves. As a result, in respect of clause 4.2, they asked the defendants to give their permission for the inspection and copy of the records, accounts, books and any other information to take place. The defendants refused. These were the general facts of the case and the cause of action concerned the defendants' refusal.

It was argued on behalf of the plaintiffs that *"it is a fundamental principle of the law of agency that an agent's duty to maintain existing records and to allow access to them after the contract of agency has been terminated, continues. The business underwritten was the plaintiff's business, not that of the defendant's, so that the fiduciary duties imposed on the defendants by the relationship of principal and agent continue in respect of business already transacted"* [22]. According to the argument the fact that the information would remain the information of the defendants did not give them the right to refuse the inspection. The only effect that this could have was that the defendants did not have to submit to the plaintiffs the original sources of information. It was also mentioned that even if the defendants, as their system, kept the records of all the customers together and not of each customer separately, this will not affect their obligation. According to their duty to provide certain information, they would simply have to provide their principals with the records of all the customers.

On the other hand, the defendants based their arguments on the case **Photo Productions Ltd. v Securicor Transport Ltd.** [23]. Generally the argument was *"that where primary obligations have been discharged by acceptance of repudiatory breach, the primary obligations can no longer be enforced, whether by specific performance, injunction or otherwise. The only available remedy to the innocent party is the secondary*

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[21] (1995) Q.B. 174. Page 174.
[22] Bowstead William. (1996)Bowstead and Reynold on Agency. Pages 191-192. Article 151. Sweet and Maxwell. 16th edition.
[23] (1980) A.C 827, 849, 850.

remedy of damages" [24]. Moreover, the court upheld that that the extent of damages that should be awarded, should be decided by arbitration.

It will be very interesting now to look at the decision of Colman J. His actual decision was that the plaintiffs, although a termination of agency agreement between them and the defendants had taken place, had a continuing right to inspect all the records they needed for the effective run-off of the business. First of all, the judge said that it was not for this court to decide which party was in repudiatory breach of contract, because this was a matter of arbitration. Further on, he upheld the plaintiffs' argument, by accepting that, because the risks that were involved were complex and long-term, it was vital for them to have quick access to the records. Following his argument, he analysed the case of **Photo Productions**. Actually, he quoted a part of Lord Diplock's speech: *"every failure to perform a primary obligation is a breach of contract. The secondary obligation on the part of the contract breaker to which it gives rise by implication of the common law is to pay monetary compensation to the other party for the loss sustained by him in consequence of the breach"* [25]. However, Lord Diplock recognised two exceptions, when the primary obligations of the parties do change and the party, who is not at fault has the right to cancel. According to his own words, the two exceptions were: *(a) when the event resulting from the failure by one party to perform a primary obligation has the effect of depriving the other party of substantially the whole benefit, which it was the intention of the parties that he should obtain from the contract, the party not in default may elect to put an end to all primary obligations of both parties remaining unperformed* [26]. *(b) Where the contracting parties have agreed, whether by implication of law or the contracting parties or by express words, that any failure by one party to perform a primary obligation, irrespective of the gravity of the event that has in fact resulted from the breach, it shall entitle the other party to elect to put an end to all primary obligations of both parties remaining unperformed"* [27].

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[24] *Ibid*
[25] Photo Productions Ltd. v Securicor Transport Ltd. (1980) A.C 827, 849, 850. Per Lord Diplock.
[26] *Ibid.*
[27] *Ibid.*

Colman J. supported the view that the right of inspection could not be cancelled, because the defendants had a fiduciary relationship with the plaintiffs and the relationship could not be affected by the repudiatory breach. He also said that this continuing relationship existed irrespective of the contract of agency. In his own words: *"although in modern commercial transactions, agencies are almost invariably founded upon a contract between a principal and an agent, there is no necessity for such contract to exist. It is sufficient if there is a contract by the principal to the exercise by the agent of authority and consent by agent to his exercising such authority on behalf of the principal"* [28]. Something else that he focused on was the fact that it was impossible for the plaintiffs to keep up with the run-off of their business, if the defendant's duty was not regognised. A citation would be quite helpful: *"that obligation to provide an accurate account in the fullest sense arises by reason of the fact that the agent has been entrusted with the authority to bind the principal to transactions with third parties and the principal is entitled to know what his personal contractual rights and duties are in relation with those third parties as well as what he is entitled to receive by way of payment from the agent"* [29]. This is quite briefly the reasoning of Colman J. in his own words. In the more recent case of **Home Insurance v M.E Rutty Underwriting Agency Ltd.** [30], it was held that in case of pool members, if the records of their agent are asked to be passed to them, they are entitled jointly to them .

7.2.2 Difference between Open Covers and Binders

It is time now to focus on the difference between open covers and binders. The difference is very important to a broker, because agency issues are involved. An open cover is when an insurer binds himself that he will accept certain kind of risks to a certain amount. In this case, there is no agency agreement and the contract is between the

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[28] (1995) Q.B 174. Page 185. Per Colman J.
[29] *Ibid.*
[30] (1996) L.R L.R 415.

reinsurer and the reinsured. Open covers are also called **facultory obligatory treaty**[31]. On the other hand, as I have already mentioned, when there is a binder, the broker is the agent of the reinsured. A case that is about open covers is **Phoenix General Insurance Co. of Greece v Halvanon** [32]. In this case the plaintiffs reinsured with the defendants. The defendants under the open covers were obliged to accept the risks that the plaintiffs would choose. It must be said at this point that all the contracts were kept in the form of slips and as a result no policies were signed. This created a lot of difficulties to the court, because, what the parties intended to do, could be very obscure. The cause was the following: it was argued by the defendants that under **the Insurance Companies (Classes of General Business) Regulations 1977**, which amended **the Insurance Companies Act 1977**, that the class of insurance which the plaintiffs undertook could be covered only by class 16. (Miscellaneous). Following the argument, the defendants continued that that this was illegal, because the plaintiffs were authorised only by section 83(4) of the original Act – **Insurance Companies Act 1977** -, which was about marine aviation and transport insurance business. As a result, a number of issues had arisen. The first issue was about the illegality on the part of the plaintiffs, which could render the contracts in question void. The principle that the defendants supported could be found in the case of **Marles v Philip Trant and Sons Ltd.** [33]: *"so far as the cause of action itself is concerned, the principle is well settled that if the plaintiff requires any aid from an illegal transaction to establish his cause of action, then he shall not be aided from the court"* [34]. The other cases that were used were the case of **Bedford Insurance Co. Ltd.**

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[31] O'Neill P.T. & J.W. Woloniescki. The Law of Reinsurance. (1998). Sweet & Maxwell. Paragraph 10-10.
[32] (1985) 2 Lloyd's Rep. 599.
[33] (1954) 1 Q.B 29.
[34] *Ibid.* Page 32.

v Instituto do Reseguros do Brasil [35], and also that of **Stewart v Oriental Fire and Marine Insurance Co. Ltd.** [36]. In the first case, the principle which was upheld was that *"a reassured could recover under a reinsurance contract on account of what he held to be the illegality of the original insurances"* [37]. In the other case it was held that *"a reassured who had not been carrying on business illegally, could recover under his reinsurance contract from a reinsurer who had"* [38]. Hence, the first thing that the judge had to decide was whether the plaintiffs had committed a criminal offence. The court answered that the plaintiffs did commit a criminal offence. As I have already stated everything depended on whether the plaintiffs were authorised to act under certain provisions or not. The plaintiffs argued that they were acting under class 5 and 6 of the 1977 Regulations. These two classes related to aviation. The defendants said that the only class, which could cover the plaintiff's activities, was class 16, which was about miscellaneous financial loss. The court upheld this opinion. The second question that the court had to decide as to the extent of illegality on the part of the plaintiffs. The court held that the transactions could not be considered void and the illegality concerned only a certain part of the plaintiffs. Finally, there was a question about the retention of risk of the reassured. This device is used to ensure that the reassured is acting in a reasonable way. The court decided that it could not be implied that the plaintiffs were under an obligation to retain any part of the risk.

Generally, the reasoning why commercially open covers are needed was very well explained in **Glasgow Assurance Co. v Symondson** [39] by Scrutton J.: *"in the insurance market quantities of risks are passed on well-known underwriters of high standing, whether companies or Lloyd's men... on the other hand, original lines of insurance could*

[35] (1984) 1 Lloyd's Rep. 210, (1985) 1 Q.B 966.
[36] (1984) 2 Lloyd's Rep. 109, (1985) 1 O.B 988.
[37] Phoenix General Insurance Co. of Greece v Halvanon (1985) 2 Lloyd's Rep. 599. Page 603. Per Mr. Justice Hobhouse.
[38] *Ibid.*
[39] (1911) 16 Com. Cas. 109.

not be placed with new companies or foreign companies who are not well known, and if they are to get any business, they must accept reinsurances of the lines of the popular underwriters" [40].

7.2.3 Conclusion

It is obvious from the above that the whole chain of open covers, binding authorities and especially how the parties of a contract deal with them is a very complex issue. Therefore, it is logical that many times abuse of binding authorities takes place and liabilities between the parties have to be settled. I will make just very brief reference at this now, because I am going to analyse it in the chapter, which will be dedicated to the topic of liability. Hence, the main thing that should be mentioned is that everything in regard to the liability of the parties depends on the actual or ostensible authority that the principal gives to his agent. Also, the liability can have more than one form. There may be liability between the principal and his agents or it may be exclusively the liability of the intermediaries- this is the category, which is of most concern to brokers-.

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[40] *Ibid.*

7.3 UMBRELLA ARRANGEMENTS

This is again a concept of Lloyd's, since it is very much related with Lloyd's practice. The definition of what constitutes an umbrella arrangement can be found in Appendix EE of the Green Book entitled: Consultative Document: The Regulation of Lloyd's Brokers: " *an arrangement between a Lloyd's broker and a non-Lloyd's broker (other than a subsidiary of the Lloyd's broker) whereby business is transacted at Lloyd's by the directors, partners or employees of the non-Lloyd's broker, using the Lloyd's brokers' slips*" [1]. It is obvious that this can be proved to be a very important device in practice. It is a way by which Lloyd's becomes more approachable and is helping non-Lloyd's brokers to conduct business. However, it is a system that has some disadvantages as well. There have been many instances when non-Lloyd's brokers have been proved to be untrustworthy and the result was that many problems were created. There was a case a few years ago where a Lloyd's broker put himself into trouble because of a non-Lloyd's broker who operated a binding authority under an umbrella arrangement [2]. However, this case remained unreported [3]. These problems have to do with for example retention of premiums for quite a long period or misrepresentation and non-disclosure of material facts. Also, there have been instances of no proper security or record of accounts. This is logical in a way because it is much more difficult for the whole Lloyd's system to be able to check and assess someone who is not a Lloyd's broker than someone who is.

I am going to refer to one case in order to look at umbrella arrangements in a practical way. The case in pont is **Johns v Kelly**[4]. The facts were as follows. Hoover plc was a company that wanted to obtain a warranty for their goods, which would be for a more extended period than the original one. In order to do that, they asked for the advice of an insurance consultants' firm who advised them to employ a company called Multi Guarantee Co. Ltd. to go through with the task. So, as a result this

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[1] The Green Paper: Lloyd's: Consultative Document: Umbrella Arrangements. May 1984.
The Green Book: Consultative Document: The Regulation of Lloyd's Brokers. November 1987. Appendix EE. / Shaw Gordon. (1995). The Lloyd's Broker. Lloyd's of London Press Ltd. Chapter 22.

[2] See: Shaw Gordon. (1995). The Lloyd's Broker. Lloyd's of London Press Ltd. Paragraph 22.1

[3] *Ibid.* Page 203.

[4] (1986) 1 Lloyd's Rep. 468.

company instructed Campbell Robert – CR - to place the cover. The problem was that CR were not Lloyd's brokers and they had to try and sort out an umbrella arrangement with a Lloyd's broker. They arranged it with a firm of Lloyd's brokers called Robert Morris Gray Ltd. The agreement was that CR would pay RMB a 5 per cent of premium income due to Lloyd's underwriters. Also, CR agreed to indemnify RMB in relation to any liability, arising in tort in relation to their activities. When CR placed the risk for Hoover there was an upper limit about claims, which could be made and the insured had to be Hoover. Hence, when the action was brought, a number of parties were involved. The insurers denied liability *"on the ground that the claim made by RMB did not fall within the policy and alternatively that they were entitled to avoid the policies on the ground of misrepresentation in that RMB had declared on the proposal form that CR was not an associate company; and on the ground of material non-disclosure in that RMB had not disclosed to the insurers the existence of the umbrella arrangement, which was a material circumstance that ought to have been disclosed"* [5]. The court held that CR was not an associate company with RMB. Also, that a duty of care was owed by RMB to Hoover and that it was clear that RMB was under a duty to control CR's actions. Thirdly, the relationship between RMB and Mr.Tim Roberts, who was CR's principal, could not be considered to be a normal relationship between an employer and an employee. It was just a method to satisfy the Committee of Lloyd's. Fourthly, the court accepted that the actual existence of an umbrella arrangement was a factor, which would have been considered material by a prudent insurer. Finally, it was held that there was no evidence proving that RMB disclosed the existence of an umbrella arrangement at any time during the conclusion of the insurance contract or its renewal. This was in fact the reason why they were held to be liable[6]. If, however, CR went insolvent but kept the premium as a result of fraud, then, RMB would be liable to the assured in tort. The general conclusion that can be derived from the above case is that the device of umbrella arrangements can sometimes be very useful for the operation of the Lloyd's insurance market. It is quite often the only way by which a non-Lloyds broker can approach Lloyd's transactions. The problem, however, as I mentioned above, is basically one of security. It is not

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[5] *Ibid.* Pages 468-469.

[6] *Ibid.*

easy, for example, for a Lloyd's broker to make proper investigation about the non-Lloyd's ones. Hence, it is a mechanism that has to be treated with caution from the parties, who intend to be involved.

7.3.1 Personal Lines Business

Binding authorities and umbrella arrangements are not the only ways by which a non-Lloyd's broker can have access to Lloyd's. Personal Lines also exist. My reference to them is going to be very brief, because it is a device that is used only to non-commercial insurance in the context of private motor car insurance or personal accident insurance. The main thing about personal lines is that the person who obtains the cover acts in a private capacity [7]. In this kind of circumstances, it is the Lloyd's broker who has to make sure that the individual that is involved will carry out his contractual obligations. His role here is more significant than when we have a commercial insurance [8]. The reason for this is that an individual cannot be expected to have the expert knowledge like parties who are involved in commercial insurance.

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[7] Shaw Gordon. (1995). The Lloyd's Broker. Lloyd's of London Press Ltd. Chapter 23.

[8] *Ibid.*

CHAPTER

8 *Liability Of Insurance Brokers*

8. 1 Introduction

The question of liability of an insurance broker in relation to his duties that arise under an insurance contract is perhaps the most significant one. The difficulty is that it is a very wide topic and it will not be easy to put all the possible aspects of an agent's liability in order. The other thing that must be noted at the beginning is that, in order to have a general view of this topic and its implications with other areas of law, that analysis cannot be confined only to the position of brokers. Other examples must be used such as these relating to solicitors and auditors. It is true that in quite a few instances higher courts have used this approach – **the incremental approach** – in order to solve legal problems. Another approach, which was used, was **the profession-by-profession approach**, but I will analyse them both in detail later. [1]

The first thing I should do is recognising the possibilities under which the agent is liable to his principal. These are three: (1) an agent can be liable in tort. (2) An agent can be liable to his principal in contract. (3) An agent can be liable under his fiduciary duties. It cannot be argued that in most of the cases the extent of liability will be the same either under contract or under tort. The main difference between contract and tort can be the limitation period. The reason for this is that in accordance with **the Latent Damage Act 1986 (section 14A of the Limitation Act 1980)**, although the normal limitation period is six years from the actual cause of action, now it is possible to uphold a claim in tort within three years from the moment, when the person, who actually brings an action has acquired knowledge of the relevant facts [2]. This point of course will be analysed further. However, in order to understand the nature of liability, it would be better to look at the cases and try to figure out the principles that derive from them [3].

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[1] Malcolm Clarke. The law of Insurance contracts. (1994). Lloyd's of London Press Ltd. 2nd edition. Page 213.
[2] Ibid. Page 211.
[3] See below.

8.2 Elements of liability in Tort.

8.2.1 Foreseeability

Foreseeability is not the only requirement. Another two were established in **Caparo Industries plc. v Dickman** [4]. I will use the exact words of Lord Bridge: *"in addition to the foreseeability of damage, the necessary ingredients in any situation giving rise to a duty of care are that there should exist between the party owing the duty and the one to whom it is owed, a relationship characterised by the law as one of* ***"proximity"*** *or* ***"neighbourhood"*** *and that the situation should be one in which the court considers it* ***fair and reasonable*** *that the law should impose a duty of a given scope upon the one party for the benefit of the other"* [5].

At this point, it would be very interesting to look at some of the leading cases and examine what was said as obiter dictum by the judges in relation to the three ingredients according to which liability can be proved. I will say a few more things about the element of foreseeability. The main thing that must be mentioned about foreseeability is the fact that although it is beyond doubt a necessary requirement for liability to exist, it can never be a sufficient cause on its own for liability to be established. This was exactly what was said by Lord Keith in the case of **Hill v The Constable of Yorkshire** [6]: *" it has been said almost too frequently to require repetition, that foreseeability of likely harm is not in itself a sufficient test of liability in negligence"* [7]. However, the position may be quite different, in cases where only physical damage is involved. In **the Caparo Industries v Dickman** case, which is mentioned it was cited that *"mere foreseeability is not of itself sufficient to ground liability unless, by reason of circumstances, it itself constitutes the element of proximity, as in the case of direct physical damage"* [8]. Moreover, in **Murphy Brentwood District Council** [9]. Lord Oliver said that *"in the straightforward case of the direct infliction of physical injury by the act of the defendant, there is no need to look beyond the foreseeability by the defendant of the result in order to establish that*

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[4] (1990) 2 A.C 605, (1990) 2 W.L.R. 358, (1990) 1 All E.R 568 (H.L).
[5] *Ibid.* (1990) 1 All E.R. 568 (H.L). Page 617. Per Lord Bridge.
[6] (1989) 1 A.C 53.
[7] *Ibid.* Page 486. Per Lord Atkin.
[8] Caparo Industries plc. v Dickman. (1990) 2 A.C 605, (1990) 2 W.L.R. 358, (1990) 1 All E.R 568 (H.L). Page 635. Per Lord Oliver
[9] (1991) 1.A.C. 398.

*there is a **proximate relationship** with the plaintiff*"[10]. It must said that the above distinction, as it is shown by the judges, is only developed as a suggestion and it must be understood that in cases where only physical damage is involved, it does not mean that the other two requirements do not exist at all. In contrast, the position of the law remains the same and the test, as this is applied in **the Caparo** case, does not change. The only difference that can be recognised is that the nature of the cases like these, is such that the other two elements- **proximity and fair and reasonable to impose a duty** - most of the times need not to be argued, because they are inferred by the circumstances. Irrespective of this, emphasis must be given to the fact that the legal position does not alter [11].

8.2.2 Proximity

Now, I can move on to the requirement of proximity. In simple words, what we mean by the element of proximity is more or less the actual existence and the exact nature of the relationship between the plaintiff and the defendant in question.

The main thing that needs to be discussed about proximity is that it must be made clear that it is not exactly a question of fact that can be decided in each case separately. It is more a question of law. It is what Lord Atkin said in his judgement in the case of **Donoghue v Stevenson** [12]: "*proximity extends to such close and direct relations that the act complained of directly affects a person whom the person alleged to be bound to take care would know, would be directly affected by his careless act*"[13].Another definition of what can constitute the necessary degree of proximity was given in the case of **Murphy v Brentwood District Council** [14] – mentioned above -: *"the essential question which has to be asked in every case, given that the damage, which is an essential ingredient of the action has occurred, is whether the relationship between the plaintiff and the defendant is such – or, to use the favoured expression, whether it is of sufficient proximity- that it imposes upon the latter a duty of care to avoid or prevent that loss which was in fact sustained"* [15].

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[10] *Ibid.* Page 486. Per Lord Atkin.
[11] Feldthusen Bruce. (1944). Economic Negligence. Thompson Canada Limited. 3rd edition. Pages 40-46.
[12] (1932) A.C 526
[13] *Ibid.* Page 581. Per Lord Atkin.
[14] (1991) 1 A.C 398.
[15] *Ibid.* Page 486. Per Lord Oliver.

8.2.3 The requirement of "fair and reasonable"

The last factor I am going to refer to in respect of liability, as this can be examined under the heading of the general law of negligence is the one that is related to the question of "whether it is just fair and reasonable to impose a duty". This specific question is one of the most important concepts that have to be discussed when dealing with liability and it is something which is very interrelated with the question of the requisite degree of proximity. An extract from the judgement of Lord Morris in the case of **Home Office v Dorset Yacht Co. Ltd.** [16] proves the significance of this ingredient and at the same time reveals its nature. The main idea that derives from his judgement is that, generally, "the question of whether or not to impose a duty has to be decided according to principles of public policy" [17]. It is obvious from the above that it is not easy to understand what is the meaning of these requirements in practice. Also, another difficulty arises in relation to the fact that it is not clear at all to be inferred from the attitude of the courts whether the factors that influence the decisions that are taken are following more the proper enforcement of the law or, on the other hand, public policy and the particular facts of each case is the vital aspect. This problem of definition was emphasised by Lord Bridge in **the Caparo** case. Actually, he specified the problem in the matters of proximity and fairness: *"the concepts of proximity and fairness are not susceptible of any precise definition as would be necessary to give them utility as practical tests, but amount in effect to a little more than convenient labels to attach to features of different specific situations which, on a detailed examination of all the circumstances, the law recognises pragmatically as giving rise to a duty of care of a given scope"* [18]. It is clear that Lord Bridge suggests that the courts usually follow a pragmatic approach to resolve the cases.

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[16] (1990) A.C 1004.
[17] *Ibid.* Page 1034. Per Lord Morris.
[18] Caparo Industries plc. v Dickman. (1990) 2 A.C 605, (1990) 2 W.L.R. 358, (1990) 1 All E.R 568 (H.L). Page 618. Per Lord Bridge.

8. 3 Negligent misstatements and services- Historical background.

The principles, which were mentioned in the introductory part, were very closely related to the general law of negligence. Now, I am going to move on to a specific area, which is concerned with brokers, because of the nature of their duties, and also other categories of professionals, such as solicitors and auditors. Before I start to analyse the earlier cases and their judicial development throughout the years, it is worth noting the difference in the approach between the Commonwealth and the United States. In the United States, where we can find – in contrast with the Commonwealth – case law, even until the 1960's - the law of negligent misrepresentation and misstatements was developed completely separately from the ordinary law of negligence [19]. In the beginning things were not so easy. In relation to tort, the only areas of law, where a claim for misrepresentation was allowed, were intentional tort or deceit. However, the main difficulty that arose, was that for a claim to be justified, fraud on part of the defendant had to be proved. Hence, it was not at all an area, where the law of negligence could be developed [20]. The result of this was that the only way of recovery was the law of contract, but its application was restricted to parties, between which privity of contract existed, so that they could bring an action against each other. This is perhaps the reason that someone can find many similarities between the law of contract and the law of negligent misrepresentation. But, perhaps the most significant point is that the law of negligent misrepresentation and misstatement developed separately also from the law relating to personal injury, in the sense that although there was an effort to apply the personal injury law's principles in cases, where only economic loss was caused, in the end the courts managed to enforce these principles in a more commercial context [21]. Something that will show the reluctance of the courts in England to recognise a duty in respect of negligent misrepresentation is the fact that the first case, which actually recognised such a duty, took place in 1963 [22].

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[19] Bruce Feldthusen. (1944) Economic Negligence. Thompson Canada Limited. 3rd edition.
[20] *Ibid.* Chapter 2. Paragraph 2.
[21] *Ibid*
[22] Hedley Byrne & Co. Ltd. v Heller and Partners Ltd. (1964) A.C 465, (1963) 2 All E.R 575, (1963) 3 W.L.R 101, (1963) 1 Lloyd's Rep. 435 (H.L).

The first case in the Commonwealth, which in practical terms dealt with negligent misrepresentation, although at that time this was not a recognised heading of law, was **Derry v Peek** [23]. The case took place in 1889 – much earlier from the time that the law of negligent misrepresentation actually developed and the facts were as follows. The directors of a company made some false statements, that they could use steam power instead of horses. They said that they relied on the Act of Parliament, by which that company was created. The Board of Trade in the end did not allow them to do so. The result was that the plaintiffs brought an action, which was based on deceit, in relation to the false statements made by the directors of the company. The court upheld the action based on deceit. The ratio decidendi of the case was that the court had decided that the directors honestly believed that their statements were actually true, but that they did not have any reasonable reasons to make such an assumption. Hence, as the Court of Appeal decided, fraud had been established. The House of Lords however overruled this decision. As Lord Hershell put it: *" first, in order to sustain an action in deceit, there must be proof of fraud and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false misrepresentation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false"* [24]. And in Lord Bramwell's words: *" to found an action in for damages there must be a contract and breach or fraud"* [25]. This approach followed by the courts shows that although an action for negligence was not brought at all, it would be very difficult for an action based on it to be successful.

The next case I am going to refer to is **Cann v Wilson** [26]. The facts of this case were related to the value of the property. The defendants negligently overvalued the property in question. The result of their negligence was that the value failed to cover a loan that took place. Emphasis must be given to the fact that the question of reliance was beyond doubt, because the defendants actually knew that the plaintiffs would rely on their valuation. The court held that the plaintiffs were liable in respect of their negligence[27]. This was actually one of the first cases, where negligent misrepresentation was not only recognised, as a sufficient cause of action, but it was also successful. However, this case did not remain established authority. It was

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[23] (1889) 14 App. Cas. 337.
[24] *Ibid.* Page 374. Per Lord Hershell.
[25] *Ibid.* Page 347. Per Lord Hershell.
[26] (1888) Ch.D. 39.
[27] *Ibid.* Page 39.

overruled in the case of **Le Lievre v Gould** [28] According to the facts of the case, a surveyor gave to the plaintiffs some certificates, which were related to the progress that was made in the construction of the building of houses. The court did not recognise that the surveyor owed a duty of care to the plaintiff. One important factor of the case, which very much influenced the decision of the court, was that the surveyor never gave his permission to the plaintiffs to use his certificates. Another fact that we must look at is how the court approached the previous cases: the case of **Derry v Peek** was followed, since it was said in the **Le Laivre** case that because of the **Derry v Peek** case, an action could not be brought when fraud could not be proved. Such a conclusion automatically meant that **Cann v Wilson** had to be overruled [29].

After the cases that I mentioned above, which actually constitute the history of the negligent misrepresentation law, we will have to come to the 1960's. This is the period that this area is really developing [30]. A case that must be mentioned is **Candler v Crane, Christmas & Co.** [31]. It is about the plaintiff who wanted to invest some money in a company. However, he wanted to secure his money as much as possible, so, he asked the director of the company to inform him about the accounts of the company. What the director did is that he put him in touch with the accountants of the company. The accountants prepared the accounts and the plaintiff decided to invest. In the end, it was proved that all the information, which was provided by the accountants was false and the result was that the plaintiff brought an action against the accountants. On their part, the accountants admitted that they acted very carelessly but not in fraudulent way. The decision of the court is of great importance. The House of Lords by a majority of two held that the loss caused by the negligence of the accountants was not actionable. The reason for the decision that was given by the majority was that a contractual relationship did not exist or any other fiduciary duty between the parties [32]. However, it is important to note that the dissenting judgement of Lord Denning in this case became more authoritative during the years that followed. He based his argument on his assumption that the law of negligence had

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[28] (1893) 1 Q.B. 491.
[29] *Ibid*
[30] Bruce Feldthusen. (1944) Economic Negligence. Chapter 2. Thompson Canada Limited. 3rd edition.
[31] (1951) 2 K.B 164.
[32] *Ibid.*

developed quite a lot [33]. His argument was divided in three separate questions: (1) what persons are under such a duty? In his own words, the answer was *" those persons such as accountants, surveyors, valuers and analysts whose profession and occupation is to examine books, accounts and other things, and to make reports on which people – other than their client – rely in the ordinary course of business"* [34]. (2) The second question related as to whom these professionals owe the duty in question. Lord Denning said *"they owe a duty, of course to their employer or client; and also I think to any third person to whom they themselves show the accounts or to whom they know their employer is going to show the accounts, so as to induce him to invest money or to take some other action on them"* [35]. (3) The third question was to what transaction does the duty of care extend? Again, in Lord Denning's words: *" it extends I think only to those transactions for which the accountants knew their accounts were required"*. The approach, which was followed by Lord Denning, was approved later in the **Caparo v Dickman** case [36].

However, the most significant case is that of **Hedley Byrne v Heller & Partners Ltd.** [37]**.** Because of the importance of this case I refer to its facts in quite some detail. The plaintiffs were contractors of advertising and their client was a company called Easipower Ltd. The plaintiffs were actually concerned about the financial position of the above company, so, they had asked their bankers about it. After a while, the bankers sent a letter to Easipower's bankers, through which they were asking about the financial position of the company in question. The defendants – Easipower's bankers- replied. The content of the letter was that the financial position of Easipower was good. The crucial part of the reply was the fact that the information was given "without responsibility on the part of the bank". In the end, the plaintiffs lost £17000, because of the negligence of the bankers. Hence, they brought an action against them. The actual decision of the court was that the plaintiffs could not recover the money, because the bankers never really accepted or implied any kind of responsibility. But, in order to understand why this case became such an authority, I

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[33] Robby Bernstein. Economic Loss (1993) Longman Group Ltd. Page 378.
[34] Candler v Crane, Christmas & Co. (1951) 2 K.B 164. Page 179. Per Lord Denning.
[35] *Ibid.*
[36] *Ibid.* / See also Caparo v Dickman (1990) 2 A.C. 605, (1990) 2 W.L.R. 358, (1990) 1 All. E.R. 568 (H.L).
[37] (1964) A.C. 465, (1963) 2 All E.R. 575 (H.L).

will analyse the reasoning of the judges [38]. I will start with the opinion of Lord Morris. Generally, what he believed – like all the other judges – is that a duty of care would be able to be justified, if the defendants had not made it clear that, that the information they gave was without responsibility. Hence, Lord Morris said: *" if someone possessed of a special skill undertakes, quite irrespective of contract, to apply that skill for the assistance of another person who relies upon such skill, a duty of care will arise. The fact that the service was given by means of words can make no difference. Furthermore, if in the sphere in which a person is so placed that others who could reasonably rely upon his judgement or skill or upon his ability to make careful inquiry, a person takes it upon himself to give information to, or allows his information to be passed on to, another person who, as he knows or should know would place reliance on it, then a duty of care will arise"* [39]. The next judgement I am going to refer to is that of Lord Devlin:*" the categories of special relationship which may give rise to a duty to take care in word as well as in deed are not as limited to contractual or fiduciary relationships but include also relationships which are equivalent to contract, that there is an assumption of responsibility in circumstances in which but for the absence of consideration, there would be a contract"* [40]. Finally, I cwill quote the wording of Lord Reid: *" I can see no logical stopping place short of those relationships where it is plain that the party seeking information or advice was trusting the other to exercise such a degree of care as the circumstances required, where it was reasonable for him to do that, and where the other gave the information or advice when he knew or ought to have known that the inquirer was relying on him"*[41].

8. 4 Requirements for a duty of care to be established

From the above extracts from the judgements, it is obvious that the judges gave emphasis to a few requirements, in order for a duty of care under such circumstances as these in the case to exist. The basic of these requirements is reliance by the party who usually brings an action against the other, who has passed some

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[38] *Ibid.*
[39] *Ibid.* Page 502, per Lord Morris.
[40] *Ibid.* Per Lord Devlin.
[41] *Ibid.* Page 486. Per Lord Reid.

by the party who usually brings an action against the other, who has passed some piece of information in a negligent way. But, this is not the only one, because there were another two- special relationship and voluntary assumption of responsibility – which were implied by the judges in **the Hedley Byrne** case and also they were developed in other cases. I will be referring to these issues in quite a detailed way later on. The general conclusion that can be made from the case is that the reason, that a duty of care was held not to exist, was that the restriction, which was put in the ***Derry v Peek*** case, was assumed to be correct. The restriction was that a person could recover from another one in respect of his negligence, if there was no contractual relationship, or the person, who was deemed to be negligent, acted as a fiduciary. This was the basis for the decision and not the fact that the damage, which resulted from the negligence, was purely economic loss [42]. Lord Devlin in upholding this conclusion said: *" that is why the distinction is now said to depend on whether it is caused directly. The interposition of the physical injury is said to make a difference in principle"* [43]. Hence, the issue of economic loss was not the vital point of the decision. Conclusively, this case is perhaps the most dominant in negligence law, because simply it was the recognition of a duty – in respect of negligent misrepresentation – that seemed overdue in relation to the commercial reality of the twentieth century [44].

It is time to move on to the requirements, according to which a duty of care may exist.

8. 4. 1 Special Relationship

The first one I am going to discuss is the requirement of a **special relationship.** It needs to be said that this is the most "debatable" requirement. Its basis was possibly the solution of two kinds of problems. The first one is that according to this, there can be no indeterminate liability, since if there is no sufficient proximity, no duty of care will arise. The second one is that the importance of this

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[42] Robby Bernstein. Economic Negligence. (1993) Longman Group Ltd.
[43] Hedley Byrne v Heller & Partners Ltd. (1964) A.C 465, (1963) 2 All E.R 575 (H.L). Page 517 per Lord Devlin.
[44] Robby Bernstein. Economic Negligence. (1993) Longman Group Ltd.

kind of relationship is actually the basis for the obligation to take care [45]. However, the situation in relation to proximity is not ideal at all. A lot of problems exist. One quite serious one has to do with the fact that a lot of precise and common relationships – e.g. broker-buyer, doctor- patient, appear to be "special". But, if a higher court adopts this approach, then a lower court will have, as a matter of precedent to follow the previous decision, as long as the relationship in question is the same. This, of course, can create problems of fairness. Also, another problem is that the term "special relationship" is not easy to be defined. Hence, what a court has to do is to see under its own circumstances and try to avoid "doctrinal decisions". This is perhaps the reason why it was said in **the Hedley Byrne** case that the term "special relationship" should be just a label for the circumstances, under which a duty would exist [46].

8. 4. 2 Reasonable Reliance

The second requirement I am going to mention is that of **reasonable reliance.** The test that one applies is if the person, who gives information can reasonably foresee that the other, who receives it, will rely on it. This of course can create difficulties, especially in cases where an expert gives advice, because in such a case it is more than logical that the person who seeks expert information will rely on it. Also, he will expect that the expert will not prove negligent and that this information will be accurate. But, it is impossible to recognise a duty of care in every case of expert advice, because the experts will refuse to give their advice, even when it is vital to do so. Another problem that may arise is that in most of the cases although the party who receives the information or any other kind of service relies on it, this does not necessarily mean that he intends to take legal action against the person who provides the information or the service because this would be completely absurd [47]. However, it must be said that the above criticisms do not imply that reliance is a wrong requirement that is used without any justification at all. If someone thinks about it, it is logical for a duty of care to exist, it must be that there is reliance from one party to another. The most crucial effect that these criticisms can have is that although reliance

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[45] *Ibid.* Pages 41-43.
[46] *Ibid.*
[47] *Ibid.* Pages 44-46

is an important factor, it cannot be a sufficient factor on its own. The others must exist as well [48].

It would be helpful at this point to see how the court looked at this issue of reliance in the case of **White v Jones** [49]. This will help us to understand the nature of reliance, but I have first to make a brief summary of the facts of the case. The whole case was about a solicitor, who delayed in the drawing of the will and as a result, the testator's daughters sued the solicitors for their loss of earnings. The court expressed its opinion, in relation to reliance, that it is not a prerequisite to the existence of a duty of care. In this case it was held that it was not reasonable for the daughters to rely on the solicitors. Besides that, a duty of care was decided to be owed by the solicitors to the daughters. The reason for this was the need for fairness. As Malcolm Clarke puts it in one of his articles: *"as a duty of care depends on what is fair and reasonable, subject to what is reasonable this allows the court to do what is "fair"- to follow what Lord Goff called "the impulse to do justice"* [50]. In simple words, this means that sometimes the decisions that the courts take have to do with issues of public policy. The last thing I need to say about reliance is that it is submitted generally that there can be great difference between cases, which concern advice and cases where action takes place. It is more possible that that the role of reliance will be more crucial in the first kind of cases than the latter ones [51]. The decision in **White v Jones** is also very significant in relation to voluntary assumption of responsibility, so, I will deal with it again in the next paragraph.

8. 4. 3 Voluntary Assumption of Responsibility

Hence, the last requirement I will have to deal with is that of **voluntary assumption of responsibility**. Again, as with the other two requirements, this one is of great importance and at the same time it has been the subject of criticism. I will try to analyse it quite briefly in order to assess its advantages and disadvantages. The basic disadvantage of voluntary assumption of responsibility is that it is nothing more

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[48] *Ibid.*
[49] (1993) 3 All E.R 481.
[50] Clarke Malcolm. Insurance Intermediaries: Liability to third parties. International Journal of Insurance Law.3. 1995. Pages 162-174. Page 163.
[51] *Ibid.*

than a label to cover certain circumstances. Also, another argument, which is quite common, is that assumption of responsibility is nothing more than an artificial legal fiction, which most of the times in not upheld by the facts. The reasoning behind this argument is this: in order for someone to have assumed beyond doubt responsibility, it must be that while he provides a certain piece of information, he has undertaken responsibility both not to be negligent and to accept legal liability in case where he is in breach of duty and as result the plaintiff has suffered damages. The problem is that all these cases are surrounded by a commercial context and in such a commercial world, it will be almost impossible not to accept legal liability. So, it might be right that assumption of responsibility is only a legal fiction [52]. However, the voluntary assumption of responsibility approach, in order to ascertain whether a duty of care exists, has its advantages as well. One of them is that it is the only requirement, which can exist on its own. If it is proved that the defendant has assumed responsibility this can be enough proof for liability to stand. The other advantage has to do with the cases, where there is a negligent performance of services. There, reliance is not a vital factor in deciding whether a duty of care is owed or not. Hence, everything depends on whether there is a voluntary assumption of responsibility or not [53]. This was a factor for the decision in **White v Jones** that I mentioned above. There, we can look at two different approaches in relation to voluntary assumption of responsibility. As Malcolm Clarke put it, the first approach was: *(1) whatever the answer, for Lord Goff the impulse to do justice was such that the House of Lords was entitled "to extend to the intended beneficiary a remedy under the Hedley Byrne principle by holding that the assumption of responsibility by the solicitor towards his client should be held in law to extend to the intended beneficiary who (as the solicitor can reasonably foresee) may as a result of the solicitor's negligence, be deprived of his intended legacy in circumstances in which neither the testator nor his estate will have a remedy against the solicitor.* On the other hand, the second approach was: *(2) in contrast, for Lord Browne-Wilkinson the question was misconceived. For him the responsibility to be assumed is not responsibility in law as such but, more simply, responsibility for the task- in this instance the task of drawing the will, which was easier to infer.*

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[52] Feldthusen Bruce. Economic Negligence. (1944). Thompson Canada. 3rd edition. Pages 46-52.
[53] *Ibid.*

Responsibility in law is the law's reaction to responsibility of the task [54]. The most vital point in relation with these approaches is that it does not matter which one will be followed, because they both reach the same conclusion.

8. 5 Liability in Contract

An agent can also be liable in contract. It must be noted at this point that his liability in contract is very closely related with his duties towards his principals. Hence, when analysing the agent's position in contract law, it is necessary to make a brief reference to his duties as well. It is said in the introductory part that one difference between bringing an action in contract and in tort is the limitation period. In contract, the limitation period is stated in section 5 of **the Limitation Act 1980**, where it is cited that the limit is six years from the date when the cause of action took place. It is worth referring at this point to an article that deals with limitation periods, which are very important for liability in contract [55]. According to it, then, the effect of **the Latent Damage Act 1986** is that there is an alternative for an action to be brought in tort three years after the date when the damage could have been discovered by the assured [56]. The two cases mentioned in this article were **Iron Trades Mutual Insurance Co. Ltd. v Buckerman** [57] and **Islander Trucking Ltd. v Hogg Robinson & Gardner Mountain (Marine) Ltd** [58]. Summarising the actual result of these cases it was cited in the article that *"where a broker procures a policy which is voidable because of the broker's failure to disclose material facts to the insurer, the assured suffers damage from the outset and not at the later date at which the insurer avoids the policy"* [59]. The same principle was held to apply in New Zealand [60].

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[54] Clarke Malcolme. Insurance Brokers Duty of Care. International Journal of Insurance Law. 3. 1995. Pages 162-174. Page 165.
[55] Insurance Law Monthly. 5 (9). 1995. Insurance Brokers Claims Insurance Policies Limitations. Newe Zealand. Pages 10-11.
[56] *Ibid.*
[57] (1989) 2 Lloyd's Rep. 85.
[58] (1990) 1 All E.R 808.
[59] Insurance Law Monthly. 5 (9). 1995. Insurance Brokers Claims Insurance Policies Limitations. Newe Zealand. Pages 10-11.
[60] For further details look at: Matthews Corporation Ltd. v Edward Lumley & Sons Ltd. November 1992.

It is obvious that the main issue in relation to the agent's liability in contract is whether there is a contract of agency between him and the principal, what type of contract that is and what are the exact circumstances. Before I start to analyse cases, I will mention a few general examples, which take place between agents and principals. If we accept that there is a contractual relationship between the agent and the principal, then the basic question is what is the scope of the mandate, according to which the contractual obligations are governed. The first general example is *(a) "where the mandate is for the arrangement of insurance or for the handling of claims, and the agent receives remuneration from the proposer himself. Under such circumstances, there is a contract between the agent and the client". (b)* The second one is *"when the agent does various things for the client, such as arranging insurance and receiving payment for the service. Again, there is a contract between the agent and the client.(c)* Thirdly, *"a very common situation arises when the agent is seeking insurance for the client and his commissions is paid if and when the contract of insurance is concluded. (d)* Finally, *the last example I am going to refer to is when there is already a contract between the agent and the client and although the agent completes the first part of the contract and later on he promises to do something else but does not do it. Then, an action can be brought for breach of the later promise* [61].

However, it is necessary to analyse possible liability in contract in some more detail. Something important that must be mentioned is that the client is not obliged to agree with one of the policies that it is suggested by the agent. The only thing that can be assumed is that the agent has only an opportunity to earn commission if the client accepts one of the policies. This actually means that there is no contractual obligation on any of the parties until one particular stage. A relevant case, where a loss of an opportunity to earn a sum of money was considered to be actionable, is **Chaplin v Hicks** [62]. The facts were as follows: the defendant was a well-known actor and theatrical manager. In November 1908 he published a letter to a daily newspaper. The purpose of the letter was the readers of the newspaper to select twelve ladies that he would give engagements to. The plaintiff was one of the ladies, who sent their photographs. However, an alteration was made to the conditions of the competition, because the response was so great that it would be impossible for him and his

[61] Clarke Malcolme. (1994). The Law of Insurance Contracts. Lloyd's of London Press Ltd. 2nd edition. Pages 219-223.
[62] (1911) 2 K.B 786 (C.A).

committee to decide in that way. The alteration had to do with the fact that the photographs, which were sent would be separated into ten districts within the United Kingdom and the readers would vote for the most beautiful. In the end, fifty photographs would be chosen by which only twelve would take the promised engagements. The plaintiff's photograph was one of the fifty and as a result the defendant's secretary wrote a letter to the plaintiff to call at the Aldwych Theatre at 4 o'clock on Wednesday afternoon, January 6 to make an appointment to see the defendant. The problem was created because the plaintiff was at that time in Dundee, while the letter was sent. So, by the time it was re-addressed in Dundee it was too late for her to look and see the defendant. Although the plaintiff after that made some efforts to have an appointment with the defendant, this was impossible. The result was that the plaintiff brought an action against the defendant on order to recover damages because his breach of the contract was the cause that she lost her chance to obtain an engagement. In the court of first instance, it was decided by the jury that the defendant did not take reasonable means in order to ensure that the plaintiff had the opportunity to be selected. There was an appeal by the defendant. The argument, which was used by the defendant, was that *"assuming there is a breach of contract, the plaintiff is not entitled to substantial damages, but to nominal damages only. Either the damages do not flow directly from the breach and are too remote, or they are so contingent as to be incapable of assessment"* [63]. The judge separated his decision into two parts. The first part of judgement had to do with remoteness. The test for remoteness according to the judge was *" to see whether the damages sought to be recovered follow so naturally or by express declaration from the terms of the contract that they can be said to be the result of the breach"* [64]. The court held that the competition the plaintiff entered in to gave her a chance of presenting herself and winning the price. Hence, *"a claim for loss sustained in consequence of a failure to give the plaintiff an opportunity of taking part in the competition, it is impossible to say that such a result and such damages were not within the contemplation of the parties as the possible outcome of the breach of the contract"* [65].

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[63] *Ibid.* Page 788. Per Mr. McCardie.
[64] *Ibid.* Pages 790-791.
[64] *Ibid.* Pages 790-791.
[65] *Ibid.*

The second part of the judgement was about the question of whether damages were capable of assessment or not. The argument, which was used in order to uphold that the damage could not be assessed, was that the exact extent of damages was based upon such a number of contingencies, which could not be properly assessed. The opinion of the judge was that the amount of damages that should be awarded under such circumstances is more or less a question of guesswork. Also, as a conclusion he said: *"my view is that under such circumstances as those in this case the assessment of damages was unquestionably for the jury. The jury came to the conclusion that the taking away from the plaintiff of the opportunity of competition, as one of the fifty when twelve prizes were to be distributed, deprived the plaintiff of something which had monetary value"* [66]. Therefore, the appeal was dismissed. So, the basic result of the case was that even an opportunity to earn some kind of reward could constitute appropriate economic consideration.

A quite common question that usually arises is what is the best basis in order to ascertain the liability of the agent. It is generally assumed that recognising an agent's duty in contract can have quite a few implications. The implications start from the fact that in English law there is no duty to perform contracts in good faith. One very important case in relation with good faith is **Interfoto Picture Library Ltd. v Stiletto Usual Programmes Ltd.** [67]. This case is also mentioned in the chapter about the duty of the utmost good faith, so I am not going to analyse it in detail. However, the principle that can be derived is that although there is no recognised duty of good faith, English law and the courts have developed other mechanisms in order to confront unfairness [68]. Whether this is a correct approach or not, implications about the agent's liability remain. This does not mean of course that the courts have not held agents to be liable in contract. I will refer first to a case of motor insurance. In the case of **O'Connor v B.D .B Kirby and Co.** [69] the main issue was that an insurance broker filled a proposal form for his client; he gave it to him in order to check it and sign it. However, the client did not exercise proper skill and care and it was proved that some piece of information, which was used in the proposal form, was incorrect.

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[66] *Ibid.* Pages 793.
[67] (1989) Q.B 433, 439 (C.A).
[68] For further details look see the actual judgement.
[69] (1971) 1 Lloyd's Rep. 454.

More specifically, it was mentioned in the form that his car was packed in a garage, while the truth was that he parked his car outside his house. The result was that in a "hit and run" accident, the client was in fact uninsured. In the court of first instance it was decided that an action for damages could be allowed on the ground that the broker was negligent in inserting a false statement in the proposal form. However, there was an appeal in respect of that decision. It was held by the Court of Appeal that: *"(1) the sole effective cause of the loss was the plaintiff's failure to check the contents of the proposal form. (2) The defendants duty was to use such care as was reasonable in ensuring that the answers recorded to the questions in the proposal form accurately represented the answers given to the defendants by the plaintiff. The duty was not a duty to ensure that every answer was correctly recorded. And, on the evidence, there had been no breach of such duty"* [70]. Hence, a duty of care was held to be able to exist in contract in respect of the duties of an agent towards his client.

The next case I am going to refer to is that of **Wilson v Avec Audio Visual Equipment Ltd.** [71]. The facts of the case were as follows: the plaintiff who was an insurance broker effected two insurance policies, one against burglary and one for the coverage of goods in transit. The defendants – the insurers - were wound up after that. Irrespective of that and although the defendants did not regognise themselves liable after a certain date, the liquidator asked the plaintiff to make a payment in respect of the two policies. The issue of the case was the willingness of the plaintiff to get the money back, on the ground that he had held himself personally liable to the defendants in relation with the premiums. The decision of the court was *"that the plaintiff had not proved to the satisfaction of the Court that the had rendered himself personally liable and the case was merely one of an agent who had chosen because he was under a mistaken belief as to his legal position vis-à-vis the third party, to assume a personal liability to the third party, and having done so, in his turn sought to make his principal liable"* [72]. Again, an agent was held to be liable in contract.

Moreover, another case, which is worth mentioning, is **B Ackbar v C.F Greenand Co. Ltd.** [73]. It involves again motor insurance and the failure of insurance brokers to arrange the passenger insurance for the vehicle in question. The plaintiff

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[70] *Ibid.* Pages 454-455.
[71] (1974) 1 Lloyd's Rep. 81.
[72] *Ibid.* Page 81.
[73] (1975) Q.B 582.

was actually a passenger in his own lorry, when he was involved in an accident. After the accident he found out that his brokers failed to arrange the passenger insurance he was looking for. The important part of the facts was that the action was brought more than three but less than six years from the date of the accident. The plaintiff brought an action against the brokers for breach of their contractual duty to arrange insurance cover, because he was unable to recover any damages from his insurers. The argument from the defendants was that the damages claimed include damages for plaintiff's personal injuries. This meant according to the argument that section 2(1) of **the Limitation Act 1939** applied and therefore the claim was barred. The court did not in the end agree with the argument and held that *"the damages which the plaintiff might have recovered were only the measure of damages claimed in the present action and the present claim did not consist of or include damages for personal injuries. Hence, section 2(1) of the Act of 1939 did not apply and the limitation period was six years"*[74].

8. 6 Liability in Tort and concurrent Liabilities

However, it must be understood that liability in contract or in tort is not a completely separate issue. The initial requirements for it to be established were mentioned above. There may be circumstances under which brokers can be liable both in contract and in tort. I will refer to a couple of cases, which deal with the aspect of dual liability. The first case I am going to mention is **Osman v J. Ralph Moss Ltd.** [75]. The facts of the case are also mentioned in the chapter, dealing with the duties of insurance brokers, so, I will make only a brief summary. The actual cause of action was that when the plaintiff was involved in an accident, the defendants – the brokers- told him, that he was in fact uninsured and he had to bear the costs of his fine, the court costs, an amount from driving without care and attention and also the money for the other driver to repair his car and hire a replacement car. The plaintiff was entitled to all the costs he had incurred in respect of the accident [76].

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[74] *Ibid.* Page 583.
[75] (1990) 1 Lloyd's Rep. 313.
[76] For more details see Chapter 4.

Another case that dealt with both potential negligence on the part of the brokers and also with a breach of contract is **Cherry v Allied Ins Brokers Ltd**.[77] The plaintiffs were manufacturers of suede and leather garments. The defendants were the brokers of the plaintiffs for quite a long period. But, the plaintiffs were not satisfied with them, because they thought that they were paying very high premiums in comparison with their record of claims, which was quite low. Hence, the result of all these, was that the plaintiffs appointed another firm to act as brokers. They did not inform the defendants at once. They did that a couple of months later. At a later meeting between the plaintiffs and the defendants, the plaintiffs were advised that the insurers would not cancel the policies, which were made with the defendants. Because of this fact, the plaintiffs thought that they had double insurance in respect of that period, so, they cancelled the insurance policy with the new insurers. However, the original insurers – General Accident Corporation – agreed to cancel the policies, but the plaintiffs were not aware of this fact. When a fire took place in the premises and caused substantial damage, the plaintiffs understood that they had no insurance. Hence, they brought an action against the defendants for either breach of contract or negligence on their part. The court held that *"after the advice from the defendants, it was logical and sensible for the plaintiffs to cancel the policies with the new insurers. The fact that the plaintiffs relied on the defendants resulted in them – the plaintiffs - being without any insurance. Also, the fact that the plaintiffs informed the new insurers that they were doubly insured was the fault of the defendants as well. And moreover it was decided that there was no urgency that the plaintiffs should inform the defendants that they cancel the new insurance policies. Since the plaintiffs did what the defendants advised them to do, they had fulfilled their obligations"* [78]. The plaintiffs were entitled to recover the amount of damages as if the original policy with General Accident Corporation had been in force.

Another very significant case is **The Zephyr** [79]. The main issues of the case were two: the first one had to do with the fact that the reinsurance cover was placed by the broker before the original insurance. Hence, this resulted in the question of whether brokers were in breach of a duty of care. I am going to refer to the facts of

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[77] (1978) 1 Lloyd's Rep.
[78] *Ibid.* Page 274.
[79] The Zephyr, General Accident Fire and Life Assurance Corporation and Others, Peter William Tanter and Other.(1985) 2 Lloyd's Rep. 529.

this case in a more detailed way: someone called Mr. S. wanted to buy a vessel and asked his insurance brokers to obtain him insurance cover. The insurance that was placed by the brokers was a normal marine insurance and reinsurance was essential. So, they started to obtain quotes from underwriters. After a while, the purchase of the vessel was complete and the insurance brokers submitted that the insurance, which had been asked for has been obtained. A few days later, the vessel was seriously damaged and there was abandonment by the crew. The original insurance worked in quite a perfect way and the shipowners were compensated. The whole problem started when the reinsurers refused to pay. The argument which was used by the reinsurers was the following: *"since an apparent insurance contract has been made by the brokers with an underwriter 12 days before any original insurance was placed and before the brokers could have any principal on whose behalf they could place any reinsurance, the first defendant and following total loss underwriters could not be bound by his initialing of the total loss slip"* [80]. Also, there was another claim against the brokers both in contract and tort. The basis for the claim was that the signing indication, which was given by the brokers, had a contractual force, which could render them liable. The brokers on their part argued that the signing indication did not and could not have any legal effect, which could cause their liability. In the court of first instance, it was first of all decided that the signing indication did not have any contractual nature, simply because it was not incorporated in the slip [81]. Moreover, it was accepted that the only obligation on part of the brokers was to use their best endeavours to achieve the signing down. The only alternative way that the brokers could be liable contractually was if the representations, which were made were proved to be false. This was submitted not to have happened in this case. However, the refusal of the court to render the brokers liable in contract did not mean that the brokers were not liable at all. The giving of an indication beyond doubt put the brokers in the position that they owed a duty of care to the total loss underwriters [82]. This was because of the reliance, which was placed by the underwriters on the broker's opinion. And since the brokers did not use their best endeavours in order to check whether their signing down indications would be met, they were liable to the

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[80] *Ibid.* Page 529.
[81] *Ibid.* Page 530.
[82] *Ibid.*

reinsurers. The damages which should be awarded had to be assessed with the difference between the actual signing down and a one-third signing [83].

There was an appeal by the brokers in respect of their liability in tort to the second and the third defendants – the Postgate syndicates-. One significant thing that has to be mentioned is that no express signing down indication was given to Mr. Postgate. It was held that *"there was nothing in decided cases to suggest that a bare promise given in circumstances where the parties stood in no relationship...was capable of creating a situation where the speakers must do or pay damages in default"* [84]. Therefore, according to this reasoning the appeal should be allowed, because simply, even if it could be accepted that a signing down indication could create a contractual liability, this could not be assumed to be owed to Mr. Postgate. There was also an analysis about the reasoning, which was given by the judge at the court of first instance. Lord Justice Mustill summarised the findings as follows: *(1) so far as concerned the claim by the all risks underwriters against the reinsurers, he held that the slip contained a mutually binding contract, and was not merely a document of honour"* [85]. *(2) The learned judge* – in respect of the signing indication – *held that such an indication did not amount to a warranty that the slip would sign down to the stated percentage...he did however go on to decide that the indication did give rise to an obligation on the part of the broker to use their best endeavours to achieve the indicated signing down, an obligation to be characterised as a tortious duty"* [86]. After that, he dealt with the main issue of the appeal- the position of the brokers in respect of the Posgate syndicates – and he came to the conclusion that I mentioned above.

One of the most significant cases, which resolved quite a lot of matters around the potential liability of brokers, is **Henderson v Merrett Syndicates Ltd.** [87] It is quite a complex case, therefore, I have to refer to the facts of it, in order to make it clear what this case was about. The plaintiffs were a number of underwriting members at Lloyd's called Names. The action was brought against some underwriting agents, who were either managing agents, members' agents or combined agents. And the allegation was that they negligently conducted the underwriting affairs of the plaintiffs. Before moving on, it would be necessary to give a few definitions in respect

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[83] *Ibid.*
[84] *Ibid.*
[85] *Ibid.* Page 533.
[86] *Ibid.* Pages 533 -534.
[87] (1994) 2 A.C. 145.

of all these kind of agents. Hence, *(1) the agents may be members agents, who advise Names on their choice of syndicates, place Names on the syndicates chosen by them, and give general advice to them. (2) They may be managing agents, who underwrite contracts of insurance at Lloyd's on behalf of the Name, who are members of the syndicates under their management, and who reinsure contracts of insurance and pay claims. (3) They may be combined agents, who perform both the role of member's agents, and the role of managing agents in respect of the syndicates under their management"* [88]. There were actually three strands of litigation: the first one was **the Merrett** actions and second one was **the Feltrim** actions. The third one was **the Gooda Walker** action. In the Merrett actions, proceedings were brought as an appeal from the Merrett Syndicates Ltd. and Merrett Agency Ltd. against some Names at Lloyd's including Henderson. At the court of first instance, the action, which was brought by Henderson, was both against some members' and some managing agents. In the Feltrim actions, the appellants were Feltrim Underwriting Agencies Ltd., who were managing agents only and some other underwriting agents called the Feltrim members' agents. Finally, in the Gooda Walker actions, the appellants were the Gooda Walker members' agents. In contrast, the managing agents were not involved in the proceedings.

Next, I am going to cite the arguments of the appellants, as these were developed by their lawyers in the Merrett actions. The basic question, as this was addressed by them was: *"did managing agents (who were not also members' agents) owe Names a duty under the pre-1985 forms of agreement to carry out their underwriting functions with reasonable care and skill"* [89]*?* It must be noted at this point that some of these actions had to do with the pre-1985 forms of agreement and some with the period after that. However, I will deal with this while I am analysing each action separately. Hence, what the lawyers did was that they have cited the three requirements, which were needed in order to establish a duty for liability in tort – foreseeability of damage, proximity and whether "it is just fair and reasonable" to establish a duty of care. The lawyers submitted that foreseeability could not be questioned. It was foreseeable that negligence on the part of the managing agents

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[88] O'Neil P.T & Woloniecki J.W. The Law of Reinsurance. 1rst edition. Sweet & Maxwell.(1998). Page 443.
[89] Henderson v Merrett Syndicates Ltd. 2 A.C 145. Page 150.

could cause economic loss to the Names. In order to support this, emphasis was given to the contractual chain between the Names and the managing agents. In respect of proximity, the submission was that it was not enough, because the relationship of the parties in question was regulated by contract and also it was a pure economic loss case. As to the third requirement it was said that since the relationship of the parties could be found on a written agreement, this was a decisive fact for not finding a duty in tort. The second question according to them was: *"did managing agents (who were also members agents) owe Names a non-contractual duty under the pre-1985 forms of agreement to carry out their underwriting functions, with reasonable care and skill"*[90]*?* The answer to that question had to do with the issue of concurrent liability that can be regognised both in contract and tort. Quite a few references were made to cases, but I will refer to them in relation to the opinion given by the judge. Thirdly, another issue was raised about the fiduciary relationship of the parties, but I am going to say a few more things about it, while examining the court's reaction to it.

Furthermore, which were the arguments of the defendants? The issues, as there were raised by them, were the following: *"whether a managing agent of a syndicate at Lloyd's owed a duty of care in tort to "indirect" and "direct" Names? Also, whether a managing agent as a fiduciary owed Names a duty to conduct the underwriting with reasonable care and skill.* And the last issue they addressed was *"whether the closing of the syndicates 1984 underwriting year of account was governed by the 1985 form of agreement or by the pre-1985 form of agreement"* [91]. The principle that the respondents relied on was that it could not be assumed that the finding of a contract could exclude the existence of a tortious duty in an automatic way. They said that the vital question in order to decide whether the principle is to be applied would be what kind of loss is suffered from the person who is harmed. Again, quite a few important cases were cited in order for the argument to be justified, but I am going to focus on the actual judgement.

The arguments in respect of the Feltrim and the Gooda Walker actions were quite of the same nature. Standard clauses of agency and sub-agency agreements were used. And the main point in relation to them was the power of agents under the agreements to delegate their powers.

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[90] *Ibid.* Page 151.
[91] *Ibid.* Page 156.

Lord Goff was the one who actually developed and assessed the arguments for both sides [92]. Due to the complexity of the case and the number of questions that needed to be answered, he tried to separate the issues that had to be resolved. Also, because some matters were common within the appeals, he answered them without making any specific reference to each case. Hence, the first thing he dealt with was the potential liability of managing agents to Names, whether these were direct or indirect, in tort. He started with the position of indirect Names, which was common both in the Merrett and the Feltrim appeals. Both the direct and the indirect Names were trying to establish that a concurrent duty of care was owed in contract and in tort as well. In the Merrett action a limitation issue was raised, since it would be much more advantageous for the Names, if the limitation period based on tort was applied- six years from the date of the cause of action as opposed to three years from the date when knowledge of the cause of action was provided. The argument, on the other hand, of the managing agents, as I analysed above, was that if a duty was to be regognised in tort, this would be quite inconsistent with the contractual relationship between the parties. The principle upon which these arguments were faced and decided was the one, which was established in the case of **Hedley Byrne & Partners Ltd.** [93]. I have referred to this case in the beginning of this chapter, so, I will focus now only to the application of the principle in relation with the managing agents at Lloyd's. Generally, the importance of this case was that it recognised that a duty of care could be recognised to exist in tort, under certain circumstances such as reliance, even if pure economic loss was involved. Lord Goff actually concluded that the above principle could extend, in order to cover managing agents at Lloyd's. The same conclusion was reached by Saville J. in the Court of Appeal. In deciding what he did, he relied on a few other cases such as **Youell v Bland Welch & Co. Ltd. (No 2)** [94] and **Punjab National Bank v De Boinville** [95]. I am going to refer to these cases later on. Hence, in Lord Goff's words: *"for my part I can see no reason why a duty of care should not likewise be owed by managing agents of Lloyd's to a Name...as Saville J. and the Court of Appeal both thought, the relationship between Name and managing agents appears to provide a classic example of the type of the relationship to which*

[92] For more details see: Henderson v Merrett Syndicates Ltd. 2 A.C 145. Per Lord Goff.
[93] (1964) A.C. 465.
[94] (1990) 2 Lloyd's Rep. 431, 459.
[95] (1992) 1 Lloyd's Rep. 7.

the principle of Hedley Byrne applies... I can see no escape from the conclusion that in these circumstances, prima facie a duty of care is owed in tort by the managing agents to such Names...furthermore, since a duty rests on the principle in Hedley Byrne, no problem arises from the fact that the loss suffered by the Names is pure economic loss" [96].

The next argument that he analysed was the one that had to do `with the meaning of "absolute discretion". The submission of the managing agents was the following: "Absolute discretion meant that the power which was given to the one who could not receive it, could not be challenged by another person, unless (a) the exercise of the power is in bad faith and (b) the exercise of the power is deemed to be completely unreasonable. But, Lord Goff agreeing with Saville J. , did not accept that the scope of the words, in the way they were used, meant that a duty to exercise due skill and care was excluded. In order to support this conclusion, he used an extract from Saville J.'s speech. The meaning of it was that the fact that the agents have very wide authority to act on behalf of a Name and secondly that their liability in a potential action against them is really unlimited, could take someone to the conclusion that a duty to exercise due skill and care was attached to them.

However, the most significant question that Lord Goff had to deal with was whether or not a concurrent duty of care in tort and in contract could be accepted. He actually started his opinion by referring to systems of law and how they try to deal with this matter. He said that two are the possible solutions: the first one is that the claimant will have the right to obtain a remedy under contract law and the second that he will be able to choose, whether he wants to bring an action in contract or in tort. For example, in France only the first solution exist because the possibility of a party having a remedy under whichever heading he chooses is not allowed. It must be said at this point – Lord Goff referred to it as well – that the only real difference between pursuing a remedy in contract and in tort was the limitation period. The effect of **the Latent Damage Act 1986** for example is limited only to tortious actions. The change that this effect causes is that the exact time of the cause of action can be postponed until the moment that the person in question has the actual knowledge. In his own words, Lord Goff decided that *"so far as the direct Names are concerned, there is*

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[96] Henderson v Merrett Syndicates Ltd. 2 A.C 145. Page 182. Per Lord Goff.

plainly a contract between them and the managing agents, in the terms of the pre-1985 byelaw form of agency agreement, in which a term falls to be implied that the agents will exercise due care and skill in the exercise of their functions as managing agents under the agreement. The duty of care is no different from the duty of care owed by them to the relevant Names in tort; and, having regard to the principles already stated, the contract does not operate to exclude the tortious duty leaving it open to the Names to pursue either remedy against the agents" [97]. He, then moved on to indirect Names and cited that the submission of the managing agents was that all the responsibility they had was in relation with another party – i.e. the members agents-. Therefore, they continued that it would not be logical for them to assume responsibility for the same things to the indirect Names. Lord Goff rejected this contention: *"I for my part cannot see why in principle a party should not assume responsibility to more than one person in respect of the same activity"* [98].

In relation to the question of whether a fiduciary duty was owed, the answer was quite short. The House of Lords agreed that with the decision that was taken by the Court of Appeal and contended that since the question of tortious duty was answered in this way, it was not possible for the question of fiduciary duty to be addressed. It has to be mentioned that this was an issue, which arose only under the Merett actions.

Finally, the last question, which was raised, was the liability of members' agents under the Feltrim and the Gooda Walker action. The period that this action referred to was 1987-1989. This meant that Lloyd's byelaw No.1 of 1985 applied. According to it, *"members' agents are responsible to the Names for any failure to exercise reasonable care and skill on the part of the managing agents to whom underwriting has been delegated by the members' agents; and that the members agents are not required to exercise skill and care only in relation with those activities and functions which members agents by custom and practice actually perform for the Names personally"* [99]. In order to reach a conclusion, Lord Goff made quite a brief reference to the agency and the sub-agency agreements. The most important section of the agency agreement was 2(a). It provided that *"the agent shall act as the underwriting agent for the Name for the purpose of underwriting at Lloyd's for the*

[97] *Ibid.* Page 194. Per Lord Goff.
[98] *Ibid.* Page 195. Per Lord Goff.
[99] *Ibid.* Page 197. Per Lord Goff.

account of the Name such classes and description of insurance business, other than those prohibited by the Council, as may be transacted by the syndicate" [100]. The argument for the Names in the Feltrim actions was that clause 2(a) actually contained an undertaking that members' agents were bound to underwrite insurance business for the Name. The only circumstances, to which this did not apply, are when there is a combined agent, who acts as a managing agent of a syndicate of which the Name is a member. On the other hand, the members agents' argument led to the conclusion that either under an agency or a sub-agency agreement both by members and managing agents did not have any contractual responsibility towards the Names for the underwriting. Again, the Court of Appeal's decision was allowed and the members' agents were held to be under a duty to exercise due skill and care in the course of underwriting.

As I mentioned above Lord Goff in his judgement referred to a number of authorities. One of them was the case of **Punjab National Bank v De Boinville**[101]. The plaintiff was an Indian bank, which was carrying business in England. Everything started when Esal Commodities Ltd., which was a customer of the Indian bank, made two shipments of gasoil to Sudan. One of the vital points was that the payment for the two shipments was to be confirmed by a letter of credit, which was issued by the Bank of Sudan with the Punjab National Bank in London. This was to be paid in 180 days from the date of the bill of lading. Of course, the two shipments were insured by the first and the second defendants, Mr. De Boinville and Mr. J. Deere. The other defendants were Lloyd's brokers, who were their employers for the period in question: F.F Wright (U.K) Ltd., Bain Clarkson Ltd., and Fielding Juggins Money and Stewart Ltd. The dispute arose when the Bank failed to meet its obligations. The underwriters tried to deny liability on the basis of misrepresentation and non-disclosure. Also, an action was brought against the brokers by the plaintiff bank, since it was argued that it was their breaches that caused the loss. The second thing they said was that the assignment by Esal to Punjab Bank was enough basis to bring an action. It was held by the Queen's Bench Division of the Commercial Court that *(1) the plaintiff bank was an assured under the first and the second policies and Esal Ltd. was the assured under the third and the fourth one. (2) Because of the assignment, no*

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[100] Punjab National Bank v De Boinville (1992) 1 Lloyd's Rep. 7. Page 7.
[101] (1992) 1 Lloyd's Rep. 7.

rights have been transferred to Punjab, which Esal might have had. (3) There was a contractual relationship between the plaintiff bank and each of the first and the second defendants employers" [102]. Hence, a duty of care was deemed to be owed by Mr. De Boinville, Mr. Deere, F.E Wright and Fieldings to the plaintiff bank. On appeal, the questions that had to be answered were the following: **(1) who was the assured under each of the policies? (2) Was there a contractual relationship between the bank and the relevant defendants? (3) In the absence of a contractual relationship, did the defendants owe a duty of care to the bank?** In respect of the first question, the Judge of the Commercial Court was accepted to be right in his conclusion. So, the plaintiff bank was held to be an assured under the first policy. As regards the second question, again, the Judge's reasoning was followed and it was decided that under the third and fourth policy, there was a contract between the bank and Wrights and Fieldings. Finally, a duty of care was held to be owed by Mr. Boinville and Mr. Deer, which could be irrelevant between the parties. The reason for the decision was that *"an insurance broker owed a duty of care to the specific person who he knew to become an assignee of the policies"* [103]. So, the brokers were liable to the bank, because they knew that the policies were to be assigned.

Another case, which was mentioned in **the Henderson case** judgement was **Youell v Bland Welch** [104]. In this case the plaintiffs were Lloyd's underwriters and companies who actually placed insurance for three gas-carrying vessels. These vessels, which were still under construction, were reinsured as well and the seventh and eighth defendants were Lloyd's underwriters, who had actually subscribed to it. It must be stated that the reinsurance contract made provision for the coverage of the potential liability of the plaintiffs. When the vessels became a constructive total loss, the plaintiffs paid a sum of money under the original insurance cover and submitted that the reinsurance contract was still in force. It must be explained at this point that the two insurance policies were actually supposed to cover the risk for the same period of time. Hence, the negligence on the part of the brokers was that they failed to extend the period of the cover under the reinsurance. The contract contained a clause, which stated that the cover in respect of the vessels was up to 48 months. It was held by the Commercial Court that *(1) the submission by the defendants that the court was*

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[102] *Ibid.* Pages 7-8.
[103] *Ibid.*
[104] (1990) 2 Lloyd's Rep. 423.

entitled to look at the slip in order to resolve any areas of doubt that arose on the wording of the policy would be rejected. (2) A period must be specified under an obligatory excess of loss reinsurance contract during which the risks, which would be ceded, should be defined. (3) The "Period of Termination and Reinsurance" clause must make provision for the period during which the reinsurance cover must remain open. (4) The words "whilst under construction" meant that "in respect of vessels...whilst under construction". (5) The phrase "for periods as original (up to but not including 48 months), referred to the duration of the reinsurance cover in respect of the ceded risk and did not form part of the definition of the risks to be ceded". Therefore, the plaintiff's claim failed [105].

8. 7 Spiral Business

I am going to move on now to another topic, which is interrelated with the potential liability of underwriters and brokers. This topic is the spiral business. Before analysing the cases, I will very briefly deal with what exactly is a spiral. I will use the definition of Lord Justice Phillips, as this was given in the case of **Deeny v Gooda Walker** [106]: *"many syndicates which wrote XL* - Excess of Loss Cover - *took out XL cover themselves. Those who reinsured them were thus writing XL on XL. They, in their turn, frequently took out their own XL cover* [107]*. There thus developed among the syndicates and companies which write LMX* [108] *business a smaller group that was largely responsible for creating a complex intertwining network of mutual reinsurance, which had been described as the spiral"* [109]. The above case is one of the most significant cases that arose under because of the LMX spiral business. LMX actually stands for London Market Excess of Loss. The case had to do with years 1988, 1989 and 1990. During these years, quite a few catastrophes occurred, which as a result caused a significant loss to underwriters at Lloyd's. There were four syndicates, which were involved with the claims: syndicates 164, 290, 298 and 299.

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[105] *Ibid.* Page 423-424
[106] (1996) Lloyd's Reinsurance Law Reports 183.
[107] Excess of Loss cover.
[108] London Market Excess of Loss.
[109] Deeny v Gooda Walker (1996) Lloyd's Reinsurance Law Reports 183. Page 190. Per Lord Justice Phillips.

The first defendants managed the first two syndicates and the second defendants the other two. The plaintiffs were most of the Names, who suffered the major loss. Their claim was based both in contract and tort for failure to exercise skill and care in the business of the underwriting by the defendants. The requirement of a balanced account was very important in respect of the claim that no due care and skill was exercised but this is anlysed in detail below.

Of course, the defendants raised their own argument. According to the judgement they contended that *(a) Names at Lloyd's knowingly accepted unlimited liability. (b) Underwriting was a risk business. (c) Underwriters assumed risk in consideration of premium and it was no part of their business to reinsure all the risks that they had assumed. (d) Lloyd's Regulations had no requirements for recording aggregate exposure or calculating probable maximum loss; (e) in the late 1980's the industry of insurance was hit with a series of unprecedented losses and the risk of such a concentration of catastrophes...could not reasonably have been anticipated or was too remote for a matter which a reasonably prudent underwriter would necessarily guard against"* [110].

I am going to refer to the actual decision of the court by analysing the judgement and the reasoning of Lord Justice Phillips. The first thing that he did was to refer to the two preliminary questions, which have already been answered. These were **(a) Did Gooda Walker owe a duty of care in negligence to all the Names on their syndicates, whether or not they were in contractual relationship with them. (b) Are the members agents contractually liable to the Names for failure to exercise reasonable care and skill on the part of the Gooda Walker as managing agents**? The Court of Appeal answered both these questions in the affirmative [111]. Then the position of the four syndicates that were involved in the claims was stated and whether or not the excess of loss insurance-, which caused the loss-, was the major part of their business. But, what about the issues of liability? Lord Justice Phillips said that the only question, which had to be answered in relation with liability, was whether or not the underwriters in question acted as reasonably competent underwriters? He said that a reasonable standard of skill expected by an underwriter involves activities such as planning and recording. The reason behind this is that with

[110] *Ibid.* Pages 183-184. Per Lord Justice Phillips.
[111] *Ibid.* Page 186. Per Lord Justice Phillips.

proper monitoring it would have been perhaps possible for the Names to reduce their losses. The other thing that was mentioned was a number of circumstances where a competent underwriter should, instead of accepting, refuse the risks. One of these circumstances is where the cost of reinsurance would have deprived it of its commercial viability.

One of the first topics that Lord Justice Philips had to decide on was the requirement of a balanced account. Before dealing with the contentions of the judge, it must be said that the principles, which should apply to the excess of loss insurance, were decided in respect of the allegations that were made by the plaintiffs. Hence, that is why the need for the balanced account is mentioned first. According to Mr. Von Eicken's report this is a very important aspect of the underwriting business [112]. But, what is a balanced account? The answer is really quite simple. A balanced account is one where the claims that an underwriter is responsible for and the premiums that he receives are capable of making him have a profit. He recognised two ways with which it is quite easy to achieve a balanced account. The first one is if the underwriter achieves a restriction to the exposure of his syndicates. If he does this it is afterwards very difficult even if a catastrophe occurs not to be able to meet his claims. The second way is the obtaining of adequate reinsurance. If, for example, he reinsures his Probable Maximum Loss- PML – then it would be almost impossible for his net premiums to be exceeded, even as a result of a major catastrophe. Conclusively, Lord Justice Phillips' decision in relation to exposure was in his own words: *"the fact that a Name who joins Lloyd's deliberately agrees to expose himself to unlimited liability does not mean that he anticipates or accepts that when he joins a syndicate, the active underwriter will deliberately expose him to the risk of such liability. On the contrary, the Name will reasonably expect the underwriter to exercise due skill and care to prevent him from suffering losses...if, however, an underwriter is deliberately to expose him to suffering losses from time to time, he must make sure that the Names are aware of this and of the scale of loss to which they will from time to time be exposed"* [113].

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[112] Expert Evidence.

[113] Deeny v Gooda Walker (1996) Lloyd's Reinsurance Law Reports 183. Pages 185-197. Per Lord Justice Phillips.

It is time now to move on to the requirement of planning that I talked about above. In relation with this, the evidence that was given by expert witnesses was quite controversial. Mr. Von Eicken argued that a competent underwriter must always plan his policy and his reinsurance protection in respect of his PML. Mr. Outwaite on his part did not have the same opinion. He thought that the only planning which had to be made had to do with the setting up of the syndicate. Afterwards, it is not a necessary factor. The only circumstance, which might make formal planning compulsory, is a major change that takes place from one year to the next one. And Mr. Jewell submitted that although it would be very helpful for underwriters to make such plans and he would expect them to do so, this did not mean that they were obliged to and that it would be strange if they did not. Again I will refer to Lord Phillips' opinion: *"in my judgement it was a fundamental principle of excess of loss that the underwriter should follow and formulate a plan as to the amount of exposure that his syndicate would run"* [114]. He referred afterwards to aggregates: *"in order to monitor the exposure that results from the business he writes, the excess of loss underwriter must be aware of his aggregates. He has the advantage that each piece of business he writes is subject to an express limit of liability...he thus has to divide into different categories the covers that can aggregate...as I have already explained, there will be some categories where it is unlikely, or indeed inconceivable that a single event will result in a claim on every cover. In respect of these categories the true exposure will be, not the aggregate, but the PML"* [115]. So, in his opinion Lord Justice Phillips believed that planning was a necessary factor for a reasonable underwriter to perform his activities properly.

After that matters of reinsurance had to be solved. Mr. Vos actually submitted that there are some elements, which had to be followed in a reinsurance policy, if an underwriter wanted to be competent and quite positive that he will not have to face an exposure, that he will not be able to deal with. In summary, these elements were: the knowledge of the exact exposure of the Probable Maximum Loss of the underwriter's syndicate, the knowledge also of the net exposure of the possible worse event, the effective reinsurance of the balance of account, the retention which must remain at the bottom and finally the fact that an underwriter should match the reinstatements on his

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[114] *Ibid.* Pages 197-198.
[115] *Ibid.*

reinsurance to the percentage that he is allowed to do so [116]. The court decided that in order to be able to ascertain whether these elements are correctly stated and if they are all critical, reference must be made both to the vertical and the horizontal exposure of a syndicate. For example, some of the elements – the first two actually- were not even challenged. For the third one it was said that it could not be argued, since it must be the aim of a reasonable underwriter. Hence, the third and the fourth were the ones, which were really challenged. The general conclusion that Lord Justice Phillips arrived at was that *"the competent excess of loss underwriter had to give careful consideration not merely to his vertical but also to his horizontal exposure. This was true, whether he was writing high level catastrophe business in the spiral or low level reinsurance of direct business and it is axiomatic that the underwriter had to plan his pattern of reinsurance protection...they should-* the Gooda Walker underwriters- *have been following a policy of matching reinstatements in relation to the catastrophe excess of loss business that they were writing to the spiral"* [117]. And in respect of the rating of the premium he said that *"the experts were agreed that it is a fundamental principle applying to all insurance business that the underwriter must satisfy himself that the premium received is commensurate with the risk assumed"* [118]. So, this led him to the conclusion that the premium must reflect the risk in order to be correct.

The next significant issue that the court turned to was the nature of the spiral business, the position of Gooda Walker underwriters towards it and the general standard of care and skill that is required by an underwriter. The first thing that was mentioned in relation to all these was that in the spiral business, an irrational way of thinking has been developed. This led to the result that the premium rates fell below the real reflection of the risks. This was supported by the evidence also of experts and by a report called the Lyons report [119]. What Lord Phillips did was that he accepted the experts' opinion and submitted that *"the Gooda Walker underwriters should have shared the appreciation of the spiral enjoyed by Mr.Emney, by the Lyons report underwriter and by Mr. Outwaite. This was a business in which they chose to specialize and they should have given the most careful thought to its nature...no reason has been suggested by the defendants why Gooda Walker underwriters should*

[116] For more details see the judgement.
[117] Deeny v Gooda Walker (1996) Lloyd's Reinsurance Law Reports 183. Pages 198-201.
[118] *Ibid.*
[119] For more details see the judgement.

not have made the same appraisal of spiral business as Mr. Outwaite and I can think of none" [120]. Finally what about the necessary standard of care and skill? Again quite a few allegations were made, in order to ascertain what an underwriter is expected to do. The first one was that the standard of care, which is expected, is that which is exercised by competent members of this job. The second one was that if a common practice was used in a particular, this could be strong evidence that the necessary standard has been achieved. Thirdly, if a choice, which was made by a professional, is proved to be wrong, this did not mean that he did not use reasonable care and skill. And the fourth one was that an error could be proved only if it was one, which could be made by an informed and reasonable underwriter. Lord Justice Phillips actually accepted these prepositions and stated that *"the underwriters in this case were putting their Names at risk to the tune of many millions of pounds. The heavy responsibility that they entailed entitled those Names to expect that their underwriters would exercise an appropriate amount of wisdom both before and during the underwriting that they transacted on behalf of their Names"* [121]. The rest of the case was dedicated to the losses of each syndicate separately and to some technical aspects of the reinsurance business.

Another case which dealt with the spiral business was **Arbuthnott v Feltrim Underwriting Agencies Ltd.** [122] In this case the principles which were mentioned in relation with **the Gooda Walker case** applied and it was held thatalthough the Feltrim underwriters had been aware the gearing effect on losses of the LMX spiral, they had acted in a negligent way in failing to calculate adequately the true extent of the syndicates' exposure to losses [123].

8. 8 Damages

Finally, the last thing I want to focus on in this chapter is the question of damages. In the Gooda Walker case, the argument on behalf of the Names was that since the underwriting was considered to be negligent, then it would be logical for them to recover the amount of damages to which they were entitled in respect of all

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[120] *Ibid*
[121] *Ibid*
[122] (1995) 2 A.C 145.
[123] *Ibid.*

these years of losses. However, the court did not follow this contention. It was held that they were entitled only to the amount of damages, which would put them in the same position as if they had obtained effective reinsurance for their exposure [124]. The same thing also applied in **the Arbuthnott case.**

8. 9 Pools and Fronting

This topic is again related more to reinsurance than directly to insurance brokers. However, its significance in respect of brokers lies on the fact that, many times, liabilities that arise under fronting agreements take place because a broker or an underwriter has failed, for example, to inform the fronting or the other pool members of their potential liabilities. So, it is quite important for a broker under these circumstances to exercise the standard of care and skill that is required by a competent and reasonable one.

I am going to start by referring to the meaning of the term "fronting": *"the meaning of fronting is clear. When one insurer is willing to take a risk but either is unable to do so, not being licensed to do business in the territory in question, or is not acceptable to the assured, for part or all of the risk, either for commercial reasons or perhaps on political grounds, then another insurer may be able to* ***front*** *for him, by underwriting the insurance in full and then reinsuring part of or all the risk with him. There may be standing arrangements to that effect when a number of insurers belong to a group or pool and for whatever reason the insurance is accepted by one or more insurers but the risk is shared by them with others under built-in reinsurance agreements"* [125]. This definition is taken from the case of **Sedwick v P.T Reinsuransi Umum Indonesia** [126]. This case demonstrates how the mechanism of fronting actually works. The facts were as follows: the first plaintiffs were brokers who had done business in Vancouver. They held some open covers, which were issued by the second defendants in the name of the first defendants. The object of insurance was a number of fishing vessels and the parties, which were insured under the insurance agreements, were the 2nd to the 70th plaintiffs. The controversial point of this case was the binding

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[124] For more details see the judgement.
[125] O'Neil P.T & Woloniecki J.W. The Law of Reinsurance. 1rst edition. Sweet & Maxwell.(1998). Pages 432-433.
[126] (1990) 2 Lloyd's Rep. 334.

authorities that the second defendants held from the first defendants. I am going to refer to the vital clauses of the agreement: *(2) Classes of risk :...(b) marine (hulls and cargo), (c) fire and allied perils. (3) Territory: Worldwide, excluding U.S.A and Canada. (4) Limits: U.S $50.000 for each class of the risk... (12) Other particulars: Whenever require fronting may be arranged"*[127]. In the end claims arose in respect of a large number of vessels. The argument on behalf of the plaintiffs was twofold. They submitted that either the first defendants were liable for the contracts that were formulated by the second defendants or that if it was accepted that the second defendants acted outside the scope of their authority, then, they were liable for the breach of their authority. On the other hand, the allegations for the first defendants were first of all that since everything happened in Canada, this was excluded by clause 3 of the binding authority. However, the second defendant argued that there was a variation in the binding authority in order to include Canada. Also, the first defendants argued that the financial limit had been exceeded [128]. Finally, the second defendants said that under the second the fronting arrangement they were entitled to front for the first defendants even outside the territorial limits, but only if there was a reduction by the reinsurance to the retention of the plaintiffs in order for it to be within the amount of their contractual limit. The decision of the court was first of all concentrated on the territorial limits. It was held that a variation was really included so as to include Canada. In respect of the limits of the risk, it was decided that the limit of $50.000 applied to each insurance which was accepted by the second defendants on behalf of the first defendants. Thirdly, in relation with the fronting arrangement it was submitted that actually the second defendants were not authorised to accept insurance on behalf of the first defendants, if the insurance was beyond the agreed limit. And fourthly, the second defendants did not have authority to act under open covers. Hence, *"there was a judgement for the first plaintiffs and the other plaintiffs against the first defendants for the balance of a claim and against the second defendants for the amount of damages"* [129].

One of the main reasons that pools and fronting arrangements exist is because many times lower rates than usual are used and this gives new companies in the market the opportunity to establish themselves. The other question is that of when an

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[127] *Ibid.*
[128] *Ibid.*
[129] *Ibid.* Pages 334-335

authority to front exists. The case in point is **Suncorp v Milano** [130]. In this case, an underwriter used a member of a pool as a front without his actual authority. However the decision of the court was that because Milano – the member of the pool- *"had become aware of the fact that their agent had exceeded his authority, took no steps within a reasonable time to bring that fact to the notice of third parties.* So, the conclusion was *"that Milano did adopt and intended to adopt the contracts at least to some extent"* [131]. One quite common issue, which is also, more related to our chapter here is the legal liability of the pool members. It must be understood that because they are the members of the same pool, this does not mean that they have any kind of partnership. They are more or less severally liable for their liabilities [132]. It works as if it is an original insurance. However, there is one more thing that needs to be cited down. There is a difference between the principal who is unnamed and the principal and the one who is undisclosed. In the first situation, it is possible for the agent not to be personally liable. In the second one, the agent is always responsible and liable in respect of his contractual position. Another element that is quite important is what is called **the cross-liability clause**. The effect of this clause is very significant because what it does is that even if only one member is liable for the agreement, with this clause it happens that the other members become additionally liable for the same amount [133]. This clause can also work progressively, because as the members become unable to pay, the more the amount is spread [134].

8. 10 Exclusion Clauses

I will move on to the possible effect of an exclusion clause that a broker can use in respect of his duties and liabilities. I am going to refer to the case of **Sharp & Another v Sphere Drake Insurance Plc & Others** [135]. In this case S, in order to comply with some tax requirements bought a yacht by means of an off-the-shelf company. A company called Roarer Investments Ltd., which was incorporated in

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[130] (1993) 2 Lloyd's Rep. 225.
[131] *Ibid.* Page 241.
[132] *Ibid.*
[133] A clause like that existed in the ACC Pool case study.
[134] O'Neil P.T & Woloniecki J.W. The Law of Reinsurance. 1rst edition. Sweet & Maxwell.(1998). Pages 432-433.
[135] (1992) 2 Lloyd's Rep. 501.

Gibraltar asked his insurance brokers, D3, who actually had insured earlier vessels to obtain cover. Underwriters D1 and D2 provided for the insurance. During the second year of insurance, the vessel became a total loss because of fire and the underwriters raised quite a few defences in order to avoid the claim: (a) S had no insurable interest in the boat. (b) The exclusion clause was based on the fact that if the yacht was used as a houseboat by any member of the crew, then the policy would not be valid. (c) When the policy was renewed S failed to disclose that a crew lived on board. (d) Also, the theft of a radio was not disclosed. (e) Non-disclosure also existed as to the fact that the proposal form was not signed by S, but by an employee of the brokers, D3. (f) Hence, a number of misrepresentations existed, namely, that the vessel was not used as a houseboat, that it had to be sealed in six months and finally that the proposal form was not signed by S. [136]. As a result S joined the brokers as third defendants and made a number of allegations that he was not aware of the exact meaning of the "house-boat" exclusion clause, that he was not informed about the theft of the radio and that the brokers should have said to the underwriters that the signature was not S's, in order to avoid the problem of insurable interest.

In respect of the allegation that there was a lack of insurable interest by S, the court rejected this argument: *" once one can establish the existence at the time of the loss of the rights enjoyed by the assured in respect of the insured property and that if it is lost or damaged such right will or may be less beneficial, an insurable interest exists regardless of the precise nature of the rights or the means by which they have been acquired"* [137]. Secondly, in relation to the false signature that was used it was held, under the old test – before the **Pan Atlantic case** [138] that *"given the width of the general principle of the utmost good faith...provided that it is established that such circumstances would influence the mind of the prudent insurer in deciding whether to take the risk they ought to have been disclosed and if they were not the insurer can avoid the policy. In the light of these findings, the first plaintiff's claim against the insurers failed"* [139].

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[136] Insurance Brokers Exclusion Clauses...Brokers negligence and other matters. Insurance Law & Practice, Vol.3, No 1, 1993. Pages 22-23.
[137] *Ibid.*
[138] (1993) 1 Lloyd's Rep. 496, (1995) 1 A.C 501 (H.L).
[139] Insurance Brokers Exclusion Clauses...Brokers negligence and other matters. Insurance Law & Practice, Vol.3, No 1, 1993. Pages 22-23.

Finally, there was a claim against the brokers. The first plaintiffs argued that the brokers actually failed to exercise their professional duty. According to the court, the question, which had to be asked, was if the people who exercise the same profession would reach the same conclusion. It was decided that the brokers fell below that standard for both the meaning of the exclusion clause and for the signing by another person. The last contention was if the plaintiff could be held to be contributorily negligent. The court rejected this kind of argument and no reference was made to **the Youell case** where this kind of argument was successfully raised. This case shows more or less how exclusion clauses work and how easy it is to complicate the situation in reality [140].

[140] *Ibid.*

CHAPTER

9 *Conclusion*

9.1 Conclusion

I have examined throughout this research the operation of the insurance industry in respect of brokers. It is obvious that brokers have been in many instances subject to criticism for not doing their job properly. The main problem most of the times was who is the broker acting for? For example, when a retrocession cover is obtained the broker becomes automatically the agent of the insurer. These agency problems create quite serious implications and the broker finds himself in a position where there is a conflict of interest between the duty of care that he owes to his original principal and the one that he owes to the insurer under the retrocession cover. The courts seem to impose on the broker quite a very heavy burden as to what he must do in order to act with reasonable care and skill.

Something else that needs to be said is that a broker is responsible for so many activities throughout the whole transaction. First of all, he needs to obtain the cover and be able to place it. This is the stage where many times problems arise between the parties of the contract. In many cases, the insurer argues that he entered in the contract because there was an alleged non-disclosure on the part of the broker. Again, the question that may arise is whose fault it is for the alleged non-disclosure. However, this matter is resolved only if someone examines thoroughly the relevant case law. Also, a broker owes a duty of care to his principal and perhaps other parties even after the insurance cover is obtained and placed. An obvious example is that of retention of documents. A broker was held liable for not keeping the relevant records after thirty years [1]. This shows that the duty of care that can be owed by the broker can be very wide and a broker can be liable long time after the conclusion of the insurance contract. My effort in this research was to try and deal with all the aspects of a broker's activities. My analysis of case law leads to e opinion that in recent years the courts have seen it fit to impose more onerous duties on brokers. If someone examines **the FNCB case** [2], **the Zephyr case** [3], **the Aneco case** [4] or **the Henderson case** [5], it

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[1] Grace v Leslie & Godwin Financial Services Ltd. (1995) L.R.L.R 472.
[2] FNCB Ltd. (Formerly First National Commercial Bank plc.) v Barnet Devanney (Harrow) Ltd. (formerly Barnet Devanney & Co. Ltd.) 1/7/1999.
http://www.casetrack.com
[3] The Zephyr, General Accident Fire and Life Assurance Corporation and Others, Peter William Tanter and Other. (1985) 2 Lloyd's Rep. 529.
[4] Aneco Reinsurance Underwriting Ltd (in liquidation) v Johnson & Higgins Ltd. 30/7/1999. (Unreported) http://www.casetrack.com
[5] Henderson v Merrett Syndicates Ltd. (1994) 2 A.C 145

will be obvious that onerous duties are imposed on brokers in respect of many of their activities as for example of a signing indication [6].

As I have already mentioned the whole regulatory aspect under which brokers are governed changed with the introduction of the **Insurance Brokers Registration Act 1977**. It was actually the first serious effort that was made in order to regulate brokers. The development of Lloyd's also had a vital effect for the whole regulatory regime to be improved through for example the **Lloyd's Byelaws**. However, the position of brokers is again a changing environment. As I have submitted in the introduction of this research the **General Insurance Standards Council** will be the new regulatory body in respect of brokers. I have mentioned in the relevant chapter a few details about the new system. Its activities are governed by a Commercial Customer Code and a Private Customer Code. A very important aspect is that everything will be regulated from branches in the United Kingdom irrespective of the location of the risk. The problems that the insurance industry has faced before and after the introduction of the **Insurance Brokers Regulation Act 1977** made it essential for a reform to be introduced. However, as I have already mentioned in many instances the vital issue now will be how the insurance industry will react to these changes. Anyway, the regulatory regime is not the only factor that will influence the position of the brokers. Of course, it will be the most important but other factors like public policy and fairness will always be decisive for a court in order to reach a decision. The examination of case law in this research made it clear that the position of brokers is such a complex issue and it will not be easy for the problems to be resolved. However, perhaps this latest reform will improve the situation. The position of a broker is not clear to be defined and a better theoretical background and regulation that is aimed by the **General Insurance Standards Council** may prove to be decisive. However, quite a long time must pass in order for everybody to be able to discuss about the advantages and disadvantages of the reform and assess the position of insurance brokers in respect of it.

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[6] This is what happened in the Zephyr.

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