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Marine Insurance Broker's Duties and Liabilities

by

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ABSTRACT

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The conduct of Marine insurance broker is subject to the general principles of agency law. However, it is also affected by the traditional customs and contemporary market practices in the field of marine insurance. As a result, marine insurance broker's duties and liabilities have unique features which are different or not that common for other general agents.

Firstly, marine insurance brokers have duties that will not be observed by other general agents who effect a contract on behalf of their principal. For example, marine insurance broker has a personal liability to pay the premium under the marine insurance contract he obtained for the assured. Secondly, marine insurance broker's multiple roles in the course of its business frequently raise the issue of conflict of duty and interest. Thirdly, the broker's way of placing a cover makes it hard to put the line between the broker's service of providing information and the service of providing advice. This is crucial for assessing the broker's liabilities when he fails to obtain the cover for the assured.

These exceptional features make marine insurance broker's duties and liabilities a valuable topic for research. However, there is no scholarly monograph which specifically considers these matters. The thesis will examine whether the exceptional duties should be reformed to comply with the general law of contract and agency. If not, is there any reform that can be made to improve the clarity, certainty and fairness of these duties. The thesis will also identify the broker's duties that are inclined to give rise to conflict of duty and interest and analyse how the issues are being treated by the court, and regulation authorities. Then the author will make recommendations on how to avoid the conflict of duties and interest. Finally, the thesis will discuss how the broker's liabilities are being assessed and how the brokers can protect their own risks of extensive liability by inserting a limitation of liability clause in the retainer.

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DECLARATION OF AUTHORSHIP

I, Miao Li

declare that the thesis entitled

Marine Insurance Broker's Duties and Liabilities

and the work presented in the thesis are both my own, and have been generated by me as the result of my own original research. I confirm that:

- this work was done wholly or mainly while in candidature for a research degree at this University;
- where any part of this thesis has previously been submitted for a degree or any other qualification at this University or any other institution, this has been clearly stated;
- where I have consulted the published work of others, this is always clearly attributed;
- where I have quoted from the work of others, the source is always given. With the exception of such quotations, this thesis is entirely my own work;
- I have acknowledged all main sources of help;
- where the thesis is based on work done by myself jointly with others, I have made clear exactly what was done by others and what I have contributed myself;
- none of this work has been published before submission.

Signed: ………………………………………………………………………..

Date:…………………………………………………………………………….

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ABBREVIATIONS

ABI	Association of British Insurers
ALRC	Australian Law Reform Commission
BEUC	the European Consumers' Organisation
BIBA	British Insurance Brokers' Association
BIPAR	the European Federation of Insurance Intermediaries
CIF	Cost, Insurance and Freight
EIOPA	European Insurance and Occupational Pensions Authority
FSA	Financial Services Authority
FSUG	Financial Services Users Group
ICOBS	Insurance: Conduct of Business Sourcebook
IMD	Insurance Mediation Directive
Law Commissions	The English and Scottish Law Commissions
LIIBA	London and International Insurance Brokers' Association
IIB	the Institute of Insurance Brokers
MIA	Marine Insurance Act
TL	Total Loss
TOBA	Terms of Business Agreement
SMEs	Micro, Small and Medium-sized Enterprises

Chapter 1 Introduction

1.1 Background

In marine insurance market, the broker plays an indispensable role. Almost all the marine insurance covers are placed with insurers through the instrumentality of brokers. The broker's intimate knowledge of insurance business is beneficial to both the assured and the insurer.

Marine insurance broker's act is subject to the general principles of agency law. However, it is also affected by the traditional customs and contemporary market practices in the field of marine insurance. As a result, marine insurance broker's duties and liabilities have unique features which are different or not that common for other general agents.

Firstly, marine insurance brokers have duties that will not be observed by other general agents who effect a contract on behalf of their principal. For example, a marine insurance broker has a personal liability to pay the premium under the marine insurance contract he obtained for the assured.[1] This is different from the principles of general agency law where the agent does not have any right or bear any responsibility under the contract he made on behalf of the principal.

Secondly, the broker's multiple roles in the course of its business frequently raise the issue of conflict of duty and interest. As Auld L.J. said in *HIH Casualty and General Insurance Co v JLT Risk Solutions*, 'the role of an insurance broker is notoriously anomalous for its inherent scope for engendering conflict of interest in the otherwise relatively tidy legal world of agency.'[2] As a 'servant of the market', [3] the brokers owe duties of care not only to their principal assured, but also to the insurers. In those situations, the issue of conflict of duty and interest will easily arise.

[1] Section 53(1) of MIA 1906.

[2] [2007] Lloyd's Rep. I.R. 717, at p.730, col.1.

[3] *General Accident v Tanter* (The Zephyr) [1984] 1 Lloyd's Rep. 58, at p.85, col.2.

Thirdly, the broker’s way of placing a cover makes it hard to put the line between the broker’s service of providing information and the service of providing advice. This is important for assessing the damages when the broker fails to obtain the cover for the assured. If the broker fails to practice a duty of care in providing advice instead of providing information that gives rise to liability exceeding the amount that would have been covered under the insurance.

These exceptional features make marine insurance broker’s duties and liabilities a good topic for research. However, there is no scholarly monograph which specifically considers these matters. Although, the issues of marine insurance broker’s duties and liabilities are mentioned in most insurance books, they have not been given enough attention comparing to other insurance issues, which is understandable considering the length of the work.

1.2 Aims and Objectives

The thesis will try to achieve the following three aims and objectives:

Firstly, the thesis will focus on the peculiar duties owed by marine insurance brokers. These include the broker’s independent duty of disclosure under section 19 (a) and the broker’s duty to pay premium under section 53 (1). The thesis will try to find out whether these peculiar duties should be brought into line with the principles in general law of contract and agency. If not, is there any reform that can be made to improve the clarity, certainty and fairness of these duties.

Secondly, the thesis will identify the broker’s duties that are inclined to give rise to conflict of duty and interest and analyse how the issues are being treated by the court and regulation authorities. Then the author will make some recommendations on how to avoid the conflict of duties and interest.

Finally, for the fact that the brokers are more inclined to cross the line of giving advice and giving information in the course of the business, the thesis will analyze its impact on the measure of damages for the broker’s liability when they failed to obtain the cover required by assured; and it will discuss how the brokers can protect their own risks of extensive liability by inserting a limitation of liability clause in the retainer.

1.3 Structure and Methodology

The thesis will achieve the aims and objectives through the exploring of the following six issues in six different chapters.

Broker's independent duty of disclosure

In Chapter 2, the issues revolving the broker's independent duty of disclosure under section 19 (a) will be discussed. As the agent of the assured, the broker has not only a duty to pass on to the insurer the information disclosed by the assured, but also a duty to disclose the information which he personally knows or deemed to know. This duty is stipulated in section 19 (a) of Marine Insurance Act 1906 (MIA 1906). The broker's failure in disclosing the fact within his knowledge which is material to the placement of the cover gives a separate cause of action to the insurer. It does not work in the way by which the broker's knowledge is imputed to the assured's. The thesis will examine the current law under section 19 (a) and the problems caused by it. Firstly, who are 'the agent to insure' that have an independent duty of disclosure; Secondly, what kind of information can be taken as within the broker's knowledge, only the one he received as the agent to insure or any information he received in any capacity; Thirdly, how will the assured be affected when the broker committed fraudulent conduct against the assured or insurer? Finally, the remedy for the broker's breach of duty of disclosure has not been stated in section 19 like that for the assured's breach of this duty in section 18. The case law shows that the remedy is avoidance of the insurance contract. Damages against the broker are available only when the non-disclosure amounts to negligent or fraudulent misrepresentation. The Law Commissions, in the project of insurance contract law reform, are considering whether the remedy against the broker's breach of duty of disclosure should be damages against the broker himself, rather than the avoidance of the marine insurance contract. The author will discuss these questions in sequence and make recommendations on the reform of section 19 (a).

Broker's personal liability to pay the premium

In Chapter 3, the thesis focused on the broker's personal liability to pay premium. According to section 53 (1) of MIA 1906, the broker is directly liable to the insurer for the premium under the policy he effected for the assured. This is different from the principles of general agency law where the agent does not have any right or bear any responsibility under the contract he made on behalf of the principal. In the Law Commissions' insurance law reform project, Issues Paper 8 pointed out that the rule in section 53 (1) potentially imposed the risk of a policyholder's insolvency on the broker and the risk of broker's insolvency on the insurers and it was asked whether there should be reform to bring the broker's liability into line with the general law of contract and agency. In answering this question, the author first examined the current law regarding the rule of broker's personal liability for the premium. This included the introduction of the rule in the legislation and at common law; the legal basis of such a rule; the problems caused by the application of the fiction which was used to rationalise the broker's liability for the premium at common law; the scope of application of the rule and the exclusion of such a rule in the contract. Then the author discussed whether the Law Commissions' proposal of repealing section 53 (1) was feasible. At this part, the author focused on the assignability of the marine insurance policy to assess whether it was advisable to totally repeal the section and abolish the rule of broker's personal liability to pay the premium. After that the author considered another option for reform which is revise rather than repeal. The author explained why there was no need to worry about the insolvency issues for the brokers and insurers even if the rule was retained and then gave some recommendations for the revise of section 53 (1) if it is to be kept.

Broker's duty to disclose the amount of the commission

Unlike the law and practice in general agency relationship, where the agent is remunerated by the principal, a marine insurance broker is assumed to be remunerated by the insurer, with whom he makes the contract on behalf of the assured. Although this position has been challenged in *Carvill America Incorporated RK Carvill & Co Ltd v Camperdown UK Ltd XL Speciality Insurance Co,*[4] there are more cases which have

[4] [2005] EWCA Civ. 645.

been decided on the basis of the existence of such an assumption either by a custom in the market[5] or by an implied term[6].

According to the general principles of agency law, the agent must fully and properly disclose any benefit he receives from the third party, and receives the principal's acknowledged consent. Failing either of the two limbs would result in the agent's breach of his fiduciary duty owed to his principal and remedies against the agent and the third party would be available to the principal and at his choice. As an agent of the assured, the broker should disclose any commission he receives from the insurer, no matter how small it is. However, the common law held that insurance brokers did not have a duty to disclose the amount of commission he received from the insurers unless it exceeded the normal rate. The regulations passed by the Financial Services Authority (FSA) also stated that insurance broker only has a duty to disclose the amount of the commission on request by the assured.

The fact that the broker receives commission from the insurer raises a matter of conflict of the duty and interest. Because the broker might be interested in looking for the insurer who would give him the biggest commission not the one who will provide the best possible deal for the assured. The issue of lack of transparency concerning the broker's remuneration had raised concern in the market and the question whether the remuneration disclosure should be made compulsory or just on demand was considered in light of the consultation made by the regulation authorities in U.K. and E.U..

Broker's duties owed to the insurers

In marine insurance market, the broker is the agent of the assured, but he may also owe duties to insurers under an agreed contract, for example, binders or Terms of Business Agreement (TOBA), or without a contract. Sometimes, the broker's performance is

[5] *E. Green & Son Ltd v Tughan & Co* (1913) 30 TLR 64; *Great Western Insurance Company v Cunliff* (1869) LR. 9 Ch.App. 525.

[6] *Power v Butcher* (1829) 10 B & C 329; *Leete v Wallace* (1888) 58 LT 577; *Lord Norreys v Hodgson* (1897) 13 TLR 421; *Bancroft v Heath* 17 T.L.R. 425; *Workman & Army & Navy Co-operative Supply Ltd v London & Lancashire Fire Insurance Co.* (1903) 19 T.L.R. 360; *Searle v A.R. Hales & Co Ltd* [1996] L.R.L.R. 68.

conducted in the mutual interest of both the assured and the insurers, for example, to keep the placing and claiming documents. The broker's role as 'the servant of the market' facilitates the insurance business transactions, but on the other hand, these multi-functions may cause problems. In this part, the author will discuss the duties owed to the insurers that might be argued to raise conflict of duties owed to the assured.

Broker's duties under reinsurance contract

Generally speaking, the broker's legal position during reinsurance transactions is the same as that under insurance transaction. However, the way the brokers place the reinsurance cover and the varied forms of reinsurance contract raises peculiar issues. Firstly, the agency issue. The various roles undertaken by the brokers posed challenges to the general principles of the law of agency. For example, the broker who places insurance with the insurers on behalf of the assured may also act for the insurer to place reinsurance. In other circumstances, the broker may design and promote insurance and reinsurance programme without having an existing insured. In these situations, it will be asked whose agent the broker is when effecting the reinsurance contracts. Secondly, there are different categories of reinsurance facilities. Some are taken to be contracts *of* insurance; some are regarded as contracts *for* insurance. This requires a reconsideration of the broker's duty of utmost good faith and the broker's duty to pay premium under different kinds of reinsurance. These issues are covered in Chapter 6.

Liabilities and Limitation of Liabilities

The normal measure of damages for insurance broker's breach of duty is the amount which the insurers would have paid under the insurance contract but for the broker's breach. However, a broker's liability may exceed the indemnity under the insurance cover if he breaches a duty to advise rather than a duty to provide information. This way of measuring damages is not unusual; but the way marine insurance brokers do the business in the London market put them in a position which is more inclined than other agents or professionals to transcend the boarder from the more traditional role of obtaining information about the price and availability of insurance cover to that advising his client on the potential merits of a transaction or the types of cover that ought to be purchased. This imposes on the brokers an inherent danger of a wider scope of damages if they made any mistakes during that process.

Moreover, the expanding scope of marine business renders the risk of high-severity claims against the brokers if they failed to obtain the cover that meet the client's requirement. On the other hand, the amount of the professional indemnity insurance the broker could buy may be limited. If a client brings a successful claim against the broker to the extent that it is not covered by the professional indemnity insurance, it has to be met out of the firm's own resources. Depending on the scale of the claim, it could cause severe financial difficulty, even, in some cases, insolvency. Although limitation of liability clause is used by other professionals, it is rarely used by insurance brokers. The author will discuss the possibility of limiting the broker's liability by a limitation of liability clause. The author first discussed why the broker may want to limit their liability. Then it was considered the enforceability of a limitation of liability clause under the current legal and regulatory framework. Finally, the author listed the elements to be considered when drafting a limitation of liability clause.

It is to be noted here that although my thesis is about marine insurance broker, the only substantial differences between the marine insurance brokers and non-marine insurance brokers are the duty to pay the premium and the broker's lien. The other principles for the marine and non-marine insurance brokers are the same. However, many of the principles in the field of insurance broker's duties derive from marine insurance cases. For example, all the cases leading to the broker's duty of disclosure under section 19 were marine insurance cases.

1.4 Outcomes

At the end of the research, the following issues should be made clear:

(1) Whether the broker's duty of disclosure is still needed under marine insurance contract; if so what is the scope of the duty; and what should be a reasonable remedy when the duty is breached.

(2) Whether the duty to pay premium under the marine insurance contract should be transferred from the broker to the assured who is the contracting party under the insurance contract?

(3) Whether the broker should disclose the amount of the commission he receives from the insurers mandatorily or just on request?

(4) Does a broker, as the agent of the assured, owes any duty to the insurers? If so, does it raise an issue of conflict of duties?

(5) The agency issues when the broker placed both the insurance and reinsurance; especially when the broker placed reinsurance before the insurance contract. Whether the broker owes duties of utmost good faith under reinsurance contract? Whether the rule of the broker's personal liability extends to marine reinsurance contract?

(6) The measure of damages for broker's breach of duty and whether the broker can limit his liability by inserting a limitation of liability clause in the retainer under the current legal and regulation framework? If so, what are the elements that should be included in the limitation clause?

Chapter 2 Broker's Independent Duty of Disclosure

2.1 Duty of utmost good faith under marine insurance contracts

Contracts of marine insurance are contracts of *utmost* good faith, this common law principle was codified in section 17 of MIA1906:

'A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.'

Speaking of *utmost* good faith is because it is different from the good faith under general contract law where the parties are only under the duty not to misrepresent the facts, but no positive duty to disclose all material facts. Under insurance contracts, the parties are obliged to disclose all the material circumstances which they actually have knowledge of or deemed to know.

The authority was found in the eighteenth century case *Carter v Boehm.*[7] In this case, a policy of insurance was made by Roger Carter for the benefit of his brother, George Carter, against the loss of Fort Marlborough by its being taken by a foreign enemy. The event happened and the assured claimed under the policy. However, the underwriter rejected the claim by saying that the assureds concealed circumstances which ought to have been disclosed (the weakness of the fort and the probability of its being attacked by French). This would avoid the policy. Although the court did not support the underwriter's case by reason of the concealment, Lord Mansfield's opinion in regard of the law of non-disclosure was taken as the classic statement of such law. He said:

'Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risqué, as if it did

[7] (1766) 3 Burr.1905.

not exist. The keeping back of such circumstance is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent intention; yet still the underwriter is deceived, and the policy is void; because the risqué run is really different from the risqué understood and intended to be run, at the time of the agreement.'[8]

Section 17 – 20 of MIA 1906 codified common law authorities. It had frequently been decided that these principles apply to all kinds of insurance contracts, marine and non-marine insurance contracts; insurance and reinsurance contracts.[9]

2.2. The broker's independent duty of disclosure under section 19 (a)

When a broker is involved in concluding a marine insurance contract, his own knowledge of material facts, even if the facts are not known to the assured, is vital to the status of the insurance contracts. The broker's duty of disclosure is stipulated in MIA 1906 section 19.

There used to be opposing views as to the reasons for the insurer's right to avoid the contract when the broker who effected the policy failed to disclose any material facts to the insurer. On one side, it was said that the insurers are entitled to do so because the broker's knowledge of the facts should be imputed to that of the assured. On the other side, it was said that the reason was that the broker has an independent duty to disclose material facts he knew or ought to be known to the insurer.

The authority for section 19 was founded in *Blackburn, Low & Co. v Thomas Vigors.*[10] In that case the claimant underwriters had underwritten a steamship for £1,500. They then reinsured part of the risk (£700) with the defendant reinsurer (the second reinsurance contract), lost or not lost, through a London broker firm Roxburgh, Currie & Co (RCC). Before this reinsurance was made, the underwriters had tried to reinsure

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[8] (1766) 3 Burr.1905, at p.1909.

[9] *SAIL v Farax* [1994] C.L.C.1094, Dillon L.J. p.1100 ; *PCW v. PCW*. [1996] 1 Lloyd's Rep. 241 at p. 252; *HIH v. Chase Manhattan* [2003]2 Lloyd's rep. 61 at para. 5, 42,87; *Manifest shipping v. Uni Polaris*(The Star Sea) [2003] 1 A.C. 469 at p. 493.

[10] (1887) L.R. App.Cas.531.

the whole risk through a Glasgow broker Rose, Murison & Thomson (RMT) and its London agents Rose Thomson, Young & Co (RTY) with another reinsurer. However they only reinsured for £800 with that reinsurer (the first reinsurance contract). The ship had been lost before the claimant tried to reinsure. This fact was known to Murison, a member of RMT, but he had not communicated this information to the claimant underwriters and the broker RCC in the current case and they were admitted to have acted in good faith throughout. The issue was whether the reinsurers in the second reinsurance contract were able to avoid the contract on the ground of non-disclosure by the reinsured and the broker who effected the contract. The House of Lords reversed the judgment of the Court of Appeal and restored the judgment of Day J. at first instance, that the knowledge of the broker for the first reinsurance contract was not the knowledge of the claimant underwriter. There was no non-disclosure under the second reinsurance contract. Therefore, the claimant underwriters were entitled to recover under the second reinsurance contract.

In *Deutsche Ruckversicherung Aktiengesellschaft v Walbrook insurance Co.Ltd. and Others Group Josi Reinsurance Co.S.A. v the Same*[11], Phillips J. took Lord Halsbury, Lord Watson and Lord FitzGerald's statements in *Blackburn* as support for the imputation theory, which means the assured is liable for the broker's knowledge of a material fact because the broker's knowledge is imputed to the assured's.

In *SAIL v Farax*[12], Dillon L.J. and Hoffmann L.J. did not agree with Phillips J.'s opinion. They endorsed Lord Macnaghten's statement in *Blackburn*.[13]

'It is quite true that the insurance would be vitiated by concealment on the part of such an agent just as it would be by concealment on the part of the principal. But that is not because the knowledge of the agent is to be imputed to the principal but because the agent of the assured is bound as the principal is bound to communicate to the underwriters all material facts within his knowledge.'[14]

[11] [1995] 1 Lloyd's Rep. 153.

[12] [1994] C.L.C.1094.

[13] [1994] C.L.C.1094, at p.1101, 1111.

[14] *Blackburn, Low & Co. v Thomas Vigors* (1887) L.R. 12 App.Cas. 531, at p. 543.

Hoffmann L.J. said, 'I think that Lord Macnaghten was right. His analysis is supported by the structure of the Marine Insurance Act 1906, which distinguishes between the duty of the insured in section 18 to disclose matters within his knowledge and the duty of the agent in section 19 to disclose matters within his. The latter section would not have been necessary if the knowledge of the agent was imputed to the insured.'[15]

In *PCW Syndicates v PCW Reinsurers*[16], Waller J. raised the same reason as that of Hoffmann LJ.[17] He also added that the agent should disclose his own knowledge because he was acting as an agent in the transaction.[18]

In *HIH Casualty & General Insurance Company & Others v Chase Manhattan Bank & Others,*[19] the judges also accepted that the broker has a separate and independent duty of disclosure to the insurers under section 19.

To the author's view, section 19 codified the decision in *Blackburn v Vigors*, but not only Lord Macnaghten's view. The other judges also favoured the independent duty theory. This is evident from the decision of the case. If the other judges all took the imputation theory, the outcome of that case would be different. Phillips J. had misunderstood what Lord Halsbury and Lord Watson have stated in Blackburn. In *Deutsche Ruckversicherung Aktiengesellschaft v Walbrook insurance Co.Ltd. and Others Group Josi Reinsurance Co.S.A. v the Same*[20], Phillips J. picked out some sentences from the decision in *Blackburn v Vigors* as evidence in support of the imputation theory. The first is Lord Halsbury's approvement to Lope's L.J.'s opinion at Court of Appeal:

'the principal is to be as responsible for the knowledge of a material fact acquired by his agent employed to obtain the insurance as if he acquired it himself.'

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[15] [1994] C.L.C.1094, at p. 1111.

[16] [1996] 1 Lloyd's Rep. 241.

[17] [1996] 1 Lloyd's Rep. 241, at p. 245.

[18] [1996] 1 Lloyd's Rep. 241, at p. 245.

[19] [2003] 2 Lloyd's Rep. 61. Lord Bingham at para. . 5; Lord Hobhouse at para. 87.

[20] [1995] 1 Lloyd's Rep. 153.

In fact, the meaning of the sentence was not that the agent's knowledge of a material fact was the knowledge of his principal. It only meant that the principal was responsible for his own knowledge of a material fact as well as the agent to insure's knowledge of the material fact. That is exactly the effect which will be achieved by section 19 of MIA 1906. If the broker had knowledge of a material fact which he had not disclosed to the insurer, the insurer is entitled to avoid the contract just as if the assured had knowledge of that fact.

The second one Phillips J. brought forward was a sentence at page 537 in Blackburn:

'When a person is the agent to know, his knowledge does bind the principal.'

The agent to know is the first kind of situation described in *Simner v New India Assurance Co Ltd* [21] by HH Judge Diamond Q.C. where the agent's knowledge would be deemed to be the assured's knowledge. The agents to know are those on whom the assured relies for information concerning the subject matter of the proposed insurance, for example, the ship master, ship agent. This is the kind of agent that is covered by section 18 not section 19. Phillips J. should not have taken these words as support for an imputation theory for the knowledge had by agents covered by section 19.

Lord Watson did not support the imputation theory either. He said: 'I am of opinion, with your Lordships, that the responsibility of an innocent insured for the non-communication of facts which happen to be within the private knowledge of persons whom he merely employs to obtain an insurance upon a particular risk, ought not to be carried beyond the person who actually makes the contract on his behalf. There is no authority whatever for enlarging his responsibility beyond that limit, unless it is to be found in the decisions which relate to captains and ship-agents; and these do not appear to me to have any analogy to the case of agents employed to effect a policy.' He then continued to distinguish the two kinds of agents in light of their relationships with the assured and the insurer. It was evident that Lord Watson concurred with Lord Halsbury that the agent to insure's knowledge cannot be imputed to the assured as that of the agent to know like captains and ship-agents.

[21] 1995 L.R.L.R. 240.

2.3. Who is the agent to insure under section 19 (a)

2.3.1 The type of agents contemplated by section 18 and section 19

Under marine insurance, the concluding of the insurance contracts and the running of the underlying business which is to be covered by such insurance contracts may involve different kinds of agents acting for the insured. Their knowledge of material facts concerning the relevant policy will affect their principal's right under the contract of insurance. The insurer may be able to avoid the contract, either because the agents' knowledge was imputed to the assured's under section 18 or because the agents have an independent duty to disclose the material facts under section 19. Then what kinds of agents are covered by section 18 and what kinds of agents are covered by section 19?

As Lord Halsbury said in *Blackburn v Vigors*, 'the somewhat vague use of the word 'agent' leads to confusion.'[22] In that marine insurance case, the judges, Lord Watson and Lord Macnaghten in particular, had distinguished between two kinds of agents. One was named the 'agent to know' who was employed by the shipowner for the management of his shipping business. They were bound to inform their employer of the condition of the ship. So their knowledge of the condition of the ship could be said to be that of the shipowner as assured at the time the insurance was effected. The ship master and ship agents were good examples of this kind. The other kind was that who were employed to effect insurance contracts. They are called agent to insure in section 19 of MIA 1906.

In *Simner v New India Assurance Co Ltd*,[23] Judge Diamond Q.C. described three kinds of situations where the knowledge of an agent of the assured would be deemed to be within the knowledge of the assured. First, there is a class of agent on whom an assured relies for information concerning the subject matter of the proposed insurance.(which described by Lord Halsburyas an 'agent to know' in *Blackburn v Vigors*); The second class of situation is where the agent can be regarded as being in such a predominant position in relation to the assured that his knowledge can be regarded as the knowledge

[22] (1887) L.R. 12 App.Cas. 531, at p.538.

[23] [1995] L.R.L.R. 240.

of the assured (Alter ego); The third situation is where the agent has effected the relevant insurance (the agent to insure).' [24]

In *ERC Frankona Reinsurance v American National Insurance Co,*[25] Andrew Smith J. considered this categorisation and said, where marine insurance is involved, the first and the second situation, 'the agent to know' and the *alter ego* were reflected in section 18 of the Marine Insurance Act, 1906, and the third, 'agent to insure', was reflected in section 19.[26]

Moreover, in *PCW Syndicates v PCW Reinsurers*, Waller J. held that 's.19 only applies to agents employed to effect the insurance, and it seems to me that the section is only intended to deal with the type of agent in respect of whom section 18 would not be deeming the knowledge to be that of the insured.'[27] It is evident from this ruling that there is no overlap between section 18 and section 19 in terms of the agents contemplated by each section.

2.3.2 The agent to insure under section 19 (a)

The leading authority which explains the meaning of the agent to insure under section 19 is *PCW Syndicates v PCW Reinsurers,*[28] The claimants were the members of the syndicates at Lloyd's. Their underwriting business was managed by PCW underwriting agencies Ltd (PCW agency). The agency was responsible for underwriting on behalf of these syndicates and for arranging and managing reinsurance for them. The reinsurance was duly made with insurance companies and Lloyd's syndicates. But the reinsurers avoided the reinsurance contracts for non-disclosure. The non-disclosure alleged was concerned with some individuals within the PCW agency who misused, for their own purposes, the premium income of the syndicates which should have been held in trust by the agency. The reinsurers argued that the agency's fraud was a moral hazard under the reinsurance contract. Since this material circumstance was not disclosed, they were

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[24] [1995] L.R.L.R. 240, at p.254, 255.

[25] [2006] Lloyd's Rep. I.R. 157.

[26] [2006] Lloyd's Rep. I.R. 157, para. 122. 123.

[27] [1996] 1 Lloyd's Rep. 241, at. p.248.

[28] [1996] 1 Lloyd's Rep. 241.

entitled to avoid the contract. It was held by the Court of Appeal that PCW agency was not the agent to insure under section 19. The agent to insure only encompassed those who actually dealt with the insurers concerned and made the contract in question.

2.3.2.1 Is it confined to the broker?

According to the test for the agent to insure set up by the *PCW* case, brokers may be one kind which complies with it. Will this be the only type covered by section 19 or the concept is wider which includes any person appointed by the assured to arrange cover, such as the managing agents[29] and underwriting agents?[30]

(A) Managing agent?

In *'Gunford' Ship Co., Limited v Thames and Mersey Marine Insurance Co., Limited,*[31] several policies were effected on the ship 'Gunford' for a voyage from Rotterdam to Hamburg and then to Santa Rosalia. One of the policies was taken out for the hull of the ship for a sum in much excess of its market value. Two other policies for freight and disbursements were also taken out at a sum in excess of the risks at stake. As a managing owner of the 'Gunford' ship company, Messrs Francis Briggs & Co., were responsible for the operation of the ship, including the employment of her officers and the effecting of insurances. They also effected a policy on hull and disbursements on their own behalf. All the policies were valued policies and in the name of the managing owner. The policy for disbursements and the policies effected on the managing owner's own behalf were all honour polices. Messrs Howard, Houlder, & Company, the broker, effected the policies with the underwriters .After the ship was lost during the voyage, the shipowner seek to recover for a total loss under the hull insurance. The insurers refused to pay the claim on the grounds that (1) the assureds were in breach of the warranty of seaworthiness; (2) the assureds failed to disclose the history of the master to the insurer; (3) the assureds failed to disclose the over-insurance effected by the concurrent honour policies. All these defences failed in the Outer House and the 1st division. However, in the House of Lords, it was decided that the insurers were entitled

[29] A managing agent is an agent who has permission from Lloyd's to manage a syndicate.

[30] An underwriting agent is a person who carries on underwriting for the syndicate at Lloyd's.

[31] 1911 section C. (H.L.) 84.

to avoid on the ground that the assureds AND the agent failed to disclose the over-insurance. The agent referred to Messrs Francis Briggs & Co., the managing agent, not Messrs Howard, Houlder, & Company, the broker. In the House of Lords, the Lord Justices held unanimously that the managing agent had a duty of disclosure under section 19[32].

In *PCW Syndicates v PCW Reinsurers,*[33] the counsel for the reinsurers took the Gunford case as a support for his argument that an agent to insure was not limited to a broker, but included managing agent like PCW Underwriting Agencies Ltd. for the reinsured in this case. The Gunford case was considered both at first instance and in the Court of Appeal. However, neither of the courts has taken it as binding upon them in this regard. At first instance, Waller J. said that the real issue in that case is materiality not whether section 18 or section 19 applied.[34] In the Court of Appeal, Staughton L.J. only said that circumstances like over-insurance in Gunford case should be disclosed under section 19.[35] In Saville L.J.'s decision it was said that there was no discussion, in the Gunford case, on the matter of whether the agent in question was the agent to insure.

Contrary to the decision in Gunford, it was held, in the *PCW* case, that the 'agent to insure' only encompassed those who actually dealt with the insurers, it did not intend to cover intermediate agents like managing agent. Waller J. decided on the ground that PCW agency, as a managing agent, was inside the organisation of the reinsured instead of outside it and they were not in direct contact with the reinsurer.[36] Saville L.J., with whom Rose L.J. agreed in this point, reached this conclusion on two grounds: the wordings used in section19 and the authorities on which section19 was based. Section 19 stipulated that the agent to insure must disclose the material circumstance he knew to the insurer. As an intermediate agent, he was not expected to communicate this kind of information to the insurer, but to pass on the information to further intermediaries or to those actually dealing with the insurer. Therefore the agent to insure under section 19 only referred to the last agent who actually dealt with the reinsurer. The authority

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[32] 1911 section C. (H.L.) 84, at pp.89,94,97.

[33] [1996] 1 Lloyd's Rep. 241.

[34] [1996] 1 Lloyd's Rep. 241, at p. 249.

[35] [1996] 1 Lloyd's Rep. 241, at p.256.

[36] [1996] 1 Lloyd's Rep. 241, at p.250.

Saville L.J. relied on to support his understanding of the ‘agent to insure’ was *Blackburn Low & Co. v Vigors.*[37] In that case, Lord Watson and Lord Macnaghten drew a clear distinction between ‘agent to inform’[38] and ‘agent to insure’.[39] The insurer was entitled to contract on the ground that the person with whom he was dealing, being someone authorized by the assured so to act (the agent to insure), had disclosed all facts within that person’s knowledge. Saville L.J. said, this basis was inapplicable to the intermediate agents with whom the insurer was not dealing. Staughton L.J. decided the case on different ground, but he also indicated that under section 19, when an intermediate agent was required to disclose any material circumstance, it was very likely that it be made through the last agent.

The reasoning given by Saville L.J. was well founded. However, it is hard to understand how they can circumvent the decisions in Gunford. Although the position of Mr. Briggs was not considered in terms of whether he was an agent to insure, that may be because this question went without saying that Mr. Briggs had a duty of disclosure under section 19. Moreover, it was evident from the decisions that the over-insurance were material circumstances, and Mr. Briggs, as the managing agent, had a duty to disclose them under section 19.[40]

However, Waller J’s comprehension at first instance of the *PCW* case can be taken as a good explanation for excluding the managing agent from the agent to insure under section 19. He said:

‘I am not going to say that this must limit section 19 to brokers although they must be the most obvious example of the type of agent contemplated. But in my view the section does contemplate the employment of someone or some firm outside the employment of the insure, or I would add someone outside the management of the insured’s business if as in this case the business is carried on through an agent.’[41]

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[37] (1887) 12 App. Cas.531.

[38] Agents who place insurance for the assured.

[39] Agents who carry out the assured’s business, for example ship masters and crew.

[40] 1911 section C. (H.L.) 84, at pp. 89,95, 97.

[41] [1996] 1 Lloyd’s Rep. 241, at p.250.

On this basis, even if there is no broker involved and the managing agent is the last agent who deals with the insurer. The managing agent's knowledge does not fall within the agent to insure's knowledge under section 19, but should be imputed to the assured under section 18. However this position has not been tested in any case.

(B) Underwriting agent?

For the same reasons given by Waller J. at first instance in *PCW* case, underwriting agents, who are within the organization of the reinsured, should not be included in the kind of agent to insure under section 19.

2.3.2.2 Is it confined to the placing broker?

When more than one broker are involved in effecting the policy, for example one producing broker and one placing broker, will the agent to insure include both of them or only refers to the placing broker. In light of the reasons given in the *PCW* case, the agent to insure only refers to the last agent, the placing broker, who has direct contact with the insurer[42]. In the *PCW* case, the counsel for the reinsurer took *Blackburn Low & Co. v Haslam*[43] as an example to show that the insurance could be vitiated through the knowledge of an agent who was not the broker who actually effected the insurance. In that case, the reinsured instructed a broker RMT to effect reinsurance for the risk he had underwritten on a ship. Before the reinsurance contract was concluded, Mr. Murison, a partner in the firm RMT was informed of the loss of the vessel intended to be reinsured. Thought he was not entitled to disclose the intelligence he received in confidence, Mr. Murison telegraphed in the reinsured's name to RTY, its London agent, about the reinsurance matter. The later transactions were done between the reinsured and RTY, and no commission was charged by RMT. The court held that the policy was void through the concealment of material facts by the agents of the assured.

Saville L.J. did not agree with the counsel. He said the contract was tainted not because the agent who knew was an agent to insure. It was because that agent should have

[42][1996] 1 Lloyd's Rep. 241, at pp.250, 258.

[43] (1888) 21 Q.B.D. 14. The fact of Haslam case was relevant to the Thomas Vigors case. It was concerned with the first reinsurance contract discussed in Thomas Vigors case.

communicated that knowledge down the line to the broker who actually effected the cover. According to section 19, the agents to insure are deemed to know every circumstance which in the ordinary course of business ought to be communicated to them.

In sum, the agent to insure under section 19 only refers to the placing broker who directly contacted with the insurer, it does not include the intermediate agent. However, the knowledge of material facts by the intermediate agent are also important, because their knowledge may be the deemed knowledge of the placing broker.

2.3.3 A narrow definition?

The term 'agent to insure' was given a very narrow definition in *PCW Syndicates v PCW Reinsurer*s[44] and *Group Josi re v Walbrook Insurance Co. Ltd.and Others.*[45] Three elements should be considered in determining whether an agent is the agent to insure under section 19: (1) whether the agent is outside the business of the assured; and (2) whether the agent is in direct contact with the insurers; and (3) whether the agent effected the contract of insurance in question.

This was applied in *ERC Frankona Reinsurance v American National Insurance Co*[46]. Andrew Smith J. referred to the fact that the limited definition of agent to insure has been 'forcefully criticised', although he concluded that he was bound to follow the Court of Appeal's decision.

Although the agent to insure is not limited to the broker, it is the most obvious example. The following discussions will focus on issues arise from broker's situations.

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[44] [1996] 1 Lloyd's Rep. 241.

[45] [1996] 1 Lloyd's Rep. 345.

[46] [2006] Lloyd's Rep. I.R. 157 at p.182. See also *GMA v. Unistorbrand International Insurance AS*.[1995] L.R.L.R. 333. In that case, Rix J. was prepared to hold (*obiter*) that an underwriting agent acted as agent to insure even where it was merely an intermediary agent rather than the agent who actually placed the insurance.

2.4 The knowledge of the agent to insure

The test for establishing the broker's knowledge is almost the same with that for the assured, that is '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.' This includes the actual knowledge and deemed knowledge of the broker. The small difference between the test for the broker and that for the assured is the circumstance which in the ordinary course of business ought to be 'communicated to' him. It was said that these words are used to work with section 19. (b) to cover circumstances that should be communicated by the assured to the broker.[47]In fact, the circumstance which ought to be communicated to the agent to insure says no more than the circumstances which in the ordinary course of business ought to be known by the agent to insure. This may be the reason why the Australian Law Reform Commission have suggested to remove this wording in section 25 (a) in the MIA 1909.[48]

The most controversial issue here is whether the broker needs to disclose all the material circumstances known to him 'in any capacity' or he only need to disclose circumstances he acquired as agent for the assured. There are conflicting authorities to this question. Some supported the proposition that the broker only needs to disclose the facts he knows as the assured's agent; some supported the proposition that the broker has to disclose all the material facts known to him irrespective in what capacity he received them.

2.4.1 Knowledge acquired as agent to insure

At first instance in *PCW* case, Waller J. said that since the agent to insure's obligation to disclose arose out of the fact that he was acting as an agent, there should not be any obligation to disclose circumstances he held not as agent of the assured. [49] This was affirmed by Staughton and Rose L.J.J. in the Court of Appeal. Staughton L.J. said,

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[47] Arnould's Law of Marine Insurance and Average 17th ed, at p. 631, footnote 92.

[48] ALRC 91, Recommendation 24.

[49] *PCW Syndicates v. PCW Reinsurers* [1996] 1 Lloyd's Rep. 241, at p. 250.

‘I don’t 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; and certainly none where the information was as to the agent’s own fraud on his principal.’[50]

2.4.2 Knowledge acquired in any capacity

The opposing view was expressed by Hoffmann L.J. *in SAIL v Farex.*[51] In this case the claimants SAIL instructed London brokers HF to arrange a facultative reinsurance facility. HF arranged reinsurance with Farex in the form of a line slip which has the words ‘subject to reinsurance and security’. Then HF arranged reinsurance for the reinsurer Farex with St. Paul through Mr. Kearney. A few hundreds of declarations were made under the line slip between SAIL and Farex during the period from 1988 to 1991. When St. Paul refused to pay under the retrocession on the ground of Mr. Kearney’s lack of authority to accept retrocession on behalf of St. Paul, Farex repudiated all liability to SAIL on the ground of the broker’s non-disclosure and misrepresentation concerning the existence of retrocession cover with St Paul, and the relevant claims history in respect of each risk declared. The point relevant here is the broker’s non-disclosure of the existence of the retrocession cover. Farex contended that HF, the broker, had known that Mr. Kearney had no authority to accept retrocession on behalf of St. Paul, and that knowledge was held as an agent for the assured. Therefore they were entitled to avoid the contract.

Hoffmann L.J. ruled on the ground that the status of the retrocession agreement was not a material circumstance in relation to the reinsurance contract. If it was material, the broker need to disclose it in the due course because ‘the insured and his agent are under a duty to disclose ‘every material circumstance’ of which they have knowledge, irrespective of the way in which that knowledge was acquired.’[52] Later he added that ‘the agent’s duty to disclose material circumstances known to him in any capacity.’[53]

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[50] *PCW Syndicates v. PCW Reinsurers* [1996] 1 Lloyd’s Rep. 241, at p.257.

[51] [1994] C.L.C.1094.

[52] [1994] C.L.C. 1094, at p. 1111.

[53] *Ibid*.

Similar comments were made by Hoffmann L.J. in *El Ajou v Dollar Land Holdings plc & Anor.*[54]

The view that the obligation extends to information however received appears to be supported by the House of Lords in *Blackburn, Low & Co. v Thomas Vigors,*[55] where Lord Halsbury said, 'In this particular case the knowledge was acquired, not because he [RMT] was the agent of the assured, but, from the accident that he was general agent for another person. The reason why, if he had effected the insurance, his knowledge, unless he communicated it, would have been fatal to the policy, is because his agency was to effect an insurance, and the authority to make the contract drew with it all the necessary powers and responsibilities which are involved in such an employment.'[56] This means if RMT was the agent to insure under the second reinsurance contract, his knowledge of the loss of the vessel should have been disclosed, even if the knowledge was acquired not as the agent of the assured, but as the general agent for another person.

The editors of Arnould's law of Marine Insurance and Average also took the view that all information that is or ought to be within the broker's knowledge must be disclosed. However, it was also noticed that

'[D]ifficult problems sometimes arise, particularly in reinsurance contracts, concerning, for example, the extent of the broker's duty to disclose his knowledge of claims pending on other policies of the same reinsured.'[57]

This issue has not been brought up specifically in front of the court for decision. All the above authorities are obiters. To the author's view, the general rule should be that the broker must disclose all the information within his knowledge, no matter in what capacity he obtained that information. Since the placing broker's duty of disclosure is an independent duty, this suggests that a broker should be obliged to disclose all material information within his knowledge, there is no reason to limit the information to what the broker received as agent for the insured. However, there should be an exception to the

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[54] [1994] B.C.C.143, at p.156.

[55] (1887) L.R. 12 App.Cas. 531.

[56] (1887) L.R. 12 App.Cas. 531, at p.539.

[57] Arnould's law of Marine Insurance and Average 17th ed. para. 16-63.

general rule where the broker owes a duty to a third party to keep that information confidential.

2.4.3 Confidential information

For confidential information, it is arguable that the placing broker should be relieved from any obligation to disclose that information if to do so would require the broker to breach his duty to his other clients.

2.5 Fraudulent conduct by the broker

The assured as the principal of the broker in concluding an insurance contract is responsible for the broker's act in performing his duties. Sometimes the broker will do wrongs or even commit fraud against the assured or the insurer. When it happens, how it will affect the assured's right under the insurance contract the broker effects on his behalf? Does the assured have any protection by law or by contract?

2.5.1 Broker's fraud against assured

2.5.1.1 Is the broker's fraud against the assured a material fact?

There is not any case which raised this issue for decision. A sample situation for the broker's fraud against assured is that the broker fraudulently diverted the money he held for the assured for his own use. In the *PCW* case, the judge said that since the matter of the agent's fraudulent conduct rendered a moral hazard under the policy, it should be a material fact. However, this was not the preliminary issue discussed in that case. The court just assumed that such circumstance was material. Therefore, the case was not an authority on the issue of whether the broker's fraud against assured can be a material fact. If the broker's fraud is not held to be a material fact in one case, the broker's duty of disclosure will not arise. On the contrary, if it is held to be a material fact, according to section 19, the broker has to disclose it in the ordinary way. Under this circumstance, will the assured be held liable for the broker's non-disclosure of his own fraud?

2.5.1.2 Does the Hampshire Land principle apply to section 19 (a)?

If the broker's fraud is not a material fact, there is no need to disclose it. If the broker's fraud against assured is a material fact, according to the wording of section 19, the broker has to disclose it in the ordinary way. Under this circumstance, will the assured be held liable for the broker's non-disclosure of his own fraud or the Re Hampshire Rule which applies to the agents covered by section 18 also applies to the brokers under section 19 and makes the broker's non-disclosure of his own fraud as an exception?

(A) The Hampshire Land principle

There is a Hampshire Land rule in the general agency law which renders the agent's knowledge of his own fraudulent conduct an exception to that which will be imputed to the principal. The Hampshire Land principle was first formulated by Vaughan Williams L.J. in In *Hampshire Land Co., Re,*[58] and was later approved by the House of Lords in *Houghton v.Nothard Lowe & Wills.*[59] It has also been applied in insurance cases.[60] The essence of the rule is that:

'It is a well-recognized exception from the general rule that a principal is affected by notice received by his agent that, if the agent is acting in fraud of his principal and the matter of which he has notice is relevant to the fraud, that knowledge is not to be imputed to the principal.'[61]

By section 18, the assured must disclose not only the circumstances actually come to his knowledge, but also those which in the ordinary course of business ought to be known to him. This includes the knowledge of the agents to whom he has entrusted all or part of the running of his business. The Hampshire Land principle has made the agent's knowledge of his own fraud against the assured as an exception to the imputation of the agent's knowledge to the assured's. Otherwise, the insurers are entitled to avoid the

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[58] [1896] 2 Ch. 743.

[59] [1928] A.C.1.

[60] *Newsholme Brothers v. Road Transport and General Insurance Co. Ltd.*,(1929) 34 Ll.L.Rep. 247; [1929] 2 K.B. 356; *Regina fur v. Bossom*,[1957] 2 Lloyd's Rep. 466. *SAIL v. Farex*, [1994] C.L.C.1094.

[61] *Belmont Fiance Corporation Ltd. V Williams Furniture Ltd.*, [1979] Ch. 250 at p. 261.

insurance contract on the ground of the agent's knowledge of his own fraud against the assured, even if the assured is himself a victim of such fraud.

(B) Will the Hampshire Land rule apply under section 19 (a)?

As had already been discussed above, under section 19, the broker has an independent duty of disclosure to the insurer. This section works without imputing the broker's knowledge to the assured. On the contrary, he must disclose every material fact that is known to him, which may include his own dishonesty. Under this circumstance, will the Hampshire Land principle still be applicable to the broker's fraud against the assured?

A majority of the Court of Appeal in *PCW Syndicates v PCW Reinsurers*[62], and Staughton L.J. in *Group Josi re v Walbrook Insurance Co. Ltd.and Others,*[63] concluded that the Re Hampshire Land principle did apply to section 19. In Staughton L.J.'s view, which Rose L.J. agreed, to conclude otherwise would create a remarkable and unwarranted difference between section 18 and section 19. He said

'If the dishonesty of the agent is not something which in the ordinary course of business ought to be known to the principal (section18), why should it be held against the principal merely because the agent is an agent to insure (section19)? It is equally absurd in either case to suppose that the agent will in fact disclose his dishonesty, whether to his principal or to the proposed reinsurer.[64] On this basis he concluded that

'the Hampshire Land principle is not confined to cases where the agent's knowledge is by law to be imputed or attributed to the principal, or deemed to be the knowledge of the principal. The doctrine should extend to any case where the principal's rights are affected if the agent does not make disclosure to a third party.'[65]

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[62] [1996] 1 Lloyd's Rep. 241.

[63] [1996] 1 Lloyd's Rep. 345.

[64] *PCW Syndicates v. PCW Reinsurers* , [1996] 1 Lloyd's Rep. 241, at p.255.

[65] [1996] 1 Lloyd's Rep. 241, at p. 256.

This decision suggests that the insurer will not be able to avoid the contract on the ground that the broker has not disclosed his own fraud against the assured when placing the risk.

2.5.2 Broker's fraud against insurer

2.5.2.1 Broker's fraudulent non-disclosure

Disclosure is a 'unitary and absolute' duty which, if breached, gave the insurer the right of avoidance, no matter whether it was made innocently, negligently or fraudulently. Being a duty as such, is it necessary to identify the way by which it is breached? If the fraudulent non-disclosure is recognised in concept, how will the assured be affected by the broker's fraudulent non-disclosure. Is it possible to insert terms in the policy of insurance to exonerate the assured's liability for the agent's fraudulent non-disclosure?

Doubt was cast upon the concept of 'fraudulent non-disclosure' by Rix L.J. in the Court of Appeal in *HIH Casualty & General Insurance Company & Others v Chase Manhattan Bank & Others*.[66] In that case, the banks who participated in a loan syndicate to provide finance for the production of five films effected, through brokers, financial contingency insurance with the insurers. The insurer issued a line slip, under which three declarations were made by off-slips in respect of three of the five films. Separate policies were issued in respect of the other two films. When the loss occurred, the banks intended to recover under the two separate policies. However, the insurers tried to avoid the contract on the ground of fraudulent or negligent non-disclosure and misrepresentation by the broker. The decision of the case depended on the construction of the truth of statement clause in the policies which was devised to exclude both the assured's duties of disclosure and representation and his responsibility for his agent's non-disclosure and misrepresentation. There was no dispute as to the waiver of the assured's own duty of utmost good faith under the policy. However, the parties and the judges had expressed different opinions upon the extent to which the assured's liability for the agent's non-disclosure and misrepresentation was excluded. Although there was no difference between misrepresentation and non-disclosure in respect of the question

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[66] [2003] 2 Lloyd's Rep. 61.

asked here, the discussion will focus on the agent's duty of disclosure. The sentence in the truth of statement clause which is relevant to the agent's duty of disclosure is as follows:

'Any such information provided by or non-disclosure by other parties… shall not be a ground or grounds for avoidance of the insurers' obligations under the Policy…'

The counsels for the assured bank claimed that the comprehensive words used in the clause was wide enough to exclude the assured's liability for the agent's innocent, negligent and fraudulent non-disclosure. On the contrary, the counsels for the insurer argued that the clause only exclude the assured's liability when the non-disclosure was made innocently by the broker.

At first instance, the judge supported the insurers' view that the truth of statement clause cannot exclude the assured's liability for the agent's non-disclosure when it was made negligently or deliberately, it only covered innocent non-disclosure. This decision was reversed by the Court of Appeal, where it was held that the exclusion clause covers all the above three situations. Rix L.J. said:

'I don't think that, in the absence of express language, any line is to be drawn between the various possible causes of or motives for non-disclosure. It is not in this way that the distinction is to be drawn.'

To Rix L.J., disclosure was a 'unitary and absolute' duty. If excluded, it was excluded altogether.

Lord Bingham and Lord Hoffmann in the House of Lords did not agree with this. They took section 84(3)(a) of MIA 1906 Act, which stipulates that when the insurer avoided the contract, the premium should be returned to the assured unless fraud is involved by the assured or his agent, as an example to show that the Act has distinguished between fraudulent and innocent non-disclosure.[67] Lord Hoffmann also said that: 'the fact that the rule imposing the duty treats it as 'unitary and absolute' and makes no distinction

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[67] [2003] 2 Lloyd's Rep. 61, para. 22, 74.

between the ways in which it may be broker is no reason why the parties should not make such distinctions in a contractual provision which limits its scope.'[68]

2.5.2.2 How will the assured be affected by the broker's fraudulent non-disclosure?

As have already been said before, disclosure is a unitary and absolute duty. If he failed to disclose material facts which induce the insurer to enter into the insurance contract, the insurers are entitled to avoid that contract no matter whether the non-disclosure is made innocently, negligently or fraudulently. The question here is whether the broker's fraud can support a claim, other than avoidance, of damages against the assured.

The common law gives a right to recover damages for deceit to the victim of a fraudulent misrepresentation. If the fraudulent non-disclosure can be amounted to fraudulent misrepresentation, the insurer can avoid the contract or recover damages against the assured.[69] Sometimes, the keep back of part of the truth may make a positive statement misleading. Such half-truth is 'no better than a downright falsehood'.[70]

For pure non-disclosure, it was decided that it does not give rise to any claim by way of damages; avoidance is the only remedy available to the insurer. In *Banque Keyser Ullmann section A.(UK) v Skandia (UK) Insurance co.Ltd.,*[71] syndicates of banks entered into separate loan agreements to provide finance for four companies owned or controlled by a businessman. Credit insurance policy was one of a series of securities provided for each loan. The banks were ranked as assured, co-assured or assignees under the policies. 'It was a condition of the loan agreements that the banks would advance the moneys only when they were satisfied that the securities were properly in place. In order to complete the first loan, L, the manager of the broker company who is in charge of the broking process, issued cover notes representing that cover was

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[68] [2003] 2 Lloyd's Rep. 61, para. 74.

[69] *HIH Casualty & General Insurance Company & Others v. Chase Manhattan Bank & Others.* [2003] 2 Lloyd's Rep. 61, LJJ Bingham and Hoffmann at para. 21, 71.

[70] *Gluckstein v Barnes,* [1900] A.C. 240, at p. 251.

[71] [1990] 1 Q.B. 665 at pp.777-781(without a misrepresentation there can be no fraud in the sense of giving rise to a claim for damages in tort') and [1991] 2 A.C. 249 at p. 280 *per* Lord Templeman and p.281 *per* Lord Jauncey.

complete even if in fact it was not. D, the underwriters of the insurance company, was fully aware of L's deliberate concealment. Without reporting the matter either to the brokers or the insurance companies or the banks of L's deceit, D went on to write further loans. When the borrowing companies defaulted on the loan, because the businessman disappeared with the bank's money, and other securities were of little value, the banks looked to the insurers for recovery. Since there was a fraud exclusion clause, the insurers were not liable under the policies. However, the banks claimed that the insurers have breached their duty of utmost good faith, they should have disclosed the broker's fraudulent conduct, and such breach sounded in damages. Slade L.J. in the Court of Appeal refused this claim by the following reason:

'The breach of the duty of disclosure itself cannot give rise to an action for damages, because no authority supports such a claim. The Act of 1906 and the judgements in many reported cases specifically refer to avoidance of the contract as the remedy for the breach of the obligation of disclosure in contracts of insurance, neither the Act of 1906 nor any reported case or any textbook cited that a remedy by way of damages may also be available.' In *Glasgow Assurance Corporation Ltd v William Symondson & Co.*,[72] Scrutton J. said: 'non-disclosure is not a breach of contract giving rise to a claim for damages, but a ground for avoiding a contract.'

At first instance, the judge said, when the insured became aware of the non-disclosure after the occurrence of the contingency insured, avoidance of the policy and the return of the premium were inadequate relief. According to the principle *ubi jus ibi remedium*, the judge gave the bank the remedy by way of damages. However, Slade L.J. in the Court of Appeal said that the principle itself did not justify a decision to give the remedy of damages in a novel situation not covered by previous authority unless this is preceded by an analysis of the origin and nature of the right in question. Thus, the question, whether or not the remedy of damages is available, depended on the nature of the right and of the corresponding duty of the other party.

The ground on which the banks relied on to claim damages was that the utmost good faith principle, and therefore the duty of disclosure, was an implied term of an insurance

[72] (1911) 16 Com.Cas. 109, at p. 121.

contract. Slade L.J. first rebutted the bank's grounds of argument that the wording of section 17 and the post-contractual duty of disclosure recognised in the *Litsion Pride* case were in support of the implied term view. Then he cited the observations of Esher L.J. in the Court of Appeal in *Blackburn, Low & Co. v Vigors*[73]

'But if this be correct, the contract should never be set aside or treated as avoid on the ground of concealment; the contract should stand and be treated as broken by the assured.'

Esher L.J. took the duty of disclosure as a condition precedent to the right of the assured to insist on enforcement of the contract. This view was concurred by Lord Watson, Lord Fitzgerald and Lord Macnaghten in the House of Lords. Slade L.J. also took this view and added that the condition referred to by Esher L.J. was not promissory condition, but contingent condition, failed of which gave no right of action for breach but simply suspends the obligations of one or both of the parties. Moreover, Slade L.J. said that the remedy of avoidance for non-disclosure, like that for misrepresentation, 'depends not on any implied term of the contract but arises by reason of the jurisdiction originally exercised by the courts of equity to prevent imposition.'[74]

Slade L.J. also refused to create a novel tort for the duty of disclosure. The reasons were as follows:

First, since duress and undue influence, which also stem from the same jurisdiction as that of non-disclosure, gave rise to no claim for damages, the outcome should be the same for non-disclosure.

Secondly, since the criterion to establish the effect of the non-disclosure is an object one, that is the effect of the non-disclosure on the mind of a notional prudent assured, not the relevant assured, it was hard to evaluate the damage if the non-disclosure had no effect on the relevant assured.

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[73] (1886) 17 Q.B.C. 553.

[74] *Banque Keyser Ullmann section A. v Skandia (U.K.) Insurance Co. Ltd. And Others* [1990] 1 Q.B. 665, at p. 779. *Merchants and Manufacturers Insurance Co Ltd v Hunt* [1941] 1 K.B. 295, at p.318.

Thirdly, no remedy of damages was mentioned in section 17-20 in the 1906 Act, it only referred to the remedy of avoidance.

Fourthly, duty of disclosure is an absolute one, if damages could be awarded to non-disclosure even if no fault was involved in the process, it will cause hardship to both insurers and assureds.

At first instance, the judge also rejected an argument based on alleged fiduciary duties owed by the insurers to the bank.

If the banks' right to full disclosure of material facts is founded neither on tort nor on contract nor on the existence of a fiduciary duty nor on statute, it is difficult to see how, as a matter of legal analysis, it can be said to found a claim for damages.

There is another possible way by which damages could be claimed by the victim of non-disclosure. That is when the conduct of non-disclosure itself constitutes the tort of deceit. However, the general rule is that mere passive non-disclosure of the truth, however deceptive, does not amount to deceit in law.[75]

In sum, only pure non-disclosure will not give rise to a right to recover damages for the victim of a fraudulent non-disclosure, avoidance is the sole remedy. If the non-disclosure can amounts to negligent or fraudulent misrepresentation, damages given by common law is available.

2.5.2.3 Whether the assured's liability for broker's fraudulent non-disclosure can be excluded?

In some sectors, insurance contracts are devised and marketed by brokers as a 'product'. The 'product' is designed to be marketable to potential assureds and will usually have been negotiated by the broker with chosen leading underwriters beforehand. The brokers will thus quite often have a relationship with the leading underwriters which

[75] *Banque Keyser Ullmann section A. v Skandia (U.K.) Insurance Co. Ltd. And Others* [1990] 1 Q.B. 665, at p. 774. Salmond & Heuston on the Law of Torts, 19th ed. (1987), pp.435-436.

precede the broker's involvement with a would-be assured.[76] Under this circumstance, the assured may well intend to distance himself from the broking process and insulate himself from liability caused by the broker's non-disclosure or misrepresentation done through negligence even fraud.

It is clear that the law, on public policy grounds, does not permit contracting party to exclude liability for their own fraud inducing the making of the contract. Will the same rule apply to the broker's fraud and making it impossible for the assured to exclude his liability for the fraud of his agent?

In the *HIH* case, on the question of whether the truth of statement clause, which exonerated the assured from liability for the broker's misrepresentation and non-disclosure, covered fraudulent misrepresentation or dishonest non-disclosure, *Pearson & on Ltd v Dublin Corporation*[77] was considered in the House of Lords. The judges agreed that there was no clear majority ratio in that case which can be said to be a rule of law that the principal cannot exclude, by contract, his liability for the agent's fraud. However, it was clear that general language would not be construed to relieve a principal of liability for the fraud of an agent, only express words referring to dishonesty were clear enough to achieve that effect. Lord Bingham and Lord Hoffmann said that this was enough to make a decision on the fraudulent issue in the *HIH* case. Since the words used in the truth of statement clause were general words, the assured's liability for the broker's fraudulent non-disclosure cannot be excluded. Lord Hoffmann also said that there was no need to finally resolve the question in this case. The judges' opinions in previous cases relevant to such fraudulent issues were only *obiter dictum*, this suggested that it is extraordinarily unlikely that the parties to a contract will agree a term which excludes liability for fraud with sufficient clarity to raise squarely the question of whether it should be lawful to do so. It is dangerous to legislate for the unforeseeable.

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[76] *HIH Casualty & General Insurance Company & Others v. Chase Manhattan Bank & Others*. [2003] 2 Lloyd's Rep. 61, para. 86.

[77] [1907] A.C. 351.

Lord Scott agreed that there was a rule that a party cannot benefit from his own fraud or fraud of his alter ego. If there was such a contract clause which was designed to cover such fraud, it cannot be permitted to have that effect for public policy reasons. However he cast some doubt on whether the same rule applied where the contract clause was used to exclude the party's liability for fraudulent conduct by his agent. He said, when the question was whether the exclusion clause covered fraudulent, two issues were relevant. One was public policy; the other was the construction of the exclusion clause. He found no reason of public policy why a party should not be allowed to exclude his liability, by contract, for fraudulent misrepresentation and non-disclosure by his agent; In terms of construction, he said, the language used in the clause should be given its literal meaning if it was consistent with the commercial purpose of the clause. Since the truth of statement clause was purported to insulate the assured from the broking process, the general word should be given its full-inclusive width to cover fraud.

Although the judges in the House had different opinions on the fraudulent issue, the majority partly reversed the Court of Appeal's decision and decided that the assurd's liability for the agent's fraudulent non-disclosure was not excluded by the truth of statement clause.

During the debate, the assured brought up two authorities from New York court , where they sue other insurers, to show that a different approach would be taken there. One is *Chase Manhattan Bank v Axa Reinsurance UK plc*, the other is *Chase Manhattan Bank v New Hampshire Insurance Co. and Axa Reassurance section A*. The judge considered the truth of statement clause and said that

'Under well-established New York law, such express, detailed disclaimers preclude a claim of fraud based on misrepresentations within the scope of the disclaimers…'

However, Lord Bingham refused to accept that there was the same 'well-established' rule in English law.

The conclusion is that there is no conclusion on the issue whether there is a rule of law that the assured cannot exclude his liability for the broker's non-disclosure. However, in terms of construction, it is clear that general language cannot achieve that effect, only express word referring to dishonesty may exonerate the assured of liability caused by the broker's fraudulent non-disclosure.

2.6 Remedies for the broker's breach of duty of disclosure

2.6.1Avoidance of the contract of insurance

As opposed to section18 and section20, which expressly stipulate the remedy for breach of pre-contractual duty of disclosure by the insured or misrepresentation by the insured or his agent, section 19 does not set out the consequences when an agent to insure breaches the duty of disclosure. Nevertheless, it is well established that a breach of section 19(a) does give the insurer the right to avoid.[78]

As regards avoidance of the insurance contract, the relevant principles are as follows: if the agent to insure breaches the duty to disclose material facts, and the insurer can prove that he has been induced to enter the insurance contract as a result, the insurer is entitled to avoid that contract of insurance. In the absence of some special factor the remedy is not dependent upon whether the non-disclosure is made deliberately, recklessly, negligently or inadvertently. If the insurer does not elect to avoid the contract of insurance, then it remained valid and enforceable even though there had been a breach of the duty; and he does not have any right to claim damages against the agent to insure even if he has breached the duty of disclosure.

2.6.2 Exclusion of the avoidance

It is possible to exclude avoidance by clear contract terms. But a clause which purported to exclude or limit the duty of utmost good faith or the consequences of a breach of duty would have to evidence a clear intention to alter what would otherwise be the parties' duties and rights. The rules of construction applicable to exemption or indemnity

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[78]*Blackburn, Low & Co v Vigors* (1887) 12 App Cas 531. *HIH Casualty & General Insurance Company & Others v. Chase Manhattan Bank & Others* [2003] 2 Lloyd's Rep. 61.

clauses drawn in a wide and general way still apply in light of the factual matrix and commercial purpose objectively ascertained.[79]

2.6.3 Are damages available?

As has been discussed in section 5.2.2, the insurer can claim damages against the insured when the broker's fraudulent non-disclosure amounts to fraudulent misrepresentation. For pure non-disclosure, it was decided that it does not give rise to a claim in damages, even if the non-disclosure is made fraudulently.

In *Banque Keyser Ullmann section A.(UK) v Skandia (UK) Insurance co.Ltd.,*[80]syndicates of banks entered into separate loan agreements to provide finance for four companies owned or controlled by a businessman. Credit insurance policy was one of a series of securities provided for each loan. The banks were ranked as assued, co-assured or assignees under the policies. It was a condition of the loan agreements that the banks would advance the moneys only when they were satisfied that the securities were properly in place. In order to complete the first loan, L, the manager of the broker company who is in charge of the broking process, issued cover notes representing that cover was complete even if in fact it was not. D, the underwriter of the insurance company, were fully aware of L's deliberate concealment. Without reporting the matter either to the brokers or the insurance companies or the banks of L's deceit, D went on to write further loans. When the borrowing companies defaulted on the loan, because the businessman disappeared with the bank's money, and other securities were of little value, the banks looked to the insurers for recovery. Since there was a fraud exclusion clause, the insurers were not liable under the policies. However, the banks claimed that the insurers have breached their duty of utmost good faith, they should have disclosed the broker's fraudulent conduct, and such breach sounded in damages.

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[79] *HIH Casualty & General Insurance Company & Others v. Chase Manhattan Bank & Others*. [2003] 2 Lloyd's Rep. 61.

[80] [1990] 1 Q.B. 665 at pp.777-781(without a misrepresentation there can be no fraud in the sense of giving rise to a claim for damages in tort) and [1991] 2 A.C. 249 at p. 280 *per* Lord Templeman and p.281 *per* Lord Jauncey .

At first instance, the judge pointed out that when the insured became aware of the non-disclosrue after the occurrence of the contingency insured, avoidance of the policy and the return of the premium were inadequate relief. According to the principle '*ubi jus ibi remedium'*, the judge gave the bank the remedy by way of damages.

However, Slade L.J. in the Court of Appeal refused giving a remedy of damages to the assured. He said that

'The breach of the duty of disclosure itself cannot give rise to an action for damages, because no authority supports such a claim. The Act of 1906 and the judgements in many reported cases specifically refer to avoidance of the contract as the remedy for the breach of the obligation of disclosure in contracts of insurance, neither the Act of 1906 nor any reported case nor text book cited that a remedy by way of damages may also be available.'[81]

Therefore, he held that the principle '*ubi jus ibi remedium*' itself did not justify a decision to give the remedy of damages in a novel situation not covered by previous authority unless this is preceded by an analysis of the origin and nature of the right in question.

2.6.3.1 Not available in contract

The ground on which the banks relied on to claim damages was that the utmost good faith principle, and therefore the duty of disclosure, was an implied term of an insurance contract. Slade L.J. first rebutted the bank's grounds of argument that the wording of section 17 and the post-contractual duty of disclosure recognised in the *Litsion Pride* case were in support of the implied term view. Then he cited the observations of Esher L.J. in the Court of Appeal in *Blackburn, Low & Co. v Vigors*

[81] [1990] 1 Q.B. 665, at p. 775.

‘But if this be correct, the contract should never be set aside or treated as avoid on the ground of concealment; the contract should stand and be treated as broken by the assured.’ [82]

Esher L.J. took the duty of disclosure as a condition precedent to the right of the assured to insist on enforcement of the contract. This view was concurred by Lord Watson, Lord Fitzgerald and Lord Macnaghten in the House of Lords. Slade L. J. also took this view and added that the condition referred to by Esher L.J. was not promissory condition, but contingent condition, failed of which gave no right of action for breach but simply suspends the obligations of one or both of the parties. Moreover, Slade L.J. said that the remedy of avoidance for non-disclosure, like that for misrepresentation, ‘depends not on any implied term of the contract but arises by reason of the jurisdiction originally exercised by the courts of equity to prevent imposition.’[83]

2.6.3.2 Not available in tort

Slade L.J. pointed out that there was no authority whatever to support the existence of such a tort by breaching the duty of disclosure. He also refused to create a novel tort for the duty of disclosure on the ground of the following reasons.

First, since duress and undue influence, which also stem from the same jurisdiction as that of non-disclosure, gave rise to no claim for damages, the outcome should be the same for non-disclosure. Secondly, since the criterion to establish the effect of the non-disclosure is an object one, that is the effect of the non-disclosure on the mind of a notional prudent insurer or insured, not the relevant insurer or insured, it was hard to evaluate the damage if the non-disclosure had no effect on the relevant insurer or insured. Thirdly, no remedy of damages was mentioned in section 17-20 in the 1906 Act, it only referred to the remedy of avoidance. Fourthly, duty of disclosure is an absolute one, if damages could be awarded to non-disclosure even if no fault was involved in the process, it will cause hardship to both insurers and assureds.

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[82] (1886) 17 Q.B.C. 553, at p.561.

[83] *Banque Keyser Ullmann section A. v Skandia (U.K.) Insurance Co. Ltd. And Others* [1990] 1 Q.B. 665, at p. 779. *Merchants and Manufacturers Insurance Co Ltd v Hunt* [1941] 1 K.B. 295, at p.318.

The second reason, which was based on the decision in *Container Transport International Inc. v Oceanus Mutual Underwriting Association (Bermuda) Ltd*,[84] is no longer applicable. Since the case *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*[85], the test for establishing a non-disclosure includes, in addition to the objective one, a subjective one which requires the party who wants to exercise the right of avoidance to prove that he had been induced by the non-disclosure of material facts.

2.6.3.3 Not available as a fiduciary duty

At first instance of *Banque Keyser Ullmann section A.(UK) v Skandia (UK) Insurance co.Ltd.,*[86], Steyn, J. also rejected an argument based on alleged fiduciary duties owed by the insurers to the bank. [87]

If the banks' right to full disclosure of material facts is founded neither on tort nor on contract nor on the existence of a fiduciary duty nor on statute, it is difficult to see how, as a matter of legal analysis, it can be said to found a claim for damages.

There is another possible way by which damages could be claimed by the victim of non-disclosure, which is when the conduct of non-disclosure itself constitutes the tort of deceit. However, the general rule is that mere passive non-disclosure of the truth, however deceptive, does not amount to deceit in law.[88]

In sum, only pure non-disclosure will not give rise to a right to recover damages to the victim of a non-disclosure, avoidance is the sole remedy. If the non-disclosure can be amounted to misrepresentation, damages given by common law is available.

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[84] [1984] 1 Lloyd's Rep. 476.

[85] [1995] 1 A.C. 501.

[86] [1990] 1 Q.B. 665 at pp.777-781(without a misrepresentation there can be no fraud in the sense of giving rise to a claim for damages in tort) and [1991] 2 A.C. 249 at p 280 *per* Lord Templeman and p.281 per Lord Jauncey …

[87] [1987] 1 Lloyd's Rep. 69, at p.102, col.2.

[88] *Banque Keyser Ullmann section A. v Skandia (U.K.) Insurance Co. Ltd. And Others* [1990] 1 Q.B. 665, at p. 774. Salmond & Heuston on the Law of Torts, 19th ed.(1987), pp.435-436.

This decision was applied in *HIH Casualty & General Insurance Company & Others v Chase Manhattan Bank & Others,*[89] where it was held that pure non-disclosure, whether dishonest or otherwise, did not give rise to a claim in damages.[90]

2.7 Reform

2.7.1 The problems under current law

The remedy for the broker's breach of duty of disclosure is unfair to the assured in the following ways

(1) Disproportionate

The present law is that the insurer can completely avoid the contract and all liabilities if he is induced to enter into a contract with an insured by the insured's or the broker's non-disclosure of material information. It deprives the assured of a recovery for a genuine loss even if the non-disclosure is made inadvertently and had no bearing on the risk which brought about the loss.

(2) Not mutually sound

Although the insured and the insurer are under a mutual duty of utmost good faith, it tends to operate in favour of the insurer and against the insured. On one hand, as discussed in the last section, when the assured or broker failed to disclose a material information to the insurer, the remedy may be disproportionate to the measure of fault of the assured or the broker. On the other hand, when the assured suffers losses on account of non-disclosure on the part the insurer, recession of the insurance contract and return of the premium will not be sufficient remedies for the assured, since he cannot recover the losses from the insurer which should have been covered under the insurance contract. If the assured does not want to lose the cover and continue with contract, he has no other remedy to redress the loss he suffered from the insurer's non-disclosure. For example, if he had paid an excessive premium, he has no right to claim it back on the ground of the broker's non-disclosure. The remedy was all or nothing. It lacks

[89] [2003] 1 Lloyd's Rep. I.R. 230.

[90] [2003] 1 Lloyd's Rep. I.R. 230, at para. 75.

flexibility. In the absence of discretion for the court, the law cannot produce a satisfactory result.

(3) Extended duty of disclosure for the assured

Section19 (a) applies when the information is known to the agent only. If the assured also knows the information, that situation falls within section 18(1). The consequence of the broker's failure to disclose is that the assured will lose his right of recovery under the insurance contract even if he has no knowledge of the information, let alone any fault on the part of the assured. This amounts to an extended duty of disclosure of unknown facts imposed on the assured.

The remedy is especially unfair to the assured where the brokers devises the contract of insurance and promote it in the market as a 'product'. Before approaching the potential assureds, the brokers may have already negotiated with the chosen leading insurers as to the terms and rates of the insurance contracts. Such brokers have far greater expertise and ability than the assured to judge the extent of the risks and what circumstances are material to them. This is what had happened in the case *HIH Casualty and General Insurance Ltd and others v Chase Manhattan Bank and others*. [91]In the House of Lords, Lord Hobhouse pointed out two problems for the assured caused by the current remedy available for breach of duty of utmost good faith: 'the first is that the insurer's only remedy for non-disclosure and the insurer's primary remedy for misrepresentation is the avoidance of the policy. The breach of duty on the part of the broker thus directly damages the position of the assured and, because it may lead to a claim over by the assured against the broker, only indirectly damages the position of the broker. The second is that, if the broker's breach of duty is accompanied by some fault amounting to a common law or statutory tort, the insurer may seek to make the assured vicariously liable for the tort of his agent, the broker, even though, as in the present case, no allegation of actual fault or breach of duty by the assured is alleged.'[92]

(4) Section 19(b)

In 2007, it was noted that section 19(b) of the 1906 Act merely replicated the

[91] [2003] 1 Lloyd's Rep. I.R. 230.

[92] [2003] 1 Lloyd's Rep. I.R. 230, para. 89.

policyholder's duty under section 18. It did not offer the insurer any rights which were not already granted under section 18 and appears redundant.[93] The responses received by the Law Commissions also indicated that the provision was otiose. Therefore, it was proposed in Consultation Paper 2012 that section 19(b) should be repealed entirely.[94]

Section 19(b) was relatively uncontroversial, the following discussion will focus on the reform of section 19(a).

2.7.2 Australian Law Reform Commission (ALRC)

Since the Australian legal system is also common law system and the Marine Insurance Act 1909(MIA1909) is the equivalent of Marine Insurance Act 1906 in Australia, it would be worthwhile investigating the Australian experience of the reform of insurance law by the Insurance Contracts Act 1984 (Cth),[95] and the ALRC report No. 91 on the Review of the Common wealth Marine Insurance Act 1909.

A type of proportionality has been adopted in Australia in general insurance law: Insurance Contract Act 1984 section 28. A similar solution was advocated in the ALRC report 91.

2.7.2.1 ICA 1984

The ICA 1984 has significantly reformed the law relating to remedies for non-disclosure or misrepresentation in the context of non-marine and pleasure craft insurance. Under ICA s28, the insurers are entitled to avoid the contract from its inception only where the non-disclosure or misrepresentation was fraudulent.[96] When the insurer is not entitled to avoid the contract, or the insurer elected not to do so, 'the liability of the insurer in respect of a claim is reduced to the amount that would place the insurer in a position in

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[93] Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured, para.9.77

[94]Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured, para.7.77.

[95] See Robert Merkin, Reforming insurance law: Is there a case for reverse Transportation? available at http://www.lawcom.gov.uk/docs/merkin_report.pdf.

[96] ICA 1984 section 28 (2).

which the insurer would have been if the failure had not occurred or the misrepresentation had not been made.'[97]

It might be asked whether an insurer will be allowed to reduce its liability to nil where it can be established that the insurer would not have accepted the cover, were it not for the insured's and it's agent's non-disclosure. The decisions of several state supreme courts in Australia have proceeded on the basis that an insurer may reduce its liability to nil;[98] and thus answered the question in affirmative.

The ALRC also pointed out that applying ICA section 28(3) involves a number of evidentiary complications, including ascertaining whether the actual insurer would have entered into the contract and if so, on what terms, had there been no misrepresentation or failure to disclose.[99]

2.7.2.2 ALRC report 91

In addition to the ICA 1984 approach, the ALRC report 91, which reviewed MIA 1909 and aiming for a reform of the Act, provided other options, among which was one suggested by Dr. Derrington that accorded with the Norwegian Marine Insurance Plan.

In Norway, the contract of insurance is not binding on the insurer if the nondisclosure is fraudulent. It is irrelevant whether the non-disclosed information caused the loss or not.[100] If the person effecting the contract of insurance breached the duty of disclosure inadvertently, the insurer is liable as if correct information had been given, but he may terminate the insurance by giving fourteen days' notice.[101] For other breaches of duty of disclosure, different remedies are available for different situations. If the insurers would

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[97] ICA 1984 section 28 (3).

[98] See eg *Ayoub v Lombard Insurance Co (Australian) Ltd* (1989) 166 CLR 606, 621–2; *Twenty-First Maylux Pty Ltd v Mercantile Mutual Insurance* (Aust) Ltd [1990] VR 919, 927–8; *Orb Holdings Pty Ltd v Lombard Insurance Co (Australian) Ltd* [1995] 2 Qd R 51, 52 and other cases cited in *Unity Insurance v Rocco Pezzano* (1998) 192 CLR 603, 636 (Kirby J), 648 (Hayne J).

[99] ALRC Report 91, para.10.106.

[100]The Norwegian Marine Insurance Plan.§3-2.

[101] The Norwegian Marine Insurance Plan.§3-4.

not have accepted the risk, the contract is not binding and liability may be avoided; if the insurer would have accepted the risk but on different conditions, he shall only be liable to the extent that it is proved that the loss is not attributable to the non-disclosed situation. In the case of both the negligent and innocent non-disclosure, the insurer may terminate the contract on 14 days' notice.[102]

In essence, both the ICA 1984 and the Norwegian Marine Insurance Plan intended to limit the situation where the insurers can avoid the insurance contract from ab inito; and put the insurer in the position he would have been if the failure of disclosure had not occurred. The difference was that in Norwegian Marine Insurance Plan, the insurer is liable for the claim when the assured breached the duty of disclosure inadvertently, no matter whether the loss was caused by the non-disclosed information or not. However, under ICA 1984, the remedies did not make differentiation between innocent and negligent non-disclosure, it treats the innocent nondisclosure the same as negligent nondisclosure and the remedy depends upon what the insurers would have done if he knows the information at the time the contract is made. This is an improvement to the Norwegian Plan. As it has been noted in the ALRC report No.91, 'One shortcoming of any differentiation of remedies based on the insured's state of mind is that it fails to recognise that the impact on an insurer, even a prudent one, of any non-disclosure or misrepresentation will be determined by the nature and extent of that error, not by the insured's attitude. Although the Commission accepts that a fraudulent insured should be punished by a complete avoidance of the policy with no return of premium, whether the insured was negligent, even grossly so, or simply mistaken will not vary the effect on the insurer.'[103]

2.7.3 Law Commissions

2.7.3.1 The 1980 report

It should be noted that before the current insurance law reform project which started in 2006, the Law Commission considered the reforming of the insurance law in light of a

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[102] The Norwegian Marine Insurance Plan.§3-3.

[103] ALRC report 91 at para. 10.117.

proposed EEC insurance Directive (which never materialised) and published a report entitled 'Insurance Law: Non-disclosure and Breach of Warranty' in 1980.[104]In that report, the English Law Commission rejected the proportionality principle espoused by the Directive as an option for reforming the remedy for breach of the duty of disclosure mainly on the ground that it would be too difficult to assess the premium that would have been charged in hypothetical circumstances.[105] Moreover, it was stated that the recommendations made in the report would not apply to marine aviation and transport insurance (MAT) since the law worked satisfactorily in those areas.[106]

2.7.3.2 The current insurance contract law reform

The Law Commission and the Scottish Law Commission (the Law Commissions) are conducting a joint review of insurance contract law. The project began in January 2006 with a joint scoping paper published in August 2006 setting out the scope of the project. Among other topics, misrepresentation and non-disclosure were included within the review. Later, the Law Commissions published two Issues Papers on Misrepresentation and Non-Disclosure (September 2006), Intermediaries and Pre-Contract Information (March 2007) inviting views on these issues relating to consumer insurance and business insurance respectively.

In the light of the responses received, the Law Commissions published the first consultation paper covering pre-contract issues in consumer and business insurance. Having completed the consultation process on consumer insurance, the Law Commissions published the first report on consumer insurance law. It later became the Consumer Insurance (Disclosure and misrepresentations) Bill, now the Consumer Insurance (Disclosure and Representations) Act 2012.

The issues of pre-contract disclosure, misrepresentation and warranties under business insurance law were reviewed in the third consultation paper which was published in 2012.

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[104] Law Com. No. 104 (1980). Cmnd.8064.

[105] Law Com. No. 104 (1980). Cmnd.8064, para. 4.8.

[106] Law Com. No. 104 (1980). Cmnd.8064, para. 2.8.

(A) For consumer insurance

According to Consumer Insurance (Disclosure and Representations) Act 2012, the consumers no longer have a duty of disclosure before a consumer insurance contract is entered into.[107] It is the duty of the consumer to take reasonable care not to make a misrepresentation to the insurer.[108] The application of section 17 of the Marine Insurance Act 1906, in relation to a contract of marine insurance which is a consumer insurance contract, is subject to the provisions of this Act.[109]

(B) For business insurance

In the business context, the view is that the duty of disclosure should be retained for the following reasons

'(1) The duty of disclosure has become part of the way the UK business insurance market works. For many business policies, there is no proposal form. Instead the broker presents the risk, and the underwriter relies on the broker and client to present that risk honestly.

(2) Business insurance involves a much greater variety of unusual risks than consumer insurance. That would make it harder for the insurer to ask questions about all relevant matters.

(3) A greater proportion of business insurance is conducted through full-time professional intermediaries, who can advise as to what is required. This means that the risk of an insured not realising that it has a general duty to disclose is reduced.

(4) Requiring insurers to ask questions even when both parties are sophisticated in insurance matters could lead to an empty formalism. If underwriters ask a general question such as 'and finally, is there anything else that we should know about?' the duty would effectively be restored.'[110]

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[107] Consumer Insurance (Disclosure and Representations) Act 2012, section 2(4).

[108] Consumer Insurance (Disclosure and Representations) Act 2012, section 2(2).

[109] Consumer Insurance (Disclosure and Representations) Act 2012, section 2(5)(b).

[110] Consultation Paper 2007, Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured, para. 5.27.

However, it is agreed that the scope of the duty should be restricted and the remedy should be more flexible.

(a) Change the materiality test

On the other hand, it was also agreed that the scope of the duty should be modified to meet the reasonable expectations of the insured and to protect those who act honestly and reasonably.

One of the recommendations is by limiting the scope of the duty by changing the current ‘prudent insurer’ test to ‘reasonable insured’ test. That means the insureds should no longer be required to disclose everything a prudent underwriter would want to know. Instead, an insured would only need to disclose a matter if a reasonable insured in the circumstances would realise that it would be relevant to an underwriter.

(b) The remedies for breach of duty of disclosure

The law commission proposed to apply different remedies in different situations categorised by the assured’s state of mind. [111]

(i) For Deliberate or reckless non-disclosure by the insured, the insurer is entitled to avoid the policy.

(ii) For Negligent non-disclosure, where the insured did not show the degree of care required, the insurer would receive a compensatory remedy, based on what the insurer would have done had it known the correct information.

(1) Where an insurer would have declined the risk altogether, the policy would be avoided and the claim may be refused.

(2) Where an insurer would have contracted on different terms, the policy would be treated as if it contained those terms. For example if the insurer would have excluded a particular type of claim, the insurer should not be obliged to pay claims that would fall within the exclusion. If an insurer would have imposed a

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[111] Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured, para. 5.87.

warranty or excess, the claim should be treated as if the policy included the warranty or excess;

(3) If an insurer would have charged more premium, the claim should be reduced proportionately to the under-payment of premium.

(iii) if an insured has acted both honestly and carefully (that is without negligence) in giving pre-contract information, the insurer should not be entitled to refuse to pay the claim, or to avoid the policy, on the ground that there was a non-disclosure.

(iv) The effect of the non-disclosure for the future cover

It was proposed that where the insured has made a negligent non-disclosure, the insurers should be entitled to cancel the policy for the future. When exercising this right, the insurer should give a reasonable notice and return a proportionate part of the premium. The claims arise before the cancellation is not affected.[112]

(c) The responsible party for the broker's breach of duty of disclosure

The Law Commission's tentative suggestion for this issue was that 'where a broker breaches section 19(a), the insurer should no longer be entitled to avoid the policy against the insured. Instead, a remedy in damages should lie against the broker.'[113]

These have been said, the parties remain free to agree what they want.

2.7.4 Recommendations for reform

2.7.4.1the remedies for breach of duty of disclosure

(A) Fraudulent non-disclosure

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[112] Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured para. 5.106.

[113] Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured para. 10.73.

There is not much dispute on the remedy for fraudulent non-disclosure, which is avoidance of the insurance contract. Where an insured has induced the insurer entering into the contract by fraudulent conduct, it is right that a penalty should be imposed.

(B) Negligent non-disclosure

An insurer's right to avoid a policy in all circumstances over-compensates the insurer for the loss it has suffered. The Law Commissions suggested that for negligent misrepresentations, the remedy should depend on what the insurer would have done had it known the full facts.[114]

The Law Commission's proposed a 'compensatory remedy' for the reform of the remedies for breach of duty of disclosure which is effectively the approach adopted by the Australian ICA 1984, section 28(3). [115]

The Law Commissions noted that proportionality was rejected in the 1980 report as an option on two main grounds. The first is that an insurer may have different reactions to the non-disclosed information, for example declining the risk altogether; imposing additional warranties; imposing an exclusion clause; or increasing the excess which the insured must bear. The proportionality principle would be useful only where the insurer would have charged a higher premium. Secondly, it was said that it would be too difficult to calculate how much the premium would have been in hypothetical circumstances.[116]

The Law Commissions agreed with the first argument. However, it was said that the difficulties were exaggerated. 'As the National Consumer Council pointed out, the Insurance Ombudsman Bureau applied proportionality, and its current successor, the FOS also does so. We found cases in FOS files where they had no trouble in dealing

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[114] Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured para. 5.18.

[115] Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured para. 4.158.

[116] Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured 4.160, 4.161.

with an exclusion that would have been added, or in working out the effect on a premium of an additional motoring conviction. The approach appears to have gained acceptance from the industry, and we note that it also has the support of the British Insurance Law Association.'[117]

Sir A. Longmore has once commented on the proportionality remedy and its interaction with the reform of the materiality test. 'It wold not be so necessary if there were to be reform of the law to adopt the reasonable insured test since, if an insured cannot recover on that test, he would only have himself to blame; it may well be for this reason that the Law Commission did not consider the proposal (proportionality remedy) in any substantial detail. But if the tests for disclosure and misrepresentation are to remain as they are, a discretionary apportionment of the loss has much to recommend it. It would, of course, lead to some uncertainty but that, after all, was a reason against the introduction of the concept of contributory negligence which, in the event, is a concept that has worn the test of time very well.' [118]

It is suggested that the compensatory remedy is suitable for negligent non-disclosure.

(C) Innocent non-disclosure

The proposal for the remedy for innocent non-disclosure was that the insurers are not allowed to refuse the claim or avoid the contract of insurance. The Law Commissions reasons were that for innocent non-disclosure, the assured should be protected. 'It would bring the law into line with good market practice and with what we believe business insureds reasonably expect.… we think the normal expectation is that an insured who was not at fault in giving incorrect or incomplete pre-contract information should be entitled to claim on the policy'.[119]

However, this approach only pays attention to the assured's state of mind, but did not consider the impact of the non-disclosed information on the insurer. It may cause

[117] Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured para. 4.162.

[118] Sir A. Longmore, 'An Insurance Contracts Act for a New Century' [2001] *L.M.C.L.Q.* 356, at p. 366.

[119] Consultation Paper 2007 INSURANCE CONTRACT LAW: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured para. 5.51.

unfairness to the insurer. The author's view is that the requirement of causation should be introduced in assessing the remedy. If the non-disclosed facts caused the loss, the insurers should be able to decline the claim; if the non-disclosed facts have no causal connection with the loss, the insurers should indemnify the assured as if there is no such non-disclosure; and the insurers should have the option to terminate the contract for the future with reasonable notice in both of the two situations.

As an alternative, the law need not differentiate between negligent and innocent non-disclosure, like Australian Insurance Contract Act 1984 section 28(3), the insurer's liability is assessed by the situation he might be in if he knows the non-disclosed information. This is the approach which had been adopted in the 2012 Consultation Paper 3. [120]

It is also suggested that the right to cancel the contract for the future should also be available to the insurers for innocent non-disclosure with reasonable notice. Because the insurers should be allowed to make their own decisions when they have a full picture of the situation; besides, with a reasonable notice period, the assured is able to find an alternative cover.

2.7.4.2 The responsible party for the broker's breach of duty of disclosure

(A) In law

In *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank and Others,*[121] the issue of whether an insurer could claim damages from an agent to insure who failed to disclose material facts was raised 9.at first instance.
Aikins J. refused the submission that an insurer can claim damages from an agent to insure who is in breach of its duty to disclose material facts as part of the duty of utmost good faith. The judge agreed that the broker's duty of disclosure under section 19 was independent, but he pointed it out that the duty is also derivative. 'While an agent was under an independent obligation to make disclosure of material facts, the agent's duty of

[120] Consultation Paper 2012, INSURANCE CONTRACT LAW: the business insured's duty of disclosure and the law of warranties, para. 9.9.
[121] [2003] 2 Lloyd's Rep. 61.

disclosure arose out of the obligation of the assured, acting personally and through its agent to insure, to exercise the utmost good faith.'[122]

The judge then refused to hold that the insurer have any right to claim damages from the broker for a failure to disclose material facts, apart from the duty of utmost good faith. He found that the law did not impose a duty to speak up on an agent in relation to a contract of insurance or a contract for insurance. Accordingly there can be no right to damages for non-disclosure in that case.

Moreover, the fact that the parties agreed that the insurer was not to have the remedy of avoidance of the contract of insurance is not a factor that could by itself create a new type of remedy, damages; let alone a new remedy against a different party, the broker.

This issue was not appealed either in the Court of Appeal or House of Lords.

However, in the Issues Paper 3, the Law Commissions provisionally proposed to replace the insurer's right to avoid by a right to claim damages from the agent when the agent to insure failed to disclose material information.

Under agency law, 'where loss or damage is caused to any third party by any wrongful act or omission of an agent while acting on behalf of his principal, the agent is, in general, personally liable, whether he was acting with the authority of the principal or not, to the same extent as if he was acting on his own behalf;'[123] 'where the principal is liable for the torts of his agent, they are in principle to be regarded as joint tortfeasors.'[124] The injured party can choose from whom to claim the damages.

It is evident that there is no difficulty in making the broker responsible for his own fault. The problem here is that no common law tort can be established for the broker's breaching duty of disclosure, except that under duty of utmost good faith. This problem

[122] *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank and Others* [2003] 2 Lloyd's Rep. 61 at p.57 col.1.

[123] Bowstead on Agency Law 19th ed., para. 9-115.

[124] Bowstead on Agency Law 19th ed., para. 8-190.

can be solved by imposing a legislative tort on the broker by changing the Marine Insurance Act. However, it should be asked whether it is fair to make the insurer bear the risk of claiming damages from the brokers. This should be considered on the feed backs from the insurers and brokers for the Law Commissions consultation papers. At present, the author has the following considerations.

(B) In practice

Making the insurer claim damages from the broker may encourage the assured instructing the less competent brokers, although not intended, for example because of the less fees they charge, to obtain cover for them and make the insurers bear the risk of the broker's carelessness. It is especially unfair to make the insurer responsible for the fraudulent conduct of the broker who is chosen by the assured.

It may be argued that the brokers may be better known by the insurers who also do business in the London market than the assured who are from foreign countries. However, it is not always the case, and the default rule should comply with the general principle that the principal should bear the risks of his agent's wrong, not the third party. Besides, the parties are always free to contract out the default rule and tailor it to their own needs by express contract terms.

(C) In light of the reform

If the remedy of avoidance is replaced by the compensatory remedy for breach of duty of disclosure in non-fraudulent situations, the outcome will be more reasonable for the assured, it is not unfair to make the assured responsible for the broker's mistakes. In the ultimate analysis, the broker is the agent of the assured. Therefore, it was proposed, in the 2012 Consultation Paper 3, that the law would not change in this respect. [125]

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[125] Consultation Paper 2012, INSURANCE CONTRACT LAW: the business insured's duty of disclosure and the law of warranties, para. 7.46.

Chapter 3 Broker's Duty to Pay the Premium

3.1 Introduction

That the broker is personally liable for the payment of premium is one of the distinguishing characteristics of marine insurance contracts. Under other insurance contracts, no personal liability for the payment of premium is borne by the brokers. They simply pass on the premium received from the assured to the insurer. Under general agency law, the intermediary neither assumes any duties, nor has any rights under the contract between his principal and the third party. Then what is this payment of premium rule under a marine insurance contract? What are the legal and commercial reasons for its coming into being? What are the problems caused by the application of the legal fiction which was used to rationalise the broker's duty to pay premium at common law? What is the scope of application of the rule? Can it be ousted and how? Does it still need to be remained as an exception to the general rule of law?

3.2. The broker's payment of premium rule

Section 53 (1) of Marine Insurance Act 1906 (MIA 1906 or the Act) stipulates that 'unless otherwise agreed, where a marine policy is effected on behalf of the assured by a 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'. As a consequence, (i) the insurers can only look to the brokers for the payment of the premiums, they cannot turn to the assured when the brokers failed to do so; (ii) only the assured are entitled to claim the losses and any returnable premiums from the insurer; (iii) the unpaid premiums cannot be set off with the losses and returnable premiums when the assured claimed for them.[126]

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[126] When the broker collected the losses and returned premium on behalf of the assured, he can set off the claims proceeds and the returned premiums against the unpaid premiums and other costs relating to the effecting of the policy owed by the assured. *Eide U.K. Ltd. and another v Lowndes Lambert Group Ltd. and another* [1999] Q.B. 199.

This section is a codification of the mercantile custom founded in the ancient marine insurance market in London, especially at Lloyd's. As Bayley J. described the custom in *Power v Butcher*, 'according to the ordinary course of trade between the assured, the broker, and the underwriter, the assured do 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 unknown, looks to the broker for payment, and he to the assured.' [127]

In many cases, more than one broker will be involved in the placement of insurance. The assured's broker (the producing broker) may appoint a placing broker to place the cover where the producing broker is located abroad, or lack the expertise for a special cover, or because he has no access to the Lloyd's market. If more than one broker is involved in the placement of insurance, it is the placing broker who will be responsible for payment of premium to the insurer.[128] The placing broker then turns to the producing broker for the payment and the producing broker look to the assured for payment.

Before the Act was passed, this custom has already been widely recognized by the courts.[129] But the judges have expressed different views on the legal basis of this rule.

3.3. The legal basis of the Rule

Under the general law of agency, an intermediary does not have any right or obligation under the contract between his principal and the third party. Thus an insurance broker cannot be personally liable for the payment of the premium, which should be the duty of the assured who benefits from the policy. Why is it an exceptional case for the marine insurance broker? From the commercial respect, the custom is justified on the ground

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[127] (1829) 10 B & C 329, at p. 339-340.

[128] *Prentis Donegan & Partners Ltd. v Leeds & Leeds Co. Inc.* [1998] 2 Lloyd's Rep. 326.

[129] *Wilson v Creighton* (1782) 3 Dougl 132; *Edgar v Fowler* (1803) 3 East. 221; *De Gaminde v Pigou* (1812) 4 Taunt. 246; *Power v Butcher* (1829) 10 B & C 329; *Universal Insurance Company of Milan v Merchants Marine Insurance Company* [1897] 2 Q.B. 93.

that the insurer is more familiar with the broker than the assured, therefore he intend to give credit to the broker rather than the assured;[130] also, the account between the broker and the insurer provides a more convenient way to pay the premium.[131] As a matter of law, the judges tried different ways to explain the judiciary bases for the rule.

3.3.1 The broker's role in dealing with the premium

There are opinions which explain the broker's liability to pay premiums by indicating his special position in dealing with the premium. In *Power v Butcher,*[132] several policies were effected by an insurance broker on behalf of the shipowners with the company of which the broker was a member. According to the rules of the company, only members of the company were allowed to effect insurance with them. Therefore, the names of the shipowners were not mentioned in any of the policies. Moreover, it was recited in the policies that the broker was interested in or duly authorised as owner, agent or otherwise to make assurance upon the vessel mentioned in each policy, and had covenanted with the company to pay the premium in respect of each of the policies to the company; and it was alleged that in consideration of such covenant the policies were effected. The broker paid the premium in respect of two policies to the company. Later, the broker became bankrupt and did not pay any of the other premiums. The assignee of the broker commenced an action against the shipowners to recover the premiums and work and labour. In delivering the reasons for awarding the sum the assignee of the broker claimed for, Bayley J. stated that the broker is not solely an agent, but a principal to receive the premium from the assured and pay it to the underwriter. One problem that will be brought up by this reasoning is when the payment of premium obligation is discharged. Is it the time when the broker received the premium from the assured or when the broker paid out the premium to the insurer? The same problem will arise if the broke is taken as a 'dual agent'[133] or 'common agent'.[134] However, Bayley J.'s

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[130] *Wilson v Creighton* (1782) 3 Dougl 132; *Universal Insurance Company of Milan v Merchants Marine Insurance Company* [1897] 2 Q B 93.

[131] *Universal Insurance Company of Milan v Merchants Marine Insurance Company* [1897] 2 Q B 93.

[132] (1829) 10 B & C 329, at p.339

[133] *Per* Brian Neil J. in J. *A Chapman and Company Ltd v Kadirga Denizcilik ve Ticaret AS* [1988] Lloyd's Rep. I.R. 377.

statement in *Power v Butcher* may be justified by the facts of that case. There, none of the assureds' names appeared on the policy but it appeared to have been made with the broker who was the member of the company. [135]

3.3.2 The fiction

The mainstream of the judicial opinions used to support the legal fiction designed to give effect to the broker's liability to pay the premiums. In *Power v Butcher*, Parke J. stated: 'By the course of dealing, the broker has an account with the underwriter; in that account the broker gives the underwriter credit for the premium when the policy is effected, and he, as the agent of both the assured and the underwriter, is considered as having paid the premium to the underwriter, and the latter as having lent it to the broker again, and so becoming his creditor.' [136]

The fiction made the premium a debt between the insurer and the broker. In *Universo Insurance Company of Milan v Merchants Marine Insurance Company*[137] and *Xenos v Wickham,*[138] the fiction was also used to rationalise at law the commercial custom that the broker is liable for the payment of premium under marine insurance policies.

The theory of the fiction is not one contradicting the broker's role. Actually, Parke J. also regarded the broker as the dual agent of the assured and the underwriter. These are only two different ways to explain, from the legal perspective, why brokers bear the liability for the payment of premium under marine policies.

3.3.3 The law itself – section 53 (1)

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[134] *Per* Lord Ellenborough in *Shee v Clarkson* [1810] 12 East 507.

[135] 'Lloyd's policies from the time Lloyd's was established have been always made in the name of the insurance broker on printed forms. The broker insures for the benefit of all whom it may concern, and the broker can bring an action, and is the person to sue and recover according to the interests of the parties.' *Lloyd's v Harper* (1880) 16 Ch.D. 290 at p.321.

[136] (1829) 10 B & C 329.

[137] [1897] 1 Q.B. 205.

[138] 14 C.B. (N.S.) 435.

The current judicial opinions on the legal basis of the broker's liability to pay the premiums tend to prefer the law itself—s.53 (1), rather than the common law fiction. This is evident from the cases from J. *A Chapman & Co Ltd v Kadirga Denizcilik Ve Ticaret,*[139] to *Heath Lambert v Sociedad de Corretaje de Seguros and Another,*[140] to *Allianz Insurance Company Egypt v Aigaion Insurance Company section A,*[141] These cases will be further discussed in the next part.

3.4. The difficulties caused by the application of the fiction

Before the Chapman case, 'the fiction' was more frequently used as the explanation for the broker's liability rule. However, the application of the fiction had made some complexities when construed together with some contract terms under the modern law. Reading the fiction into section 53 (1) also conflicts with other section in the Act.

3.4.1 Conflict with contract terms

There were some decisions suggested that the fiction had survived the codification of section 53 (1) and thus making some contract terms which were inconsistent with the fiction ineffective. There are other decisions which suggested that there was no need to refer to any fiction to establish broker's liability to pay premiums, it was section 53 (1) itself that today governs that liability. This gave rise to a conflict in the authorities as to whether and to what extent one can rely on the fiction that is said to be the basis of the payment of premium rule in marine insurance.

The controversy starts from the case *Black King Shipping Corporation and Wayang (Panama) SA. v Mark Ranald Massie (the 'Litsion Pride'),*[142] where the shipowners insured the vessel named 'Litsion Pride' against war risks with the underwriters. The policy incorporated the War Risk Trading Warranties which may result in additional premium if the vessel sailed for or being within the high risk areas described in the

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[139] [1998] C.L.C. 860, at p.865.

[140] [2004] EWCA Civ. 792.

[141] [2008] EWHC 1127 (Comm), at para.66.

[142] [1985] 1 Lloyd's Rep. 437.

Current Exclusions and proper notice was given. The vessel went to Bandar Khomeini at the time when it was the most dangerous port in the Persian Gulf attracting additional premium at a very substantial rate. The notice dated 2 August 1982 was only received by the broker on 12 August 1982 after the risks happened on 9 August 1982. When the claimant claimed under the policy, the underwriters refused to pay on the ground that the notification requirement was a condition precedent to the underwriters' liability for loss in an additional premium area, and the shipowners and/or brokers were fraudulent or at least in breach of a duty of utmost good faith to the underwriters. The issues under consideration before the court are construction of the trading warranties clause and fraud and bad faith. The vessel was mortgaged and the morgagees are the effective claimant. In arguing against the bad faith, the representative for the claimant relied on section 53 (1) to show that even if the intention of the owners was to conceal their knowledge of the vessel's E.T.A. and its discharge port to put off the payment of the premium, which would be a breach of duty to the brokers not to the underwriters. Since the assured owed the premiums to the brokers not to the underwriters. The representative for the defendant argued that section 53 (1) would never apply to the additional premium, because it was only fixed after the risk had incepted, and this is incompatible with the fiction underlying section 53 (1), by which the premium was deemed to have been paid to the underwriter and lent back to the broker at the beginning of the contract. So the additional premium fell in the cases which were otherwise agreed. Hirst J. agreed with the defendant’s explanation for ousting out section 53 (1) on the ground that the payment of additional premium is incompatible with the fiction. This decision indicated that the common law fiction did survive the codification of section 53 (1).

In *Prentis Donegan & Partners Ltd. v Leeds & Leeds Co.Inc,*[143] the fiction was not only used to explain who is responsible for the payment of premium under marine policy,[144] but also when the liability is fulfilled. This case concerned with marine insurance placed

[143] [1998] 2 Lloyd’s Rep. 326.

[144] [1998] 2 Lloyd’s Rep. 326, at p.334 Rix J. said that by reason of the loan fiction, the broker remains liable for the payment of the premium, even if the policy has an express clause requiring the assured to pay the underwriters.

by Lloyd's brokers by the instructions of the New York brokers for their principal. The premium was agreed to be paid in four instalments. But only the first two instalments were paid to the Lloyd's brokers. So the Lloyd's brokers applied for summary judgment for the unpaid premium from the New York brokers. The New York brokers denied their liability and one of the arguments they raised was that the automatic termination clause brought an end to the policy and their liability to pay the premium. The automatic termination clause read as follows: 'This Policy shall automatically terminate… and all liability of Underwriters herein shall end at noon of the tenth day following non-payment of any of the last three instalments on the due date thereof…'

But the judge did not agree with that argument. Rix J. cited the paragraphs of Parke J. in *Power v Butcher*[145] and that of Collins J. in *Universo Insurance Company of Milan v Merchants Marine Insurance Company,*[146] both of which upheld the loan fiction that the premium is deemed to have been paid by the broker to the underwriter when the policy is effected, and loaned back by underwriter to the broker. On account of the fiction, the judge held that the automatic termination clause could not operate under English law to forfeit the policy, because the assured's obligation to pay the premium would always be timeously discharged.

By contrast, in *J. A Chapman and Company Ltd v Kadirga Denizcilik ve Ticaret AS,*[147] the judges expressed some doubt about the appropriateness of using the fiction to determine when the premium was deemed to be paid. In this case the broker effected marine policies on behalf of the shipowners. When the broker went into liquidation, the shipowners denied their liability to pay premiums to the broker. One of their arguments was that the premium warranty in the policies, which entitled the underwriter to be discharged from liability when the payment is not made within the time limit, was inconsistent with the fiction underlying section 53(1), by which the premium is deemed to have been paid when the policy is effected. Therefore, the payment of premium rule under section 53 (1) had been ousted. But this argument was not supported by the court.

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[145] (1829) 10 B & C 329, at p.347.

[146] [1897] 1 Q.B. 205, at p. 209.

[147] [1998] C.L.C. 860.

At the court of appeal, Sir Brian Neill agreed with the court below that since the enactment of the 1906 Act the legal relationship of the parties in respect of the payment of premium should be regulated by statute not the fiction. It might be more satisfactory to treat the broker as a 'dual agent' or 'an independent intermediary' and the parties have independent rights and obligations. If so, only clear wording can bring about a fundamental change in that relationship.

In the Court of Appeal in *Heath Lambert v Sociedad de Corretaje de Seguros and Another,*[148] Clarke L.J., with whom Phillips L.J. and Wall L.J. agreed, accepted Sir Brian Neill's observation that in the light of section 53 (1) of the 1906 Act, each of the three parties has independent rights and obligations. He further observed that in the absence of other specific agreement between the parties, those rights and obligations stem from the terms of the policy. As a result, the issue as to when the broker should pay premium to the insurer should be answered by the true construction of the terms of the policy. Although neither party raised the fiction as an argument in this case, it is evident from the court's opinion that the broker's obligation to pay premium was subject to the policy terms and not automatically satisfied by the fiction.

At first instance in *Allianz Insurance Company Egypt v Aigaion Insurance Company section A.*[149], H.H.J. Chambers was asked to deal with an issue, which did not arise for decision of the case, namely whether section 53 (1) of MIA 1906 embodies the fiction. The judge said that the wording of the section was clear that, without contrary agreement, the broker was liable for the payment of premium. There was no such fiction included in the section with the effect that no policy could be rendered invalid for non-payment of premium, because the premium was always be treated as having been paid by the assured at the commencement of the contract.

Since J. *A Chapman and Company Ltd v Kadirga Denizcilik ve Ticaret AS,*[150] the courts appear to be consistently of the view that the fiction is of no use in establishing the broker's liability to pay the premium, especially in construing when the premium is paid

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[148] [2004] EWCA Civ. 792.

[149] [2008] EWHC 1127 (Comm).

[150] [1988] C.L.C. 860.

by the broker to the underwriter. It is the statutory rule that gives effect to the broker's liability to pay the premium and it is the policy terms relating to the payment of premium that should be used to construe when the premium should be paid.

However, in the absence of express legislation to deal with the liability of the assured to the broker,[151] the fiction might still be of some use for limitation issues. If the broker asks for an indemnity in respect of the premium actually paid, the cause of action will accrue on payment; if the broker asks for indemnity in respect of premium deemed to have been paid, the cause of action accrues when the broker is deemed to have paid the premium. In the situation where there is no express term of the time for the payment of premium, when is the broker entitled to ask for the premium from the assured? The answer is that he can ask for the premium when the policy is effected. Because the fiction is that the premium is deemed to have been paid by the broker to the underwriter when the policy is effected and loaned back to the broker.

It should be admitted that the fiction made the commercial custom, by which the insurer looks to the broker for payment of premium rather than the assured, accommodated in common law before the statute MIA 1906 was established. But, since then, it has been the statute itself that governs the broker's liability to pay the premiums to the insurer, and it has been the contract terms that should be used to determine when the premium is due between the broker and the underwriter. No resort needs to be made to the fiction again to seek explanation as to who should pay the premium and when the premium should be paid. The fiction might only be useful to construe when the premium is due between the broker and the underwriter if the contract is silent about this matter.

3.4.2 Conflict with legislation

The opinion that the common law fiction exists alongside section 53 (1) not only conflicts with some payment clauses in the marine insurance contract, but is also incompatible with the provision in the Act. section 54 of MIA 1906 provides that: 'Where a marine policy effected on behalf of the assured by a broker acknowledges the

[151] Section53 (1) of MIA 1906 only recognized the broker's liability to the insurer for the payment of the premium, but it does not deal expressly with the relationship between the broker and the assured.

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 broker.'

The Law Commissions pointed out two contradictions between the common law fiction and section 54 in the Issues Paper 8. First, if the common law fiction was preserved under section 53 (1), the policyholder would always be deemed to have paid the insurer and the insurer would never be able to claim the premium from the policyholder, no matter whether there was any acknowledgment of payment in the policy or not. Section 54 would be rendered superfluous in this situation; secondly, under the fiction, the broker is deemed to have paid the premium to the insurer and borrowed it back. The amount became a debt between the insurer and the broker. The fact that section 54 provides that an acknowledgment in the policy is not conclusive as between the broker and the insurer is therefore contrary to the 'fiction of lending'.

Seen from the above, the fiction could not have been reinstated in the Act. It is section 53 (1) itself that governs the broker's liability to pay the premium under marine insurance.

3.5 The scope of application of the Rule

3.5.1 Marine insurance both at Lloyd's and in the company market

It can be seen from *Wilson v Creighton*[152] that the broker's personal liability to pay marine insurance premium had already existed in 1782.[153] Later cases also recognised this custom.[154] The most well-known law upon the subject is stated by Bayley J. in *Power v Butcher*: '[A]ccording to the ordinary course of trade between the assured, the broker, and the underwriter, the assured do 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

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[152] (1782) 3 Dougl 132.

[153] (1782) 3 Dougl 132, at p.134. Lord Mansfield. said 'with regard to the premium, the credit is given to the broker; and as between the principal and the underwriter it must be regarded as paid. The broker is the debtor for it.'

[154] *Edgar v Fowler* (1803) 3 East. 221; *Edgar v Bumstead* (1807, 1808, 1811) 1 Camp 411.

the underwriter the premiums are considered as paid. The underwriter, to whom, in most instances, the assured are unknown, looks to the broker for payment and he to the assured. The latter pay the premiums to the broker only, and he is a middle-man between the assured and the underwriter. But he is not solely agent; he is a principal to receive the money from the assured, and to pay it to the underwriters.' [155]

However, all the marine insurance policy were underwritten by individual underwriters at Lloyd's or privately until 1720 when a new act, 6 George I.,Cap.18, was passed to give exclusive right and monopoly to two companies[156] to insure ships and their merchandize. Moreover, only after 1824, When a new act which repealed the act 6 George I., Cap.18 received royal assent, the monopoly for the two companies was withdrawn and more insurance companies were allowed to be set up and to enter into marine insurance contracts.[157] So it is not surprising that people questioned the applicability of the payment of premium rule to the marine insurance policy written not at Lloyd's but by insurance companies at that time.

In *Xenos v Wickham,*[158] an insurance broker effected a marine policy for the shipowners with an insurance company. The policy was duly signed and sealed but was not delivered to the shipowners or the broker. The broker and the company had a running account for premiums which was settled every month. When the premium became due, a debit note was sent to the broker, but the broker said it was a mistake and the policy had been cancelled. The company accepted the cancellation and indorsed on the policy. The indorsed policy was given to the broker only for stamp duty reasons. When the insured ship was lost, the shipowners brought an action under the policy. Not surprisingly, the insurer refused to pay on the grounds that the policy had never been

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[155] (1829) 10 B & C 329, at p.339.

156 The two companies were 'London Assurance Corporation' set up by Chetwynd L.J.and 'Royal Exchange Assurance Corporation' set up by Onslow L.J.. For further reading, refer to The History of Lloyd's and of Marine Insurance in Great Britain by Frederick Martin, London: Macmillan and Co., 1876.

[157] The History of Lloyd's and of Marine Insurance in Great Britain, Frederick Martin, London: Macmillan and Co., 1876.

[158] (1867) [L.R.] 2 H.L.

issued, if it had, it had been cancelled. Although the judges at the House of Lords expressed different opinions on the issues in the case, they agreed that the payment of premium rule under policies underwritten by companies was the same as that under policies underwritten by private underwriters at Lloyd's.[159] But these were all *obiter* comments which were not binding on the following courts.

In 1897, the issue of the applicability of the payment of premium rule to marine insurance policy underwritten by insurance companies was raised in *Universo Insurance Company of Milan v Merchants Marine Insurance Company*[160] at Queen's Bench Division and reached Court of Appeal. In this case, a marine reinsurance policy was effected by the reinsured with the reinsurer through the broker. When the broker became insolvent and suspended the payment of premium, the reinsurer turned to the reinsured for the payment of the premium. But the reinsured insisted that they had no responsibility to pay the premium to the reinsurer, they should pay the premium to the broker, against whom they claimed a right of set-off. So the main issue in the case was whether the custom, that the broker, not the assured, was liable to the insurers for the premiums, applied to company's policies. The difference between a Lloyd's policy and a company's policy at this point was that a Lloyd's policy contained an acknowledgement of the receipt of the premium from the assured, but a company's policy did not have this acknowledgement but contained a promise by the assured to pay the premiums to the insurer. The reinsurer argued that the promise from the assured in a company's policy was inconsistent with the custom that the broker is liable for the premium and the payment of premium rule did not apply in this form of policy. At first instance, Collins J. said, although the Lloyd's policy contained a recital that the premium has been paid, it did not amount to an estoppel if the policy was not under seal. Then under the policy the assured would still have an obligation to pay the premium if there was one. So the custom that the broker is personally liable for the premium could not be explained by the acknowledgment in the policy but rather by the fiction that the premium is deemed to have been paid by the broker to the underwriter

[159] (1867) [L.R.] 2 H.L. Baron Pigott J., at p. 307; Willes, J. at p. 313; The Lord Chancellor, Chelmsford L.J., at p.319.

[160] [1897] 1 Q.B. 205; [1897] 2 Q.B. 93.

and loaned back to the broker by the underwriter. This rendered the custom applicable to the company's form as it applied to the Lloyd's policy. This decision was upheld by the Court of Appeal.

It is evident from this decision that the rule that the broker is liable for the payment of premium applies to all the marine insurance contracts no matter whether it is made at Lloyd's or in the company market.

3.5.2 No extension to non-marine insurance

Although MIA 1906 is a codification of the common law principles and applies to general insurance, decisions have shown that the rule of the broker's personal liability to pay premium has not extended to the field of non-marine insurance either inside or outside Lloyd's.

In *Wilson v Avec Audio-Visual Equipment Ltd.*[161] , a non-Lloyd's broker effected two non-marine insurance policies on behalf of the assured with an insurance company. When the insurance company was compulsorily wound up, the liquidator asked for the premiums from the broker. The broker paid the premiums despite the refusal letter from the assured. Later the broker sought to be fully indemnified by the assured on the ground that he had rendered himself personally liable for the premiums in effecting the policies for the assured. In the Court of Appeal, Edmund Davies L.J. said that the ordinary position of an agent was that he bore no responsibility under the contract into which he entered on behalf of his principal. If someone wanted to make the agent personally liable under the contract, clear and precise evidence must be shown to prove the special relationship between the parties. But in the present case, the broker failed to present such evidence. As noted by Buckley L.J. and Scarman L.J., the broker also failed to prove that he had any implied authority to pay premiums on behalf of the assured. So, it was decided that the broker had no personal liability to pay premiums under the current policy which was a non-marine insurance policy.

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[161] [1974] 1 Lloyd's Rep. 81.

In *The Pacific & General Insurance Company Limited v Hazell and others,*[162] it was decided that the broker is not liable for the payment of premium under non-marine insurance policy either at Lloyd's or outside Lloyd's. In this case the broker effected four excess of loss contracts of reinsurance on behalf of the reinsured with syndicates at Lloyd's and companies in the London market to cover the reinsured's casualty and property accounts. When a provisional liquidator was appointed to the reinsured, the broker was concerned about the premium he advanced and would advance under the market payment mechanism and asked the provisional liquidator to pay the premiums, but the request was refused. Later, the broker succeeded in negotiating with most of the reinsurers to cancel the policies *ab initio* and returned the premiums paid. Disputes arose when the liquidator was appointed and asserted that the policy remained effective. One issue among these disputes was whether the broker was liable to pay the premium. The reinsured first argued that there is the same custom as that of the marine market that the broker is personally liable for the payment of the premium. But they found no evidence to support it. Alternatively, they argued that the settlement and accounting rules at Lloyd's and London company's market made the brokers liable to pay premiums to the reinsurers or that the adoption of the rules by the market had given rise to a custom to that effect. But Moore-Bick J. did not agree. He said that the brokers who did business with Lloyd's and the companies' market were obliged to comply with these settlement and accounting rules. But the mere fact that the rules required the brokers to pay premium to the underwriters through a central accounting system did not impose any personal liability on the brokers to pay premium due under non-marine insurance contracts. The system was introduced to make sure the premiums were paid to the underwriters promptly. Based on expert evidence, the judge further concluded that there was no evidence to prove the existence of such a custom that the brokers were liable for the premium in the non-marine market. In *Goshawk Dedicated Ltd v Tyser & Co Ltd,*[163] Clarke J. noted that in the *Pacific and General* case an attempt to establish the same custom in non-marine market had failed.

[162] [1997] BCC 400.

[163] [2005] EWHC 461 (Comm).

In view of these rulings, it is to be noted that the court is reluctant to extend the rule, that the broker is personally liable for the premiums, to non-marine policies. Therefore, the brokers should be cautious about advancing premiums when they do non-marine insurance business, because the advanced premium may be taken as paid voluntarily and it will be hard for the broker to claim them back from the assured.

People may ask why the broker's liability to pay premiums under marine insurance is different from that under non-marine insurance and other ordinary position of an agent under agency law. Is it still necessary to exist as an exception? These questions will be discussed at part 7 of this chapter.

3.6 Contract out of the Rule

As can be seen from section 53 (1), the broker's legal liability to pay premium can be altered by agreement. But this rule cannot be displaced easily, only clear and unambiguous wording releasing the broker from the liability can achieve this fundamental change.[164] One discordant clause is not strong enough to make such change in the ordinary relationship between the parties.

3.6.1 Payment of premium warranty

In J. *A Chapman and Company Ltd v Kadirga Denizcilik ve Ticaret AS & Orsection,*[165] the shipowners Kadirga denied their liability to pay the premiums to the broker on the ground of a payment of premium warranty in the polices. This provision was stated as follows: 'Warranted each instalment of premium paid to underwriters within 60 days of due dates.' The shipowners argued that if underwriters were entitled to be discharged from liability for breach of the warranty to pay premium on time, that would be inconsistent with the hypothesis underlying section 53(1) of the 1906 Act that as between broker and underwriter premiums were considered as paid. Therefore, the general practice recognised by section 53 (1) did not apply in the present case. The judge at first instance rejected the shipowners' argument. He said, the contract should

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[164] *J. A Chapman and Company Ltd v Kadirga Denizcilik ve Ticaret AS* [1988] Lloyd's Rep. I.R. 377.

[165] [1998] C.L.C. 860.

be read as a whole; other clauses, especially the broker's cancellation clause indicated strongly that the parties intended the broker to be liable to the underwriters for the premium and the shipowners to be liable to the brokers. Moreover, the payment of premium warranty which ensured the underwriters to be paid on time is not inconsistent with section 53 (1) which answers the question of who is liable for the premium. They could be read together as follows: '[I]f the underwriters did not receive the premium on the due date then there would be a breach of warranty with the usual consequence that would flow from that; the payment by the assured was to be made to the brokers, and they were to be responsible for the paying of the underwriters.'[166]As to the hypothesis underlying section 53 (1), no resort needs to be had to it, since the statute said what it means. This reasoning was confirmed by the Court of Appeal.

3.6.2 A promise by the assured to pay premiums to the insurer

In *Universo Insurance Company of Milan v Merchants Marine Insurance Company,*[167] the policy contained a promise by the assured to pay premiums to the insurers. After the brokers got into financial difficulties and suspended payment of the premiums, the insurers turned to the assured for the unpaid premiums. The insurers argued that the custom that the broker was responsible for the payment of premium was not applicable to the present case where the assured had promised to pay it to the insurers. But the Court of Appeal held unanimously that the promise was not inconsistent with the custom: they could be read together to mean that the assured promised to pay in accordance with the custom.

3.7 Whether the rule should still exist as it is in MIA 1906

There are voices from both the academia[168] and law reformers that the rule relating to marine insurance broker's personal liability to pay the premium should be repealed or at least amended. In the United Kingdom, the Law Commissions' 2006 Joint Scoping

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[166] [1998] C.L.C. 860, at p. 863.

[167] [1897] 2 Q.B. 93.

[168] Dame Elizabeth Gloster, Who Pays the Pipe— who pays the tune? Recent issues arising in the context of Section 53 of the Marine Insurance Act 1906, *L.M.C.L.Q.* 2007.

Paper on insurance contract law[169] says of section 53 (1), which regulates the broker's payment of premium liability, that this provision no longer reflects the realities of the insurance market and should therefore be repealed or amended. Seventy-two of the ninety-three responses to the scoping paper were in favour of the inclusion of section 53 in the review of insurance contract law. In July 2010, the Law Commissions published Issues Paper 8[170] which asked for comments and responses for the legislative reform of section 53. In Australia a much bolder step was taken by the Australian Law Reform Commission (ALRC). In ALRC Report 91,[171] the Commission recommends that, 'in order to remove the regulatory gap in the conduct of agents and brokers relating to marine insurance and non-marine insurance', section59 and 60 of MIA 1909[172] should be repealed, the conduct of marine insurance brokers and agents should be governed by those regulations which regulates the conduct of non-marine insurance brokers and agents. This recommendation was approved and section59 and 60 were repealed. That means the marine insurance brokers in Australia, like those non-marine insurance brokers, no longer bear the personal liability to pay the premium.

Marine insurance has long been governed by its own statutory regime, because some of the marine insurance law, including the broker's liability to pay the premium, originate from the customs of this unique practice. Is it necessary and possible to unify the conduct of the marine insurance brokers with that of the non-marine insurance brokers? Is the broker's payment of premium rule become obsolete and need to be repealed? If the rule is still needed, whether it should stay as it is in MIA 1906 or any improvement could be made?

3.7.1 Repeal?

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169 http://lawcommission.justice.gov.uk/docs/ICL_Scoping_Responses_and_Analysis.pdf. The Law Commission and The Scottish Law Commission, Insurance Contract Law: A Joint Scoping Paper,2006, section 2.54.

170 http://www.lawcom.govuk/docs/issues8_brokers-liability.pdf

171 http://www.austlii.edu.au/au/other/alrc/publications/reports/91/

172 Section 59 of the Australian Act was identical to section 53 of the Marine Insurance Act 1906.

The custom was said to be justified on the ground that the insurer was more familiar with the broker than the assured, therefore he intends to give credit to the broker rather than the assured.[173] While, in the Issues Paper 8, the Law Commissions expressed the view that the original justification for the custom underlying section 53 (1) may no longer apply and there was no reason to keep the broker's personal liability to pay premiums. In fact, the broker's liability to pay the premium is still needed for a more fundamental reason—the assignability of marine insurance policy. As opposed to non-marine policy, 'A marine policy is assignable unless it contains terms expressly prohibiting assignment.'[174] As a consequence, the policyholder of a marine policy may be changing from time to time, especially under cargo insurance. If the broker's payment of premium rule is abolished, as under other non-marine insurance contract, the assured is liable for the payment of the premium, problems will be met by the assured, the insurer and the bank as a special policy holder.

3.7.1.1 For the assured

The policy's assignability is vital for cargo insurance in international trade. Take C.I.F. sale as an example, the seller provides the proper documents including the invoice, the bill of lading and the policy in return for the price comprising of the cost of goods, freight and the premium. He will assign the documents to the buyer when the buyer pays the price. If the payment is made by a letter of credit, which is quite common in international trade, the seller will first assign the documents to the bank when the bank negotiates the documents. Then the bank will assign the documents to the buyer when the buyer pays the price. Sometimes the seller may purchase goods afloat which comply with the sales contracts. That means the seller can perform his duty by buying and selling these documents. Even if the goods get lost or damaged in transit, the buyer must pay the price, provided the documents comply with the contract requirement. When the loss or damage happens, the buyer can claim the indemnity from the insurer in his own name if the policy is properly assigned. The buyer will become the assured under the policy. Under this circumstance, if the broker's payment of premium rule is abolished,

173 *Wilson v Creighton* (1782) 3 Dougl 132; *Universal Insurance Company of Milan v Merchants Marine Insurance Company* [1897] 2 Q B 93.

[174] MIA 1906 section 50 (1).

like other non-marine insurance contract, the assured is liable for the payment of premium, the buyer will face with the defence raised by the insurer to set off the loss money against the unpaid premium if the seller did not pay the premium when he effected the policy. This will cause unfairness to the buyer as an assured, because he had already paid the consideration for insurance in the purchase price but still faces liability to pay the premium under insurance contract. Admittedly, the buyer will be allowed to sue the seller for not performing his duty under the sales contract and claim back the premium. But it will cause a lot of unnecessary and laborious litigation especially where it concerns several on-sales. If the law changes as such, the buyer will be more hesitant to trade by document sale, or he might be willing to insist on the seller rendering an old fashioned insurance policy in which the insurer acknowledges the receipt of the premium from the assured.

3.7.1.2 For the insurer

On the other hand, will the abolition of section 53(1) benefit the insurer? According to section 50 (1) and section 50 (3), a marine policy is assignable unless it is expressly prohibited. The way of assignment is by way of endorsement. A customary manner of assignment of marine policy is by delivering a policy indorsed in blank.[175] The assignment of the policy may happen several times during trade transactions. So when the premium is due, the assured may well have changed to the buyer or other sub-buyers, rather than the seller who effected the insurance. Since no notice is required to be given to the insurer when the policy is assigned, the insurer may never know who the assured is by then, unless the holder of the policy makes a claim under the policy. If the law makes the assured liable for the payment of the premium, the insurer may only receive the premium by way of set-off against the loss money when the assured come to claim for it.

Although the law entitles the insurer not to issue the policy until payment or tender of the premium,[176] it is impractical to make the seller pay the premium when he effects the insurance contract every time. Nor is it possible to make the assured to give notice to

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[175] *J.Aron & CO. (Inc.) v Miall.* (1928) 31 Ll.L.Rep. 242.

[176] Section52 of MIA 1906.

the insurer every time when he assigns the policy. These may be the reasons why the insurer prefers to give credit to the broker rather than the assured who will change from time to time.

3.7.1.3 For the bank

In the modern world, banks take an active role in financing all kinds of businesses. Their biggest concern lies with the existence of the whole value of the subject matter they financed. So they will either make the debtor to provide proper insurance for the subject matter or they will arrange it by themselves. If the payment of premium rule under marine insurance is changed, the bank, as a possible party under the marine insurance policy, will also be affected.

The possible set-off defence after the change of law will raise the risk to the bank's credit in trade financing and ship financing. The bank may draw back from these businesses or insert more terms and conditions to protect its own interest which will make the transaction more complicated.

It is also impractical to repeal section 53 of MIA 1906 and abolish the broker's payment of premium rule for commercial reasonableness. Since marine insurance is usually placed on an international market, and the insurers may take only a percentage of the risk, sometimes very small. It is inconvenient for either the insurer to collect the premium from the assured from abroad, or the assured to pay the premiums to different insurers.

Seen from the above analysis, the broker's payment of premium rule is still of much importance in the present day as in the past. Abolishing this rule might cause problems and inconvenience for both the insurers and the assureds. This will also explain, to some extent, why the courts take such strict view in displacing this rule.

3.7. 2 Retention?

Apart from the proposal for repealing the broker's liability to pay the premium, there were arguments for retention of the rule in the Law Commissions' Issues Paper 8.

Firstly, the rule is said to be needed for market certainty;[177] secondly, the brokers wish to be the exclusive channel of communications to their clients.[178]

Furthermore, the rule that the broker pays the premiums to the insurer and gets reimbursement from his principal gives certainty in the obligor for the premium. As already discussed in the above paragraphs, the assignability of marine insurance policy may make the assureds changing from time to time. It is hard for the insurer to find out the current assured when he claims the premium. If the law makes the broker liable for the payment of premium, the party from whom to collect the premium is straightforward. Because to the insurer, the broker who effected the insurance contract will not be changed; to the broker, the principal who instructed him to place the insurance will not be changed.

One issue that may hinder the Law Commissions from retaining section 53 (1) is that the operation of the current law causes unfair distribution of the risk of insolvency among the three parties, which is the risks of insolvency usually fall on either the insurer or the broker, and not on the assured who benefit from the insurance.[179] In fact, this worry is unnecessary, the payment of premium rule under section 53 (1) is more of a protection rather than a mischief for the broker. It protects the broker against voluntary payment under a central accounting system; the broker's lien under section 53 (2) and the broker's cancellation clause in the insurance contract also provide some protection to the broker against non-payment of the premium. For the insurers, they can make special agreement with the broker to mitigate the credit risk.

3.7.2.1 For the broker

(A) Protection from the voluntary payment

At London market, most premiums are paid through the central accounting bureau, nowadays called Xchanging. Under the central accounting process, once the broker

[177] Issues Paper 8, para. 6.25.

[178] Issues Paper 8, para. 6.26-27.

[179] Issues Paper 8, para. 1.4, 6.29.

submitted the Premium Advice Notice (PAN) to the bureau, the premium settling procedure would be triggered and the instalments will be debited from the broker's account automatically when they are due, even if he has not received payment from his client.[180] If it were not for the broker's payment of premium rule, these premiums might be taken as paid voluntarily by the broker.

In *Heath Lambert Ltd v Sociedad de Corretaje de Seguros and another*,[181] Scort, a Venezuelan broker placed marine insurance with Banesco, a Venezuelan insurer, on behalf of a Venezuelan company. Scort was also responsible for obtaining the reinsurance in London market for Banesco. HL was involved as a placing broker at the London market. The reinsurance was duly made and took the form of a slip policy which was evidenced by a cover note. On the cover note, the choice of law clause provided 'Subject to Venezuelan Law and/or Venezuelan Jurisdiction if required'. HL paid the premiums to the reinsurers, but neither Scort nor Banesco reimbursed him. One of the contentions made by Scort and Banesco is that section 53 of MIA 1906 and London market practice only applies to marine policies governed by English law, it had no application to non-English law marine policies. The reinsurance contract was governed by Venezuelan law, so HL was under no obligation to pay premiums to the reinsurer. Since he did so, the payment was made voluntarily and he is not entitled to indemnity by the principal. Jonathan Hirst Q.C. sitting as a deputy High Court judge did not agree, he stated that: 'it is probably right that section 53 only applies to English law insurance/reinsurance contracts. But that is by no means an answer to the question whether London brokers, placing foreign law insurance/reinsurance contracts into the London market, assume liability for payment of the premium to underwriters. section 53 was based on the practice of the London market. Nowadays, at least, the London market quite frequently deals with non-English law policies. Whatever the proper law of the reinsurance policy, the relationship between the placing brokers and their principals is typically governed by English law.'[182]

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[180] *The Pacific & General Insurance Company Limited v Hazell and others* [1997] BCC 400; Insurance Broking Practice and the Law, CMS Cameron Mckenna, Informa, London, 2009, at para. . 10-20.

[181] [2004] 1 Lloyd's Rep. 495.

[182] [2004] 1 Lloyd's Rep. 495, para. 20.

Together with other two reasons particular to the case, the judge decided that the London placing broker HL did not pay the premium voluntarily, he was under a legal liability to do so and was entitled to be indemnified. This issue was not appealed to the Court of Appeal.

If English law repeals section 53 (1) and abolishes the broker's payment liability rule, the brokers will not be able to claim back the premiums advanced in the situation like that in the Heath Lambert case. Considering the practice in the London market, the broker's payment of premium rule is more of a protection for the brokers rather than a mischief.

(B) Law protection—the broker's lien

The law not only imposes obligations on the brokers, but also gives them corresponding rights to protect their interest.

Section 53 (2) of MIA 1906 stipulates that: '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 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.'

The common law also makes it clear that, the lien is not only on the policy itself, but also on the proceeds of the policy.

In *Eide UK Limited v Lowndes Lambert Group Ltd,*[183] a broker placed hull and machinery insurance on behalf of the operators of a fleet of ships. The operators chartered a ship by demise charterparty, which provided that 'such marine, war and protection and indemnity insurances shall be arranged by the charterers to protect the interests of both the owners and the charterers and morgagees (if any)'. The ship had been mortgaged to the bank by the shipowner. So when the operator instructed the

[183] [1999] Q.B. 199.

broker to add the ship to the existing policies, the operator, the shipowner and the bank become co-assureds. Later the ship was damaged. The brokers collected the claim proceeds from the underwriters and retained them for satisfaction of the operators' liability on an unrelated insurance account. The brokers asserted that they were entitled to do so because of a general lien on the policies under section 53 (2) of MIA 1906. The bank disputed and raised the issue before the court. At first instance, the judge held that section 53 (2) conferred a lien over the policy itself and no more, and it did not apply in the case of composite insurance. The brokers appealed. The appeal was dismissed by the court of appeal, but the decision on the issue of the interpretation of the 'lien on the policy' in section 53 (2) was reversed. Phillips L.J. cited and affirmed the statement in the 16th edition of the Arnould's Law of Marine Insurance and Average that where the broker was authorised to collect losses or returns of premiums, he was entitled to retain the sum for which he had a lien out of moneys received by him under the policy. The judge also used the judges' rulings in five 19th century cases and the authors' statements in four 19th century textbooks of distinction to support his view that the broker's lien on the policy also extends to the proceeds collected under the policy. The judge admitted that the precise basis of this right is not clear from these authorities, but it should have become established as a matter of mercantile usage. It would be absurd if the broker's lien on the policy would be defeated by the act of his collecting the insurance proceeds which was his obligation when he retained the possession of the policy. As to the scope of the general lien under section 53(2), the Court of Appeal agreed with the court below that it was contrary to commercial sense and legal principle to subject one co-assured to the burden of a general lien in respect of anther co-assured's indebtedness to the brokers. Separate assureds with separate interests should be treated as if they were insured under separate policies. No general lien should be conferred in favour of brokers under composite policies. Moreover, the wordings of section 53 (2) suggest that the dealing is between a broker and a single employer. So it was decided that section 53 (2) only deals with the situation where one assured who employed the broker is concerned and it doesn't apply to composite policies.

This decision was followed by in *Heath Lambert Ltd v Sociedad De Corretaje De Seguros (No 2).*[184] In this case, a London broker (HL) instructed by a Venezuelan

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[184] [2006] 2 Lloyd's Rep. 551.

broker (Scort) to place marine reinsurance in the London market for a Venezuelan insurer (Banesco). HL duly placed the required insurance and paid the premiums to the reinsurers. But neither the Venezuelan broker nor the Venezuelan insurer reimbursed the London broker. In September 2002, the London broker collected the loss money under the reinsurance policy. Banesco claimed for the loss money, but HL argued that they have lien over the loss proceeds under section 53 (2) of MIA 1906. HHJ Mackie Q.C. cited *Eide UK Limited v Lowndes Lambert Group Ltd*[185] and decided that HL has a lien over the proceeds of the policy and the lien was not affected by the intermediary in the chain.

But the problem remains that if the shipowner fails to indemnify the broker, and there is no claim under the policy, or the shipowner can recover directly from the insurer without production of the policy,[186] the broker is unable to deduct the premium from the loss money and therefore left exposed. Then what can the brokers still do with the policy in his hand? In *Eide UK Limited v Lowndes Lambert Group Ltd*,[187] Phillips L.J. recommended two ways suggested in Arnould's Law of Marine Insurance and Average: (1) the broker can give notice of his interest and apply to be joined in the proceedings brought by the assured under the C.P.R. Pt20; or (2) the broker can commence his own proceedings.

One question that may need further research here is that whether the law should make it a default position that the loss money should be paid through brokers and give them more protection from the assured's failure to indemnify the brokers.

(C) Contract protection—the broker's cancellation clause

The brokers are always free to use contract terms to protect their interest. One commonly used provision is the broker's cancellation clause. By this clause, the broker

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[185] [1999] Q.B. 199.

[186] *Swan & Cleland's Graving Dock and Slipway Co. v Maritime Insurance Co.* [1907] 1 K.B. 116. This undermined the broker's possessory lien on the policy.

[187] [1999] Q.B. 199.

is entitled to give notice to the insurer to cancel the insurance contract if he has not been indemnified by the principal for the premium due.

One example of the broker's cancellation clause is as follows: 'Notwithstanding anything contained in this Policy to the contrary, [the broker], in addition to their lien on the policy, shall be entitled to cancel this Policy in the event of any premium not having been paid to them when due and the Underwriters hereby agree to cancel this Policy on presentation at the request of [the broker] and to return any premium payable thereon in excess of a pro rata premium up to the date of the cancellation.'[188]

The broker's cancellation clause will preclude the broker from advancing premiums when he is not indemnified by the principal for one or more instalments. To some extent, it softens the broker's liability to pay the premium.

3.7.2.2 For the insurer

It is suggested in the Law Commissions' Issues Paper 8 that it is the assured rather than the insurer that should bear the risk of the broker's insolvency, because the assured stands more chance than the insurer to recover the premium from the broker when the broker goes bankrupt. Since there was a fiduciary duty owed by the broker to the assured, when the broker become insolvent, the assured has priority over the broker's other creditors in respect of the separate account which holds the premium.[189] In fact, such a result can also be achieved between insurer and broker by a special agency agreement between the parties.

In *Vehicle & General Insurance Co. Ltd. v Elmbridge Insurances,*[190] the plaintiff insurance company entered into an agency agreement with the defendant broker, in which it was stated: 'All monies received on behalf of the Company in your capacity as an Agent of the Company are at all times the property of, and received for, and on

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[188] *Heath Lambert Ltd v Sociedad de Corretaje de Seguros and another* [2004] 1 Lloyd's Rep. 495. para. 4.

[189] Issue Paper 8, para. 7.9.

[190] [1973] 1 Lloyd's Rep. 325.

account for and in trust, to pay the same to the Company and can in no way form part of your personal estate or have any connection with any business you may transact apart from that done on behalf of the Company…' Later the brokers used the money received on behalf of the company to pay premiums with other companies. When the plaintiff company went into liquidation, the liquidator claimed the money from the broker. One basic question is: on whose behalf did the broker hold the money. Both parties agreed that, at common law, the brokers were the agent of the assured, and they held the money on behalf of the assured not the insurer. However, the plaintiff argued that this position was overruled by the clear provision in the agency agreement. This view was confirmed by the judge.

It is evident from the Vehicle & General case that it is possible to impose fiduciary duty on the broker by the insurer through clear wordings in an agency agreement. This will provide some protection for the insurers against loss of premium caused by the broker's insolvency.

It is to be noted here that such an agreement will not give rise to the issue of conflict of interest,since the assured owes the premium to the broker. When he paid it to the broker, the money is the property of the broker, not that of the assured. The broker is free to agree with the insurers on how to deal with the money.

Moreover, such distribution of risk is rationalised as a response to the market practice by which the premium and loss moneys are processed via a central accounting system between the insurers and brokers. As The ALRC stated in its 1980 report on insurance agents and brokers: 'It is the insurer, not the insured, which agrees with the broker on credit terms and acquiesces in a broker's temporary treatment of premium money as his own. It is also the insurer, not the insured, which is in the better position to know the overall payment performance of a broker and to become aware of his impending insolvency… If convenience of accounting between insurer and broker should dictate the adoption of other procedures, it is the insurer, not the insured, which should be exposed to the additional risk.'[191]

3.7.2.3 Conclusion

All in all, repealing of section 53 (1) will do harm to the underlying business, and may cause problems for both the insurers and the assureds; while retaining the rule can keep market certainty and efficiency. If the parties are not satisfied with the rule, they are free to contract it out, provided that the clause is properly formulated. Weighing the pros and cons, the broker's payment of premium rule should be preserved.

Some of the replies to Issues Paper 8 also support the position that the broker's payment of premium rule should be retained. In consultation paper 2, it provisionally proposed that the default rule should remain the same that the broker is automatically liable for the premium unless the duty is contracted out. It was also proposed that the policy holder should be primarily liable to pay premium to the insurer, and should pay the broker as agent. In fact, the assured and the broker are made jointly and severally liable for the premium. It was suggested that the broker and insurer should be able to contract out of the broker's liability for premium. It was said that there was no need for a tripartite agreement, since the assured's position was not affected.

The proposal may be effective in resolving the insolvency issue and the problem met by the insurers with the assignable policy. However, as it was discussed in para.3.7.1.1, the problem for the assignee of the policy, for example the CIF buyer, was still the same if the insurer and broker contract out the broker's duty to pay the premium, and the CIF buyer may lose the cover or pay twice the premium, if the CIF seller failed to pay the premium.

3.7. 3 Revise

3.7.3.1 Section 53 (1)

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[191]The Australian Law Reform Commission, Insurance Agents and Brokers: Report 16 (1980), at para. 51.

Preserving the law does not mean it is perfect and does not need any amendment. On the contrary, some judges had already noticed the drawbacks in the formulation of the payment of premium rule in section 53 (1) of MIA 1906, which only recognises the broker's liability to pay the premium to the insurer, but does not deal expressly with the liability of the assured to indemnify the broker.[192] Under case law, the courts have already affirmed that as a general rule, the broker has a cause of action in his own right against the assured in respect of unpaid premium.[193] Moreover, the law is ambiguous about the assured's position when the broker failed to pay the premium. Since the wording of the section is that the broker is 'directly' liable to the insurer for the payment of premium, it doesn't say that it is the broker's 'personal' liability or say that the broker is 'solely' responsible for the premium. This gives rise to the possibility that the insurer may choose to claim for the premium from the assured, at least when the broker fails to pay.[194]

In order to avoid or reduce the litigation in the above said situation, the payment of premium liability among the insurer, the broker and the assured should be regulated clearly by the statute. First, it should be made clear that it is the broker's 'personal' liability, or the broker is 'solely' responsible, to pay the premium to the insurer, even if the broker fails to do so, the insurer cannot turn to the assured for payment. Secondly, the assured's duty to reimburse the broker should be included in the Act, and the wording should be clear that the assured is the one who instructed the broker to effect the policy (the principal), not other assureds who get the policy by assignment, unless otherwise agreed in the marine insurance contract. If not, the problem for the insurer in the above paragraph 3.7.1.2 will still arise, only the broker takes the place of the insurer.

3.7.3.2 Should section 54 be remained?

(A) Before MIA 1906

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[192] J. *A Chapman and Company Ltd v Kadirga Denizcilik ve Ticaret AS* [1988] C.L.C. 860, at pp.862, 865.

[193] J. *A Chapman and Company Ltd v Kadirga Denizcilik ve Ticaret AS* [1988] C.L.C. 860, at p.865.

[194] *Universo Insurance Company of Milan v Merchants Marine Insurance Company*. [1897] 1 Q.B. 205.

It used to be common practice in the Lloyd's market that a recital that the premium has been paid by the assured would be included in a Lloyd's policy. In the Lloyd's section G. form it was said that 'we, the assurers,…, confessing ourselves paid the consideration due unto us for this assurance by the assured'. The effect of such acknowledgment is that, in the absence of fraud, the policy would be treated as conclusive evidence between the underwriter and the assured, but not between underwriters and brokers.

In *Dalzell v Mair,*[195] the assured sued the underwriter for the return of the premiums under a policy in which it contained the usual acknowledgment by the underwriters. The underwriter did not agree and argued that the action would not stand since no money was received either from the assured or the broker. Lord Ellenborough held that 'if a man acknowledged that he had received a sum of money from a broker, and accredits him with his principal to that amount, he shall not afterwards, as between himself and the principal, be allowed to say that the broker never paid him.' The acknowledgment of the receipt of the premium is conclusive evidence between the underwriter and the assured, but it is no bar to an action for the premium by the underwriter to the broker.

In *De Gaminde v Pigou,*[196] a policy of insurance was effected, through a broker, upon goods by ship or ships from Alicante to a port of discharge in Great Britain. The goods were shipped on board the ships 'Discado' and 'Louisa'. During the voyage, 'Discado' was captured and recaptured; 'Louisa' sailed with convoy and arrived at the discharge port. According to the policy terms, the amount of the loss by salvage paid to the recaptors, returns of premium for convoy and short interest upon the whole insurance become payable to the assured. The assured claimed for such amount and the insurer claimed to set off the unpaid premium against the amount the assured claimed for. The premium was said to have been received by the insurer in the policy, but it was only debited in the accounts between the insurer and broker, and between the broker and the assured. The issue before the court was that whether the insurer could set off the amount of the premium against that the assured claimed for. Heath J. decided that when the underwriter acknowledged that he had been paid by the assured, the premium was

[195] 1 Camp. 532.

[196] 4 Taunt. 246.

considered as actually paid by the assured, but it must be allowed in account by the broker to the underwriter. Therefore, the underwriter cannot set off the premiums from the amount payable to the assured.

Generally speaking, in a case of contract irrelevant to marine insurance, an acknowledgement of the receipt of money forming the consideration for the promise would go strongly to show that the person in whose favour the receipt is given is liable to pay the consideration which has not in fact been paid. But under marine insurance, it was a long established custom and later law that the broker is liable for the payment of the premium. Then what is the reason for the insertion of such acknowledgment in the policy?

It was said, this may be the result of the way the premium is dealt with between brokers and underwriters in the Lloyd's market.[197] At Lloyd's, brokers and underwriters usually have net accounting agreements, under which the premiums and loss moneys are settled periodically in their common account. This will probably involve an underwriter to issue a policy before the premium is paid to him. In order to protect the assured's interest, an acknowledgment of the receipt of premium will be included in the policy to preclude the necessity of proving the payment of premium when a loss happens, even if the broker has not actually paid it.

(B) In MIA 1906

In MIA 1906, the broker's liability to pay the premium is codified in section 53 (1). However, it is not clear whether the assured can be sued for the premium by the insurer.[198] It is possible that section 54 is a codification, alongside section 53 (1), of the common law rule that the insurer cannot turn to the assured for the payment of premium when there is an acknowledgment of receipt of premium in the policy.

(C) Is section 54 still needed?

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[197] See R Merkin (ed), *Colinvaux & Merkin's Insurance Contract Law*, at para. B-0361.

[198] For the reasons see 7.3.1.

The Lloyd's section G. form, which includes an acknowledgment of receipt of premium, is attached to MIA 1906 as Schedule One. This form is widely used before 1980s when the Institute Clauses was introduced. One of the changes that the Institute Clauses made to the section G. form was that it removed the acknowledgment of the receipt of premium from the policy. This shows, to some extent, that such acknowledgment of receipt of premium is not commonly used under modern conditions of commerce. Moreover, if the payment of premium liability between the broker and underwriter and between the assured and broker can be made clear as that suggested in 3.7.3.1, there is no need to have section 54 to protect the assured against non-payment by the broker.

Chapter 4 Broker’s Commission Disclosure

4.1 Broker’s right to commission

When a broker is the effective cause of the conclusion of an insurance contract, he is entitled to be remunerated for his services either by the express or implied terms of the contract or by the law of restitution.[199] The broker will not be remunerated if the contract is not completed, even if the reason for the break off is the assured.[200] Moreover, if a broker’s action is taken beyond his authority or breaches his duties as an agent, for example, receiving secret commission from insurers, he is also debarred from claiming the commission.[201]

4.2 Who should pay the commission?

In practice, rarely is the case that the amount of commission is agreed between the broker and the assured, but it is agreed between the broker and the insurer by way of inserting a commission clause in the slip rendered to the insurer. The payment is made by broker’s deducting a sum from the premium before it is paid to the insurer. This leads to an assumption that the broker is paid by the insurers rather than the assured. There are some cases which have been decided on the basis of the existence of such an assumption either by a custom in the market[202] or by an implied term.[203] But the issues

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[199] *McNeil v Law Union* (1925) 23 Ll.L.R. 314; *McNeil v Steamship Mutual* (1940) 67 Ll.L.R. 142; *Bright & Co (Insurance) Ltd v Wright* (1946) 79 Ll.L.R. 207; *Velos Group Ltd Harbour Insurance Services Ltd* [1997] 2 Lloyd’s Rep. 461; *Standard Life Assurance Co v Egan Lawson* [2001] E.G.L.R. 27; *Harding Maughan Hambly Ltd v CECAR* [2000] Lloyd’s Rep. I.R. 293.

[200] *Broad v Thomas* 131 E.R. 38; *Toppin v Healey* (1863) 11 W.R. 466; *Marsh v Jelf* (1862) 3 F. & F. 234; *Gillow & Co. v. Lord Aberdare* (1892) 9 T.L.R. 12.

[201] *Andrews v Ramsay & Co.* [1903] 2 K.B. 635; *Hippesley v Knee Brothers*[1905] 1 K.B. 1; *E. Green and Son (Limited) v G. Tughan and Co*.(1913) 30 TLR 64.

[202] *E Green & Son Ltd v Tughan & Co* (1913) 30 TLR 64; *Great Western Insurance Company v Cunliff* (1869) LR. 9 Ch.App. 525.

[203] *Power v Butcher* (1829) 10 B & C 329; *Leete v Wallace* (1888) 58 LT 577; *Lord Norreys v Hodgson* (1897) 13 TLR 421; *Bancroft v Heath* 17 T.L.R. 425; *Workman & Army & Navy Co-operative Supply Ltd v London & Lancashire Fire Insurance Co.* (1903) 19 T.L.R. 360; *Searle v A.R. Hales & Co Ltd* [1996] L.R.L.R. 68.

in those cases were how much the brokers were allowed to receive from the insurers, rather than the question whether it is the insurers who are solely responsible for the payment of commission. At common law reference is often made to the accepted standards and practices of a profession. However, they may not be decisive of what is proper or lawful.[204] The position that there is a custom that the broker is paid by the insurer rather than the assured was challenged, at least in the reinsurance circumstances, in *Carvill America Incorporated RK Carvill & Co Ltd v Camperdown UK Ltd XL Speciality Insurance Co.*[205]

In that case, an American insurance broker, who has a subsidiary in London, placed two treaties of reinsurance on behalf of the reinsured, an American insurance company. Cover under both treaties was subscribed in part by the US reinsurers and in part by the UK and other European reinsurers. When the reinsured asked the broker to give a rebate of the commission received from the European reinsurers, which was 10 per cent of the gross premium, the broker refused. Consequently, the reinsured terminated the broker's agency during the currency of the policy. As soon as the agency was terminated, the reinsured ceased paying premiums to the broker, and the broker ceased to receive commission.

The broker initiated an action in UK to claim for the unpaid commission from the European reinsurers. Alternatively, the broker claimed against the reinsured for the unpaid commission, if their claim against the reinsurers failed. The reinsured applied to the court for setting aside service in the proceedings. The arguments raised by the reinsured, which is relevant to the current discussion, was that the custom and practice in the reinsurance market in Europe or London was that the broker was the agent of the assured but was paid by the underwriters. They also argued that such customary practice had also been inserted in the appointment letter, where it was said that 'Remunerations earned by Carvill [the broker] will be paid entirely by the reinsurers to which ELU's (a specialty division of the reinsured] premium is ceded as is customary in the industry.' Therefore the position was clear that it was the reinsurer rather than the reinsured who

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[204] see *O'Brien v Hughes-Gibb & Co Ltd* [1995] LRLR 90; *Bolitho v City and Hackney Health Authority* [1998] A.C. 232.

[205] [2005] EWCA Civ. 645.

was liable for the commission and the broker did not have an arguable case against the reinsured.

At first instance, Judge Havelock-Allan QC was very dismissive of the notion that the broker was paid by the insurers/reinsurers and held that the broker had an arguable case against the reinsured for the commission. The reasons were: (1) in establishing a customary practice, it must be shown to be certain, notorious and reasonable in that market. The existence of some customary practice in some sections of the insurance market did not mean it was also customary in the reinsurance market. The cases cited by the reinsureds were all, but one, insurance cases, not reinsurance cases. The only reinsurance case they cited, *Grace v Leslie & Godwin,*[206] where it was held that the broker has a contractual obligation to collect claims in consideration of the insured or reinsured agreeing to pay the commission to the broker, was inconsistent with the reinsured's argument; (2) the cases cited by the reinsured has not decided whether the underwriter's promise to pay brokerage for the introduction of the business was a promise which was legally enforceable, especially where the gross premium has not been paid to the reinsurer; (3)In section 53 (2), it was provided that 'Unless otherwise agreed, the broker has, as against the assured, a lien upon the policy for the amount of the premium *and his charges'*. This also evidenced that the broker may have cause of action against the assured or reinsured for the commission.

The decision was upheld by the Court of Appeal. However, the judges sidestepped the issue whether the broker was paid by the insurers/reinsurers. The judges held that the reinsured's liability for the commission was arguable, since it was the reinsured's duty to pay gross premiums either directly to the reinsurers or through brokers, where the broker would be allowed by the reinsurer to deduct the commission from the gross premiums before they were ceded net to the reinsurers. It was arguable that the reinsurer's obligation to pay the commission only arose on receipt of the gross premiums. When the reinsured stopped paying gross premiums (which is the situation in the current case), the liability to pay the commission reverted to the reinsureds.

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[206] [1995] L.R.L.R. 472.

The common law authorities are strongly in favour of the customary practice that the broker's commission is paid by the insurers.[207] In the Carvill case, the Court of Appeal did not negate the custom but found that it was at least arguable that the reinsured was also liable for the commission when they stopped paying gross premiums either to the insurer or to the broker.

In marine insurance cases, the answer could be much simpler. The broker could just sue the assured for the unpaid gross premium which includes the commission, because under marine insurance, the broker is directly liable to pay the premiums to the insurer which gives him a cause of action against the assured for the gross premium.

The fact that the brokers are paid by insurers in practice may raise concerns of conflict of his duties and interest. However, this practice can be justified by the broker's full disclosure of such fact to the assured and to obtain their informed consent.[208]

4.3 Commission Disclosure

4.3.1 Why should the commission be disclosed

It is now clear law that the broker is the agent of the assured.[209] Thus, there is a fiduciary relationship between the broker and his principal. Such a relationship requires a broker to always act in his principal's best interest and not to place himself in a position where his interest may conflict with his duty[210] and not to make a personal profit out of his position without his principal's knowledge and consent.[211] If the broker

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[207] *Lord Norreys v Hodgson* (1897) 13 TL 421; *McNeil v Law Union & Rock Insurance Co Ltd* (1925) 23 Ll L Rep. 314; *Pryke v Gibbs Hartley Cooper* [1991] 1 Lloyd's Rep. 602; *Velos Group Ltd v Harbour Insurance Service* [1997] 2 Lloyd's Rep. 461.

[208] *Regal (Hastings) Ltd v Gulliver*[1942] 1 All ER 378.

[209] *Gerling-Konzern General Insurance Co v Polygram Holdings & Metropolitan Entertainment Inc* [1998] 2 Lloyd's Rep. 544; *Goshawk Dedicated Ltd v Tyser & Co Ltd* [2005] Lloyd's Rep. I.R. 379;*Anglo-African Merchants Ltd v Bayley* [1970] 1 Q.B. 311.

[210] *Thompson v Havelock* (1808) 1 Camp 527; *Keech v Sandford* (1726) Sel Cas t King 61; *Aberdeen Railway Co. v Blaikie* (1854) 1 Macq 461; RE Biss [1903] 2 Ch. 40.

[211] *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378; *Dale v IRC* [1954] A.C. 11; *Brown v IRC* [1965] A.C. 244. *Bray v Ford* [1896] A.C. 44.

received any commission from the insurer without the assured's knowledge, he obviously put himself into a position where he had a conflict of interest. Because the broker will be interested in looking for the insurer who would give him the biggest commission not the one who will provide the best possible deal for the assured. But 'the real evil is not the payment of money, but the secrecy attending it.'[212] If the broker properly discloses the payment of commission by the insurer and receives the assured's informed consent, he is fully entitled to receive that commission or other profit.

4.3.2 Compulsory or just on demand?

4.3.2.1 FSA regulation- on demand

The conduct of intermediaries is regulated both by statute and by rules and guidance drawn up by the Financial Services Authority (FSA). The current Insurance Conduct of Business Rules Sourcebook (ICOBS) came into full effect in January 2005.

The commission disclosure rule in ICOBS 4.4.1 states that:

'(1) An insurance intermediary must, on a commercial customer's REQUEST, promptly disclose the commission that it and any associate receives in connection with a policy.

(2) Disclosure must be in cash terms (estimated, if necessary) and in writing or another durable medium. To the extent this is not possible, the firm must give the basis for calculation.'[213]

As can be seen from the rule, the intermediaries should disclose the commission only when the commercial customer's requested. There is no proactive duty to disclose the commission to the customer.

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[212] Chitty L.J. in *Shipway v Broadwood* [1899] 1 QB 369, at p.373.

[213] http://fsahandbook.info/FSA/html/handbook/ICOBS/4/4.

Moreover, as a guideline, the Authority requires all forms of remuneration from any arrangement should be disclosed. This includes 'arrangements for sharing profits, for payments relating to the volume of sales, and for payments form premium finance companies in connection with arranging finance'[214].

Finally, the commission disclosure rule is applicable whether or not the intermediary is the agent of the commercial customer, because such a duty is imposed additionally to the general law on the fiduciary obligations of the intermediary.[215]

4.3.2.2 Common Law-on demand for ordinary amount

The commission disclosure rule in ICOBS echoes that in the common law. *In Great Western Insurance Company v Cunliffe,*[216] a marine insurance company in New York instructed a firm of merchants in London as their agent with two agreements. Some of the matters the company authorised the agent to do were: a. settling and paying claims arose from the company's policies in London or Liverpool; b. placing reinsurance. They have agreed the commission for settling and paying claims at 2 ½ per cent. . But the company did not ask about the remuneration for placing reinsurance. In the account between the reinsurers and the agent, the reinsurers allowed 5 per cent on each re-insurance the agent placed with them as brokerage and further 12 per cent on the profits of the year as discount. Only the 5 per cent was shown in the accounts sent to the company by the agent, the 12 per cent was not mentioned. The company did not know about the 12 per cent discount until 1866, but they made no objection to it until 1868. In the bill filed against the agent, one of the claims was that the allowance of 12 per cent was made to the company by the re-insurer and should be accounted to them.

At first instance, the judge ruled against the agent on the ground that he was acting not as an insurance broker who was the agent both for the underwriters and the assured, but was solely the agent of the assured, whose fiduciary duty required that no benefit should be received for themselves in the course of his agency. In the Court of Appeal, the decision was reversed. The reasoning was as follows:

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[214] ICOBS 4.4.2.

[215] ICOBS 4.4.3.

[216] (1869) L.R. 9 Ch.App. 525.

When the company asked the agent to settle and pay the claims, they asked about the remuneration the agent asked for. But they never asked about their remuneration for effecting re-insurance. This showed that they must have known that the agent would be remunerated by receiving a certain allowance or discount from the underwriters. In fact, it was a well-established practice that the person, whether you call him a broker or not, who effected insurance for the merchant or anyone else received a discount of 5 per cent of the premium from the underwriters. If upon the settlement of the account, there was a profit for the underwriters, 12 per cent upon the profit would be given to the agent as a gratuity. Such practice was recognised by the Courts of Law. If, the company wanted to know the rate the agent received from the underwriters, they should have inquired about that. If they did not, the normal rate should be allowed to the agent. This position was conveniently summarised by Sir G.Mellish, L.J.

'If a person employs another, who he knows carries on a large business, to do certain work for him, as his agent with other persons, and does not choose to ask him what his charge will be, and in fact knows that he is to be remunerated, not by him, but by the other persons-which is very common in mercantile business-and does not choose to take the trouble of inquiring what the amount is, he must allow the ordinary amount which agents are in the habit of charging.'[217]

An additional factor that made the court reach that decision was that the company did have a conversation with the agent about the 12 per cent discount in 1866, but did not make any objection until 1868. That constituted a waiver by conduct which prevented the company from re-opening the account.

The Court of Appeal's decision was followed by the courts in *Barring v Stanton.*[218] The difference between the two cases was the fact that the payment of premium in Great Western was made through the 'credit system', while in *Barring v Stanton* the premium was paid through the 'cash system', and 10 per cent discount was allowed to the broker on each transaction. The agent failed to establish that such conduct was a custom in the market, but they have showed that it was their usual way of doing business. At first

[217] (1869) L.R. 9 Ch.App. 525, at p.540.

[218] (1876) 3 Ch.D. 502.

instance, the judge held that whether the money was actually paid made no difference, the giving and receiving of the credit between the underwriter and the agents was equivalent to payment. Therefore, Great Western could not be distinguished from the current case, but should govern this case. The Court of Appeal affirmed the decision.

Seen from these decisions, it is obvious that if the amount allowed by the underwriters are usual, and the assured have not asked about the amount, the agent need not disclose it proactively, and such usual amount would most probably be allowed by the court. It can also be seen from the two cases that the court not only recognised the amount established by custom (*Great Western*), but also the amount the agent was in the habit of making to any of its customers (*Barring v Stanton*) as ordinary amount.

The above cases indicate only normal commission. What about the situation with exceptional commission? Is it compulsory that the broker should disclose it? There is no clear case law in insurance context. But according to the principles of fiduciary duties, If a broker is to receive commission greater than is usual in the market, that fact has to be disclosed to the assured and the assured's consent should be sought.

4.3.2.3 Will the Bribery Act 2010 change the common law position?

Earlier 2012, the High Court of Hong Kong SAR considered the question of whether the payment of commission by an insurer to a broker was prohibited by the Prevention of Bribery Ordinance (PBO) in *Hobbins v Royal Skandia Life Assurance Ltd*.[219] Reyes J. followed the long line of common law authorities such as *Great Western v Cunliffe* and held that the commission paid by an insurer did not constitute an illegal profit unless it was in excess of what was normally paid; there is no duty to disclose the amount of the commission if it is normal. Moreover, the 'lawful authority' is not merely a custom in section 19 of PBO which cannot be a defence to the PBO obligations.

The same issue about the impact of Bribery Act 2010 (the Act) on insurance broker's remuneration may also arise under English law.

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[219] [2012] HKCFI 10.

The broker's act of receiving commission from insurers is regulated by the Act. If dispute arises, it will generally be considered under section 2 'Offences relating to being bribed'. In establishing a bribery offence, it should be proved that (1) the broker have requested, agreed to receive or accepts a financial or other advantage; and (2) the broker conducted improper performance. Section4 explained what constitutes improper performance. Briefly speaking, the act is improper if it is performed in breach of a relevant expectation. Section 5 stipulates the expectation test:

(1) For the purposes of sections 3 and 4, the test of what is expected is a test of what a reasonable person in the United Kingdom would expect in relation to the performance of the type of function or activity concerned.

(2) In deciding what such a person would expect in relation to the performance of a function or activity where the performance is not subject to the law of any part of the United Kingdom, any local custom or practice is to be disregarded unless it is permitted or required by the written law applicable to the country or territory concerned.

(3) In subsection (2) 'written law' means law contained in—

(a) any written constitution, or provision made by or under legislation, applicable to the country or territory concerned, or

(b) any judicial decision which is so applicable and is evidenced in published written sources.

According to section 5(2) and section 5(3) (b), if the act is permitted by law, including case law, it is not improper. As a result, the Bribery Act 2010 has not changed the common law position that the commission paid by an insurer did not constitute an illegal profit unless it was in excess of what was normally paid. For the brokers, they have no duty to disclose the amount of the commission he received from the insurer if it is normal.

However, it was said that the way the system of remuneration operates is contrary to modern standards of transparency.[220] It is much hoped that the broking community can take the lead in ensuring full disclosure of commission earned.

4.3.2.4 The new development for commission disclosure

There were calls for greater disclosure of insurance commissions and avoiding conflicts of interest in U.K. and E.U. in the wake of the Spitzer enquiry in US in 2004, which focused on contingent commissions which were in effect bonuses to brokers for selling high volumes or more profitable products.[221] In June 2005, the European Commission initiated a sector inquiry into the provision of insurance products and services to businesses in the Community and published a report on Business Insurance Sector Enquiry in 2007. In the U.K., CRA International (CRA) carried out an independent research on behalf of the Financial Services Authority (FSA) and produced a report (the CRA report) which focused primarily on commission disclosure in 2007. Both pieces of work found evidence of a lack of transparency in the commercial insurance market in relation to intermediary remuneration and services, which could give rise to customer detriment and impair market efficiency.

In March 2008, the FSA published the Discussion Paper 08/2 on Transparency, Disclosure and Conflicts of Interest in the Commercial Insurance Market,[222] in which three options for reform were proposed. They were (1) a more rigorous enforcement of existing rules; (2) enhancing the current ‘on request’ regime; or (3) mandatory commission compulsory.

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[220] Financial Services Authority, FS08/07Transparency, disclosure and conflicts of interest in the commercial insurance market; Commission of the European Communities, Sector Inquiry under Article 17 of Regulation (EC) No 1/2003 on business insurance (Final Report), p. 65.

[221] It is to be noted here that in February 2010, officials in New York, Connecticut and Illinois agreed to lift the ban on the larges brokers accepting contingent commissions, a ban that had been in place since the beginning of 2005. However, none of the three largest brokers seem keen to pick up contingent commission again.

[222] http://www.fsa.gov.uk/pubs/discussion/dp08_02.pdf.

Following various consultations with the industry participants it was found out in the Feedback Statement 08/7 on Transparency, Disclosure and Conflicts of Interest in the Commercial Insurance Market, that mandatory disclosure of commissions was unpopular amongst respondents. It is also to be noted here that in the CRA report it was found out that 'the cost of mandatory commission disclosure would outweigh the benefits'[223] Therefore, it was agreed that an industry-led solution should be made to achieve five outcomes for commercial customers.[224]

The Industry Guidance was later drawn up by the British Insurance Brokers' Association (BIBA), the London and International Insurance Brokers' Association (LIIBA), the Institute of Insurance Brokers (IIB) and the Association of British Insurers (ABI) and was published on 1st April 2009. The Guidance was confirmed by FSA, which means that, although it is not compulsory, the FSA will not take action against a firm that acted in compliance with the guidance. The guidance has, in fact taken the second approach in the discussion paper which is an enhanced 'on request' scheme. The broker still has the obligation to disclose the commission only when requested by the customer. Besides, the guidance suggested that the firms should remind the customers in writing at least every twelve months about their right to ask for this information. The guidance also suggested the way the commission should be disclosed and provided a standard form for remuneration disclosure.

At Lloyd's, the market guidance titled Distribution Costs, Broker Remuneration and Additional Charges was published in Lloyd's Market Bulletin on 22nd February 2012. In that guidance, no contingent commission[225] was allowed in the Lloyd's market.

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[223] CRA International, *Commercial insurance commission disclosure: Market Failure Analysis and high level Cost Benefit Analysis*, at p. 109.

[224] Feedback Statement 08/7 on Transparency, disclosure and conflicts of interest in the commercial insurance market para. 3.3 (a) customers should have clear and comparable information about the commissions intermediaries receive; (b) customers should have clear and comparable information about the services intermediaries are providing; (c) customers should have clear information about the capacity in which an intermediary is acting; (d) customers should be alerted to their right to request commission information; and (e) customers should be made aware where there is a chain of intermediaries.

[225] Commissions based on the volume the broker brought to the insurers and the profitability of the introduced business.

Another trend to be noticed in the London market is that the Market Reform Contract (MRC) became the London Market standard on 1st November 2007. Since then it has been widely used in the London market. The MRC is made up of six sections, one of which is 'Broker Remuneration & Deductions'. [226] In Apendix F to the Implementation Guide 2011, it was suggested that the brokerage should be written in the contract no matter whether it is total brokerage or split out as wholesale and retail brokerage.[227]The European Commission also took the broker's commission disclosure as part of the review of the current Insurance Mediation Directive 2002/92/EC (IMD), which does not contain information requirements relating to the remuneration for intermediaries. In its Consultation Document on the Review of the Insurance Mediation Directive (IMD), which was published on 26th November 2010, the Commission asked for views on how a revised directive, IMD2, could address the problems of lack of transparency and conflicts of interest.

The European Commissions considered three options for remuneration disclosure: the mandatory 'full disclosure'/ on request disclosure, ban on commission or soft law which include issuing guidelines, self-regulation, ethical codes, etc. It is highly controversial among the consultees. The mandatory full disclosure scheme was strongly opposed by insurance intermediaries, because they are concerned with vertical integration, which means the customer will deal with the insurers directly to avoid the commissions. They advocated a disclosure regime on request by the customer or the adoption of ethical codes (the soft law option). On the other hand, mandatory disclosure is supported by consumer groups (FSUG, BEUC, German association of consumers, etc.).

In the Impact assessment document, it was said that both mandatory disclosure and on request disclosure would have positive effects on competition in insurance distribution

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[226] Market Reform Contract (Open Market) Implementation Guide Version 1.4 September 2011 para.3.1. http://www.londonmarketgroup.co.uk/index.php?option=com_content&view=category&id=41&Itemid=144&2ced3df0a1c08ee30f41a6e26bbeabd2=1da5af74b0cfcb70ef35c5eb62d5907f.

[227] Market Reform Contract (Open Market) Implementation Guide Version 1.4 September 2011,F2.2-2.4.

at a low cost. It will mitigate the conflicts of interests and the information asymmetry between the seller and the buyer.

IMD II legislative proposal was published on 3rd July 2012.[228] In article 17 titled Conflicts of interest and transparency, it proposed in section 1 (f) that the intermediaries, either for life or non-life insurance, should disclose, prior to the conclusion of any initial insurance contract, and, if necessary, upon amendment or renewal thereof, the amount of remunerations paid as fees or commissions, if the amount is not known, the way how the remuneration would be calculated should be disclosed to the client; according to section 1 (g), the contingent commission should be disclosed as well. This is in fact a mandatory 'full disclosure' regime.

In section 2, a transitional period of five-year was proposed for the remuneration disclosure for non-life intermediaries. During this period, the intermediaries soliciting non-life insurance covers will be remained under the ‘on request’ scheme, but they have a proactive duty to inform the customer of his right to request the remuneration information. After the expiry of this transitional period, the mandatory ‘full disclosure’ regime will automatically apply for the intermediaries who sell non-life products.

It was said in the Impact Assessment that for the mandatory ‘full disclosure’ and ’on request’ disclosure, the preferred option was ‘to introduce an on-request regime for the sales of non-life products with a 3 years transition period. ‘This will allow SMEs to prepare and adjust themselves to the legislative change and measure the impact of the suggested change in real life. This is in line with the views of most stakeholders (intermediaries, insurance industry) as well as EIOPA and, at the same time, insures proportionality and flexibility towards SMEs. It will provide a useful midway balancing consumer groups' and intermediaries' as well as SME's interests.’[229]

In summary, the information requirement for insurance brokers in U.K. will still be within the enhanced ‘on request’ scheme for some time. Whether it will switch to the mandatory disclosure scheme may subject to a further review and evaluation of the

[228] http://ec.europa.eu/internal_market/insurance/docs/consumers/mediation/20120703-directive_en.pdf.

[229] Impact Assessment Accompanying the document Directive of the European Parliament and of the Council on Insurance Mediation, at p.43.

impact of these disclosure rules on non-life insurance intermediaries in the IMD II after its entry into force.

4.3.3 What is full and proper disclosure

Whether there has been full and proper disclosure depends upon the facts of each case.[230] The burden of proving that full disclosure has been made to the assured lies on the agent.[231]

To free the broker from liability for receiving unusual commission, partial disclosure is not enough. In *Bartram & Sons v Lloyd,*[232] the purchaser only knew of an arrangement for the payment of commission by the shipbuilder to the agent at an interview after the contract was made, he did not know the content of the arrangement. The court of appeal held that this was not enough. A full disclosure requires all the material circumstances relating to the arrangement of the commission be communicated to the principal.

In *Hurstanger Ltd v Wilson and another,*[233] where the principal was informed that the third party will pay commission to the broker, was held not proper enough to relieve the agent of his liability for breach of fiduciary duty. Tuckey L.J. cited a paragraph from Bowstead & Reynolds, which he said was an accurate statement of the law. '[I]t is not sufficient for the agent merely to disclose that he has an interest or to make such statements as would put the principal on inquiry, nor is it a defence to prove that had he asked for permission it would have been given'[234] The judge went on to say that 'whether there has been sufficient disclosure must depend on the facts of each case given that the requirement is for the principal's informed consent to his agent acting with a potential conflict of interest.' [235]

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[230] *Hurstanger Ltd v Wilson and another* [2007] 1 W.L.R. 2351.

[231] *Jordy v Vanderpump* (1920) 64 section J. 324; *Dunne v English* (1874) L.R. 18 Eq. 524.

[232] (1904) 90 L.T. 357.

[233] [2007] 1 W.L.R. 2351.

[234] Bowstead & Reynolds on agency 18th ed. para. 6-057.

[235] Bowstead & Reynolds on agency 18th ed. para. 6-057.

The most controversial point of the standard of the disclosure may be the issue whether the agent's duty of disclosure requires him to disclose to his principal the amount of the commission he is to receive from the other party. There is no set rule for this, but it depends on the circumstances of each case. If there is a custom to receive a set amount of commission in the market, like in the cases of marine insurance,[236] there is no need to disclose the usual rate. The assured should find the market as it is. Where no usage is involved, or the broker is to receive some exceptional commission, he may well be required to be more specific about the amount or the way it is to be calculated.

4.3.4 The assured's informed consent

Only the evidence of full and proper disclosure is not enough to relieve the broker of liability from breach of fiduciary duty. The principal's consent with full knowledge of all the material circumstances has to be obtained. Full knowledge of the principal assured is the counter part of the requirement of full disclosure on the part of the broker.

4.3.4.1 'Informed'

As the requirement for the broker's full disclosure, the requirement for the assured's informed consent is that the assured should have full knowledge of the nature and circumstances of the transaction between the agent and the third party relating to the transaction the agent done on behalf of the principal;[237] the informed consent also requires that the assured's has an actual awareness of the potential conflict of interest.[238] However, it is not necessary to show that the principal know that what he is consenting to is a breach of duty, so long as he clearly knows that what it is.[239]

4.3.4.2 'Consent'

There will not be much dispute, if the consent has been positively shown. However, when the material circumstances which may give rise to conflict of interest have been

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[236] *Great Western Insurance Co. v Cunliffe* (1896) L.R. 9 Ch.App. 525.

[237] *De Bussche v Alt* (1878) L.R. 8 Ch.D. 286, at p. 313.

[238] *Hurstanger Ltd v Wilson and another* [2007] EWCA Civ 299, at para. 35.

[239] Re Pauling settlements Trusts [1962] 1 W.L.R. 86 at p.108.

disclosed to the assured, but the assured does not say anything about his decision, the issue of whether acquiescence can be found will be raised.

In *Anangel v IHI,*[240] Mr. Campbell, who was a distinguished naval architect, set up two companies. One of the companies (Algoship) was a joint venture set up by him and a shipbuilding company (IHI), which was used to design and develop vessel; the other (Campbell International) was used by Mr. Campbell to deal with shipowners. IHI agreed to pay $30,000 per vessel to Mr. Campbell . The payment was made to Algoship. Some shipowners who had ordered vessels from IHI through Mr. Campbell claimed to recover the payment made to Mr. Campbell as for money had and received. One of the issues was that whether the shipowners consented to the payment. The judge was satisfied that the shipowners were aware of the existence of the payment and he said that 'despite their [the shipowners] knowledge of the payments to Algoship [the agent], the claimants [the shipowners] were content to contract with IHI [the ship building company], and must therefore be taken to have consented to such payments being made.'[241]

The decision suggested that the assured could be taken as giving the consent by his acquiescence or more accurately being estoppeled by his own conduct.

4.3.5 Remedies against the broker for non-disclosure of secret commission

4.3.5.1. Account to the assured for the secret commission

An agent who receives commissions without obtaining the principal's informed consent will be bound to account them to his principal. The ground upon which such liability arises was stated by Lord Russell in *Regal (Hastings) Ltd v Gulliver* as follows:

'The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the claimant, or whether the profiteer was under a duty to

[240] [1990] 1 Lloyd's Rep. 167.

[241] [1990] 1 Lloyd's Rep. 167, at p.176.

obtain the source of the profit for the claimant, or whether he took a risk or acted as he did for the benefit of the claimant, or whether the claimant has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account.'[242]

The interest on the secret commission is also accountable from the date the secret commission is received.[243] But the claim for interest is alternative to a proprietary claim for profits,[244] if there is one (this will be discussed in the next head). So the assured has to elect whether to sue for the interest or for the profits of the secret commissions.

(A) Secret commission and rescission

It is also to be noted that the assured's right to claim against the broker for money had and received is separate and distinct from that to claim rescission of the contract against insurer. [245] The fact that the assured claims against the broker for the secret commission will not affect his equitable right of rescission of the contract against the insurer who pays the secret commission. On the other hand, no matter whether the assured chooses to affirm the contract or to rescind the contract, it does not affect his right to claim against the broker for the secret commission for money had and received.[246]

(B) Secret commission and damages

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[242] [1967] 2 A.C. 134, at p. 144-145. See also *Keech v Sandford* Sel.Cas.Ch.61; *Exparte James* 8 Ves. 337; *Boston Deep Sea Fishing & Ice Co. v Ansell* (1888) 39 Ch.D. 339.

[243] *Hurstanger Ltd v Wilson and another* [2007] 1 W.L.R. 2351; *Nant-y-glo and Blaina Iron Co. v Grave* (1878) 12 Ch.D. 738; *Boston Deep Sea Fishing and Ice Co. v Ansell* (1888) 39 Ch.D. 339.

[244] Re Davis [1902] 2 Ch. 314.

[245] *Logicose Ltd v Southend United Football Club Ltd* [1988] 1 W.L.R. 1256; *Bagnall v Carlton* (1877) 6 Ch.D. 371.

[246] Emma Silver Mining Co v Lewis (1879) 4 C.P.D. 396; *Lydney and Wigpool Iron Ore Co. v Bird* (1886) L.R. 33 Ch.D. 85; *Grant v The Gold Exploration and Development Syndicate, Ltd*. [1900] 1 Q.B. 233.

However, the money recovered from the broker as money had and received will be given credit when calculating the actual loss sustained by the assured in an action against the insurer for damages for fraud.[247]

Nevertheless, when the assured intended to sue only the broker, he has to choose to sue either for money had and received or for damages for fraud, since the two remedies are alternative rather than accumulative.[248]

4.3.5.2 Any proprietary remedy against the broker?

The answer to this question depends on the finding of the nature of the secret commission. Is it to be treated as a debt between the assured and the broker or a trust property between them? If the secret commission is treated as a debt between the assured and the broker, the broker is only liable to pay back the amount of the secret commission and the interest on the secret commission from the date it was received, no proprietary remedy is available. If the secret commission is considered to be a trust property, a proprietary claim may be made against the broker. From the assured's point of view, the proprietary remedy has a few advantages: (1)it enables the assured to recover not only the amount of the secret commission with interest but also the increased value from investment made by such money; (2) Where the broker is insolvent, the assured will be able to recover the secret commission in full in priority to other creditors; (3) tracing to a third party.

There were some Court of Appeal cases which held that the agent was only liable for the secret commission as a debtor to the principal,[249] not as a constructive trustee. The most discussed one was *Lister v Stubbs*,[250] where the principal claiming to be entitled to follow the profit which have been gained through investment of the secret commission. In this case, the agent of a manufacturing company purchased materials for his principal's business from a third party who gave him large sums by way of commission.

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[247] *Mahesan v Malaysia Government Officers' Co-operation Housing Society Ltd* [1979] A.C. 374.

[248] *Mahesan v Malaysia Government Officers' Co-operation Housing Society Ltd* [1979] A.C. 374.

[249] *Metropolitan Bank v Heiron* (1880) 5 Exch D 319(a case of bribe); *Lister v Stubbs* (1890) 45 ChD 1(a case of bribe); *Powell & Thomas v Evans Jones & Co.* [1905] 1 KB 11(a case of secret commission).

[250] (1890) L.R. 45 Ch.D. 1.

He used these moneys to purchase freehold land and do other investment. The principal claimed, inter alia, that the moneys belonged to the principal rather than the agent who was only trustee of such money. Therefore they could recover not only the secret commission, but also the profit made from the investment of the moneys. However, the court did not agree and held that the relationship between the principal and the agent regarding the secret commission was creditor and debtor, not *cestui que* trust and trustee. Some of the reasons that the court was reluctant to award proprietary remedy were that (1) the general creditors of the fiduciary would be prejudiced when the fiduciary went insolvent; (2) the principal would be able to recover not only the secret profit and interest, but also the profits the agent make, which the principal may not be able to make by himself.

These are not sufficient reasons for withholding the proprietary remedy from the principals. For the creditors of the false fiduciary, such profit should never have formed part of their debtor's estate. The creditors should be in no better position than the defendant himself. The grant of a proprietary remedy causes no injustice to the creditors of an insolvent broker. For the agent, a proprietary remedy is necessary to enforce the high standards which equity demands of a fiduciary. A fiduciary who fails to observe them must be stripped of every advantage which he has obtained thereby. Otherwise, the agent will benefit from his own breach of duty, which is not allowed by equity.

In fact, there were some cases which supported the view that the secret profit was held by the fiduciaries as constructive trustee. One of the prominent cases which so held was *General –Attorney for Hong Kong v Reid.*[251] In this case, a public prosecutor in Hong Kong, induced by bribes, exploited his official position by obstructing the prosecution of some criminals. The Attorney General tried to claim the titles to three properties in New Zealand controlled by the former prosecutor which could only have been derived from the bribe. Both the first instance judge and the Court of Appeal of New Zealand ruled that as between principal and fiduciary, the receipt of a bribe by the fiduciary only gave rise to the relationship of creditor and debtor and not trustee and cestui que trust. The Attorney General appealed to the Privy Council, where it was decided that a fiduciary who accepted bribe held that bribe in trust for the person to whom he owed the

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[251] [1994] 1 All ER 1.

duty as fiduciary. Lord Templeman delivered the judgement on behalf of the board. The analysis of Lord Templeman was that

'As soon as the bribe was received it should have been paid or transferred instanter to the person who suffered from the breach of duty. Equity considers as done that which ought to have been done. As soon as the bribe was received, whether in cash or in kind, the false fiduciary held the bribe on a constructive trust for the person injured.'[252]

Later, Lord Templeman cited some cases, the decisions of which were consistent with his analysis. He also considered *Lister v Stubbs*, saying the decision was not consistent with the equity principles, which included: (1) a fiduciary must not be allowed to benefit from his own breach of duty; (2) the fiduciary should account for the bribe as soon as he receives it; (3) equity regards as done that which ought to be done. [253]

The case involved a bribe, but its reasoning is applicable to any case in which a fiduciary is accountable to his principal for a secret profit,[254] because the basic equitable principle is that the fiduciary's liability does not depend upon dishonesty or bad faith, but upon the mere fact that a profit has been made.[255] The derivative which is useful for the current discussion is that it also applies to the marine insurance broker's receiving secret commission. According to the decision in *Attorney General for Hong Kong v Reid,*[256] a proprietary remedy is available to the assured against the broker. The broker is liable to account to the assured of all the secret commissions and all the profits made out of these commissions. If the value representing the secret commission decreases, the broker must pay the difference between that value and the initial amount of the secret commissions, because he should not have subjected them to the risk of loss.

4.3.5.3. Claim for the unpaid secret commission

[252] [1994] 1 All ER 1, at p.5.

[253] [1994] 1 All ER 1, at p. 9.

[254] [1994] 1 All ER 1, at p.5.

[255] Ex p. James (1803) 8 Ves 337; *Keech v Sandford* (1726) Sel Cas t King 61; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378.

[256] [1994] 1 All ER 1.

It was discussed above that the broker must account to the assured for the secret commissions he received. However, the question of whether the assured can claim against the insurer to recover the unpaid commission in the secret agreement between the broker and the insurer still need to be answered.

(A) Assured's right to enforce the agreement to claim the unpaid secret commission

In *Whaley Bridge Calico Printing Co v Green and Smith,*[257] Mr. Green (G) had purchased certain calico painting works and premises for the sum of 15,000l. He associated with Mr. Smith (S), who was the manager in Mr.Green's employment at the time, to float a company for the purchase of the works from G. G and S made a sham contract to pretend a sale of the works by G to section for 20,000l. After the company was formed, G and S conveyed the works to the company for 20,000l. It was agreed between G and S that G should pay the sum of 3,000l. out of the 20,000l. purchase-money to S, but this agreement was not communicated to the directors of the company when the sale to the company was effected. The company claimed that they were entitled to enforce against G the agreement between G and S to pay over the secret profit to S, on the ground that they were entitled to treat this contract with S as made for the profit of the company and not for S. The judge held that as a promoter of the company, section had no right to derive any secret profit from the promotion, it was contrary to good faith. The relief granted by equity was the account of the secret profit by the promoter to the company. If the secret profit had been paid by G to S, there was no doubt that section would be compelled to pay it over to the company. However, the issue here was that the secret profit has not been paid to the promoter, whether the company can enforce the secret agreement in their favour? Objections were that the agreement was still unexecuted and that the agreement was illegal.

The judge first dealt with the illegality issue. He said that there was nothing illegal in the contract that section should receive 3000l. out of the sale, provided that it was disclosed to the company before they entered into the transaction. Then the company may choose either to sanction the agreement or claim the benefit of the bargain. The

[257] (1879)5 Q.B.D. 109.

company cannot be worse off because the existence of the contract was concealed from him.

As to the issue of unexecuted contract, the judge said that '[i]n many unexecuted contracts the principal could not substitute himself in the agent's place, as the person for whose benefit the contract was to be performed, without altering substantially the character of the contract. But where nothing has to be done under the contract but payment of money to the agent, I think that the principal, under circumstances such as these, is entitled to stand in the agent's shoes and compel a payment of money directly to himself.'

In *Powell & Thomas v Evan Jones & Co.*,[258] a sub-agent succeeded in obtaining a loan for his principal from a third party with whom he used to do business with. The sub-agent and the third party entered into a commission agreement, by which the sub-agent was entitled to receive his usual commission for introducing business to them, which amounted to 145l. and a certain percentage on the annual premiums payable upon an insurance policy which had to be taken out by the principal with the third party. This agreement was neither known to the agent or the principal. In the court, the principal claimed for the secret commissions which had been received by the sub-agent and a declaration to the effect that the principal were entitled to any benefit acquired by the sub-agent under the agreement for commission made by the sub-agent with the third party, as having been made by him as their agent, and they were therefore entitled to have the sums payable under it paid to them as and when they become payable by the third party. It is necessary to note that the court followed the decision in *Lister v Stubbs* [259]and held the relationship between the sub-agent and the principal in respect of the secret commissions was debtor and creditor, not trustee and cestui que trust. On this premise, Collins MR did not give the principal the right to enforce the secret commission contract. However he said, obiter, that 'If the parties were held to be trustee and cestui que trust, cowperthwaite [the sub-agent] was to be regarded as a trustee for them of the agreement which he had made with the society [the third party who made contract with the principal] for commission, and they could insist on that agreement

[258] [1905] 1 K.B. 11.

[259] (1890) 45 Ch.D. 1.

being enforced for their benefit: and that again would involve the result that he would be a trustee for them of any sums received by him under it.'[260]

(B) Claim for the unpaid commission for money had and received.

Another ground upon which the unpaid commission can be claimed from the insurer is an action for money had and received.

In *Grant v The Gold Exploration and Development Syndicate, Ltd.*,[261] the claimant vendor met the director of the defendant syndicate in British Columbia where the vendor owned certain mineral rights. Negotiations took place about selling the mining properties. The vendor gave a commission note to the director promising to pay him 10% on all sums whether in cash or shares which accrued to him on the transaction. At that time the vendor did not know the fact that the man he dealt with was the director of the defendant syndicate. This was known to him only after the price was fixed and before any contract for the purchase of the property was entered into between the vendor and the syndicate. However, the vendor did not disclose the commission note to the syndicate. The contract for purchase was performed. When the syndicate found out the existence of the commission arrangement between the vendor and the director, they appointed a committee to inquire into the matter and recovered from the director the received commission in cash and share. In the current case, the syndicate claimed against the vendor to recover 500l., the reduced amount of commission agreed between the vendor and the director. The court held that the syndicate was not bound by the agreement as to the reduction of the amount of commission and that the syndicate was entitled to recover any part of the agreed commission remaining in the vendor's hand. As to the ground upon which the decision that the syndicate was entitled to recover the unpaid commission from the vendor was made, the judges all agreed that it can be claimed as damages for deceit.[262] Collins L.J. also added that even if the vendor acted bona fide, the fact that he did not disclose the existence of the commission note to the

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[260] [1905] 1 K.B. 11, at p.20.

[261] [1900] 1 Q.B. 233.

[262] This will be further discussed in 7.6.5.

syndicate entitled them to recover the unpaid commission for money had and received for the syndicate's use.[263]

It won't be a surprise if a marine insurance broker receives secret commissions from insurers, the assured will be allowed by the court to receive the future secret commissions either by enforcing the commission agreement or by claiming damages from the insurers for money had and received for the assured's use. Because, in breach of his fiduciary duty, where the broker does act for himself, he is treated as if he had acted for his principal and is accountable to his principal for any profit which results. Moreover, the agent's obligation of loyalty required him to obtain the best deals for the principal. If the insurer is willing to give the broker the amount of the secret commission by way of deducting them from the premium, that means he is willing to accept the risk on a lower price, so no injustice will be done to either the broker or the insurer, if the unpaid secret commissions is awarded to the assured.

4.3.5.4 Is the broker still entitled to the contractual commission for remuneration?

When the brokers received secret commissions from insurers, they have to pay over that amount to the assureds. What will happen to the commission which is the remuneration for their services? Are they still entitled to the commission as agreed or that right is deprived by their wrongful act, even if the contract of insurance has been concluded and the assured benefits from it? If there are several separable transactions done by the broker for the assured under the agency contract, some of the transactions are tainted, others are not. Will the broker's commission for the untainted transactions be affected by the tainted transactions?

(A) No right to receive commission when the broker received secret commission

In Andrews v Ramsay & Co.,[264] a property owner instructed an estate agent to sell a property at the price of 2,500l. and agreed to pay 50l as commission. Later, the agent wrote to the property owner saying that there was a Mr. Clutterbuck who was willing to buy the property for 1,900l. The owner refused that offer. Subsequently, the owner

[263] [1900] 1 Q.B. 233, at p.249.

[264] [1903] 2 K.B., 635.

agreed Mr. Clutterbuck's offer of 2,100l., of which the agent said was the best price they could get. The agent deducted 50l. as commission due from the 100l. deposit with the owner's consent. However, it subsequently transpired that the agent had previously done business of sales of property with Mr. Clutterbuck, and he received 20l. as commission from him for this time. The owner brought an action against the agent to recover the secret commission of 20l., and the agent paid them into court. The action which is relevant here is the one which was then brought to recover the 50l. retained by the agent as commission for remuneration.

The Court of Appeal affirmed the County court judge's decision and gave judgement for the owner. The agent's arguing point was that by suing for and receiving the 20l., the owner had approved the transaction. The owner had had the benefit of their services. Alverstone L.J. held that the secret commission rightly belonged to the owner, the fact that the owner sued for and received that money had nothing to do with the matter whether the agent was entitled to their commission. In answering the question whether the agent was entitled to receive the commission when he received secret commission, Alverstone L.J. took *Salomons v Pender*[265] as a governing case, where it was held that an agent who was himself interested in a contract to purchase property of his principal was not entitled to any commission from the principal. This decision was followed by the judge in *E. Green and Son (Limited) v G. Tughan and Co.*[266]

In breach of the duty of fidelity owed to the principal, the agent is not only liable to account for the secret commission which he has received, he may also be deprived of the right to his commission which would otherwise be payable to him. In Andrews *v Ramsay & Co*.,[267] Alverstone L.J. expressed his doubt about whether the agent would be entitled to receive the commission if they had acted honestly.[268] Two years later, he had a chance to consider this issue in *Hippesley v Knee Brothers.*[269]

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[265] (1865) 3 H. & C. 639.

[266] (1913) 30 T.L.R. 64.

[267] [1903] 2 K.B. 635.

[268] [1903] 2 K.B. 635, p. 637.

[269] [1905] 1 K.B. 1.

In that case, the cargo owner employed auctioneers to sell his goods by auction. The owners agreed to pay a lump sum commission and 'all out of pocket expenses'. In rendering the account of the out of pocket expenses, the auctioneers debited the owner with the gross amounts of the printers' bill and of the cost of advertising while in fact they had received discounts for both of the expenses. Evidence showed that there was a general custom for printers and newspaper proprietors to allow the auctioneers a trade discount off the charges which they would not give to the cargo owner if he dealt with them directly, and that the auctioneers failing to disclose the receipt of the discounts was made with the honest belief that he was lawfully entitled to receive them under the custom. Basing on the interpretation of the terms of the contract, the court held that the auctioneers were not entitled to debit the cargo owners with the gross amounts of the printing and advertising bills. However, since the non-disclosure was made without fraud and the duty to account correctly for the out of pocket expenses was merely incidental to and separable from their main duty to sell the goods, the non-disclosure of the receipt of the discount did not deprive their right to retain the commission. Alverstone L.J. said that, 'If the court is satisfied that there has been no fraud or dishonesty upon the agent's part, I think that the receipt by him of a discount will not disentitle him to his commission unless the discount is in some way connected with the contract which the agent is employed to make or the duty which he is called upon to perform. … If the discount had been received from the purchasers the case would have been covered by *Andrews v Ramsay'*.

As can be seen from the proviso, the test is not whether the broker had acted honestly or not. The test is whether the broker's act renders a potential conflict of interest. If there is not a potential danger of conflict of interest and he had acted honestly, the broker is still entitled to receive the commission. If the broker's act renders a potential conflict of interest, even if he acted honestly, he is not entitled to receive any commission. Accordingly, if a marine insurance broker receives unusual commission from the insurer which is not known to the assured, this situation will be covered by *Andrews v Ramsay*, and he will not be entitled to any commissions as remuneration even if he acted honestly, because that renders a potential conflict of interest.[270]

[270] *Imageview Management Ltd v Kelvin Jack* [2009] EWCA Civ 63.

(B) Separable transactions under the agency contract

It has been decided at least in one case[271] that when the transactions under the agency contract was separable, the agent's entitlement to commission under the transaction which he had acted honestly will not be affected by his dishonesty in other transactions. To the author's view, distinguishing the broker's right to commission between separable transactions under the same agency contract is feasible. However, as has been said in the above paragraph, the test should be whether the broker's act renders real conflict of interest rather than whether he acts honestly or dishonestly.

4.3.5.5 Liable for damages

The giving and receiving of secret commission was treated as a fraud.[272] If the secret commission was given by an insurer in connection with the marine insurance contract between the assured and the insurer, the assured was entitled to claim damages for fraud against the insurer. Since the broker was a party to the fraud, he is jointly and severally liable for damages for fraud. [273] The principal can sue either the insurer or the broker, or both. This principle was recognised in *Salford Corporation v Lever*[274] and *Mahesan S/O Thambiah Apellant v Malaysia Government Officers' Co-operative Housing Society Ltd.*[275] However, the judges in the two cases had different opinions in regard to the relationship between the principal's right to claim the secret commission for money had and received and the right to claim for the actual loss as damages for fraud.

In *Salford Corporation v Lever,*[276] Lord Esher,M.R.. said that the agent's receiving a bribe from the third party committed two distinct and independent frauds. One was committed in his character of agent, the other was committed by conspiring with the

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[271] *Nitedals Taenstickfabrik v Bruster* [1906] 2 Ch. 671.

[272] *Panama Telegraph Co. v. India Rubber Telegraph Works Co.*(1875) L.R. 10 Ch. App.515, at p.526 James L.J..

[273] *Mahesan S/O Thambiah Apellant v Malasia Government Officer's Co-Operative Houseing Society Lt.* [1979] A.C. 374.

[274] [1891] 1 Q.B. 168.

[275] [1979] A.C. 374.

[276] [1891] 1 Q.B. 168.

third party with whom he has been dealing. Therefore, the principal was entitled to recover the bribe from the agent and recover from the agent and the third party damages for any loss he sustained by entering into the contract. That means the two remedies were accumulative instead of alternative.

However, in *Mahesan S/O Thambiah Apellant v Malaysia Government Officers' Co-operative Housing Society Ltd.*,[277] the court held that the relationship between the two remedies was alternative, not accumulative as was held in *Salford Corporation v Lever.*[278] Lord Diplock who delivered the judgement for the court, said that the principle was established from a long line of authority and was confirmed in the House of Lords decision in *United Australia Ltd. v Barclays Bank Ltd.*[279]

Therefore, the principal has to elect between the remedies before judgement was recovered on one cause of action or the other. Moreover, fraud is a tort for which the damages are limited to the actual loss sustained; and if the principal has recovered the bribe from the third party, the actual loss he has sustained in consequence of entering into the contract is reduced by that amount.

The action for damages is said to be preferable to the restitutionary and proprietary claims where the loss suffered exceeds the amount of the bribe, where the bribe has decreased in value, or where the bribe has not yet been paid.[280]

4.3.5.6 Liability of the placing broker

(A) The placing broker's fiduciary duty

It was settled law that there is generally no contractual relationship between the assured and the placing broker.[281] Does this exempt the placing broker from receiving secret commission?

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[277] [1979] A.C. 374.

[278] [1891] 1 Q.B. 168.

[279] [1941] A.C. 1.

[280] Bowstead on Agency Law 17th edn. at para. 6-085.

In *Powell & Thomas v Evan Jones & Co*.,[282] the defendant shipowners intended to raise some money by debentures. They applied to the claimant to obtain for them some money required on debentures and agreed to pay 2% of the amount obtained as commission. For this purpose, the claimant employed a sub-agent on the terms that they should share the commission the claimant might receive from the shipowners on the transaction. The sub-agent was introduced to the shipowners. During the transaction, a great deal of correspondence and negotiations took place directly between the sub-agent and the shipowners. Unknown to the claimant agent and the defendant shipowners, the sub-agent had had an agreement for commission with the third party whom they deal with. Once the required money was successfully obtained, the claimant claimed the agreed commission from the defendant shipowners. However, the shipowners refuse to pay the commission and counter-claimed for the secret commission received by and payable to the sub-agent. The sub-agent argued that he was the agent of the claimant, not that of the defendant shipowners. There is no privity of contract between them. The judge held that the facts supported the finding of a contractual relationship between the principal and the sub-agent. The judge went further to say that even if no privity of contract existed between them, the sub-agent stood in a fiduciary relation to the principals, and was therefore accountable to them for the commission which he had received from the third party. Collins M.R. said that

'Inasmuch as Cowperthwaite [the sub-agent] knew that Powell & Thomas [the agent], in employing him, were acting as agents for Evan Jones [the principal], for the purpose of procuring an advance for them, either directly or through an intermediary, he stood in such a fiduciary relation to Evan Jones as debarred him from acting in a manner contrary to their interests, or putting himself in the position of having an interest of his own in the matter which might lead him not to obtain from the third party the best terms possible for Evan Jones.'[283]

This suggested that even if there is no contractual relationship between the assured and the placing broker, the placing broker may still be liable to account for the secret

[281] *Prentis Donegan & Partners Ltd v Leeds & Leeds Co Inc.* [1998] 2 Lloyd's Rep. 326; *Heath Lambert Ltd v Sociedad de Corretaje de Seguros.* [2004] Lloyd's Rep. I.R. 495.

[282] [1905] 1 K.B. 11.

[283] [1905] 1 K.B. 11, at. p. 19.

commission to the assured on the ground of breach of the fiduciary relationship. But it should be noticed that the premise of establishing a fiduciary relationship between the placing broker and the assured is that the placing broker knows that the broker who he deals with is not his principal but is acting for another person. If the assured has never been disclosed to the placing broker, and the placing broker has reasonable grounds to think that he is dealing with the principal. It will be hard to establish a fiduciary relationship between the placing broker and the assured.

(B) Will the broker's right to commission be affected by the sub-broker's receiving secret commission?

In *Powell & Thomas v Evan Jones & Co.*,[284] the agent knew as little of that agreement between the sub-agent and the third party as that of the principal. When the agent claimed commission agreed in the commission note against the principal. Kennedy J., at first instance, gave judgement for the agent, and this issue has not been raised in the court of appeal.

The decision suggested that if the agent has acted honestly and with due diligence in his supervisory role, his right to the commission will not be affected by the sub-broker's receiving secret commission.

4.3.6 Impact on insurers for non-disclosure of the secret commission

The alternative remedies for money had and received to recover the secret commission or for damages for fraud to recover the actual loss from entering into the insurance contract can be made either against the insurer or against the broker. [285] The peculiar

[284] [1905] 1 K.B. 11.

[285]*Mahesan s/o Thambiah v Malasia Government Officers Housing Co-operative Society Ltd [1979] A.C. 374; Hurstanger Ltd v Wilson and another* [2007] 1 W.L.R. 2351.

remedy for the assured against the insurer is rescission of the contract, in respect of which the secret commission is given.[286]

In *Panama and South Pacific Telegraph Co v India Rubber, Gutta Percha and Telegraph Works Co,*[287] a telegraph works company agreed to manufacture and lay down a series of submarine cables for a telegraph company. The payment was agreed to be made by the telegraph company in the following terms that the first instalment should be paid on the order of the start of the manufacturing of the cables and that the following instalments should be paid upon certificates from the company's engineer approving the sufficient progress of making the cables and the completion of the lay of the cables. The telegraph company also agreed to pay the engineer 1 ½ per cent on the amount to be paid to the telegraph works company as commission. The telegraph company gave an order to begin making the cable and paid the first instalment and the corresponding commission to the telegraph working company and the engineer respectively. After the work had commenced, the engineer entered into another cable-laying contract with the telegraph works company, the payment of which was agreed to be made by the works company when they received the instalments from the telegraph company. When the telegraph company found out the secret contract between the engineer and the telegraph works company, they filed a bill to set aside the contract they made with the telegraph works company and claimed the first instalment and the commission they paid to the telegraph works company and the engineer.

James L.J. said that 'I take it to be clear that any surreptitious dealing between one principal and the agent of the other principal is a fraud on such other principal, cognizable in this Court. That I take to be a clear proposition, and I take it, according to my view, to be equally clear that the defrauded principal, if he comes in time, is entitled,

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[286] Since the right to avoid is available if the insurers have paid or promised a bribe to the broker, there is no need to apply the duty of utmost good faith in this circumstance. In this part, the focus will be put on the right to avoid on the ground of fraud or breach of fiduciary duty. But, if the duty of utmost good faith is to be raised, it could be argued that the payment of a secret commission is a material fact. The moral hazard doctrine requires the assured to disclose all facts relating to his (dis)honesty.

[287] (1875) LR 10 Ch App 515.

at his option, to have the contract rescinded, or if he elects not to have it rescinded, to have such other adequate relief as the Court may think right to give him.'

Mellish L.J. reached the same conclusion that the secret agreement between the engineer and the telegraph works company was a fraud committed against the telegraph company. The secret agreement made it impossible to keep the engineer as a disinterested agent and it rendered impossible that the telegraph company can have the full benefit of the contract. Therefore, the telegraph company was entitled to rescind the contract.

In *Hurstanger Ltd v Wilson and another*, the borrower was informed that the lender would pay the broker in some circumstances, but the specific amount to be paid was not known to the borrower. Tuckey L.J., in the court of appeal, recognised a half-way house where the agent's disclosure negated secrecy which would otherwise constitute a fraud, but not proper enough to relieve the agent of his liability for breach of fiduciary duty.[288] The remedies for breach of fiduciary duties were equitable and would be given at the discretion of the court. In this case, rescission was not granted by the court. In obiter, Tuckey L.J. expressed his concern about whether the borrower would be entitled to rescission as of right if it was a true secret commission case which would be treated as a fraud.

In fact, this issue had been dealt with in *Panama and South Pacific Telegraph Co v India Rubber, Gutta Percha and Telegraph Works Co.*, where James L.J. said that the right of rescission was at the defrauded principal's option.[289] The judges went even further to say that even if the parties to the secret agreement had acted bona fide, this would not suffice to bar the remedy of rescission.[290]

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[288] *Hurstanger Ltd v Wilson and another* [2007] 1 W.L.R. 2351 at para. 39.

[289] (1875) L.R. 10 Ch.App. 515 at p.526.

[290] (1875) L.R. 10 Ch.App. 515 at pp. 527, 531.

Chapter 5 Broker's Duties owed to Insurers

In the marine insurance market, the broker is the agent of the assured, but he may also owe duties to insurers under an agreed contract, like Terms of Business Agreement (TOBA), or even without a contract. Sometimes, the broker's performance is conducted in the mutual interest of both the assured and the insurers, for example, to keep the placing and claiming documents. The broker's role as 'the servant of the market'[291] facilitates the insurance business transactions, but on the other hand, these multi-functions may cause problems like the broker's agency in conducting the performance or conflict of duty and interests. As Auld L.J. said in *HIH Casualty and General Insurance Co v JLT Risk Solutions*, 'the role of an insurance broker is notoriously anomalous for its inherent scope for engendering conflict of interest in the otherwise relatively tidy legal world of agency.'[292]

5.1 The broker's duty under a binding authority

A 'binding authority' is an agreement between an insurer and a cover holder under which the insurers delegate its authority to enter into a contract or contracts of insurance to the cover holder in accordance with the terms of the agreement. A binding authority agreement can also be used to give a cover holder the authority to issue insurance documents on behalf of the insurers. A marine insurance broker can act as a cover holder.

5.1.1The broker's agency

One problem that may arise with a broker placing risks under the binding authority is that in which capacity the broker is acting in conducting a performance. Whether he is acting as the agent of the assured or he is acting as the agent of the insurer.

5.1.1.1 The insurer's agent?

[291] *General Accident v Tanter* (The Zephyr) [1984] 1 Lloyd's Rep. 58, at p.85, col.2.

[292] [2007] Lloyd's Rep. I.R. 717, at p.730, col.1.

In *Stockton v Mason,*[293] the owner's wife of a Ford car contacted the insurance broker to exchange the Ford for an M.G. car under the comprehensive motor insurance policy which cover passenger injuries and the liability of any authorised driver of the insured car. The broker's employee said, 'Yes, that will be all right. We will see to that.' The car owner authorised his son to drive the M.G. car. But the son had an accident negligently and a passenger in the M.G. car was injured. One day before the accident, the broker wrote to the assured saying that he could only get insurance which restricted driving the M.G. car to the owner himself. But this letter was received by the assured after the accident. In an action by the injured party against the owner's son for damages for personal injury, the son joined the insurers and brokers as third parties. The issue was whether there was an interim contract of insurance entered into between the insurers and the car owner as a result of the broker's response to the wife of the car owner to substitute the subject matter of the comprehensive motor insurance policy.

At first instance, Arnold J. held that by saying those words, the broker was not acting as the agent of the insurer in entering into the interim insurance contract, but as the agent for the car owner. His statement meant no more than accepting the owner's instruction to negotiate the change under the policy. So there was no interim contract between the insurer and the car owner. But the judge found that in failing to inform the car owner of their inability to carry out the owner's instructions, the broker was liable to them for his negligence.

In the Court of Appeal, the judges unanimously overturned this decision. Diplock L.J., who delivered the reasoned judgement, said that a broker in non-marine insurance had implied authority to enter into an interim insurance contract on behalf of the insurer and to issue cover note accordingly. To this background, it was reasonable for the car owners and his family relied upon the broker's statement and thinking that they were covered by the insurers under the same policy terms. 'In that sort of conversation they are speaking, in the absence of any special circumstances, to the broker as agent for the insurance company, and the broker, in dealing with the matter, is acting as agent for the insurance company and not as agent for the person wishing to have insurance.'[294]

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[293] [1979] R.T.R. 130.

[294] [1979] R.T.R. 130, at p.135.

Therefore, there was an interim contract between the insurance company and the car owner; and it should be the insurance company, instead of the brokers, that were responsible for the liability for the passenger's injury.

The same situation may arise under marine insurance policies. For example, the ship owner may want to substitute one ship for another under the hull and machinery policy. Although *Stockton v Mason,*[295] is a case for motor insurance, the broker's implied authority to bind the insurers under an interim contract is similar to the situation where a marine insurance broker holds a binding authority. The decision shows some light on the issues that may arise for marine insurance brokers when they are acting both as the agent of the assured and as a cover holder. It is advisable that the brokers who choose to be in this situation do not reply the assured's instructions with general comments like those in the Stockton case. At least, it should be made clear that they are only accepting the instructions not accepting the risks.

5.1.1.2 The assured's agent?

In *Callaghn v Thompson,*[296] the broker placed insurance for the assured's premises under a binding authority. Later, the premises were destroyed by fire. The underwriters made two payments via the broker's account without admission of liability. Particularly, the second payment was made with 'without prejudice' qualification. When the underwriters and the assureds cannot reach an agreement on the settlement figure, the assured issued a claim for the indemnity under the insurance contract. The underwriter became aware of the assured's criminal record which was not disclosed at placement, and they tried to avoid the insurance contract. The issue of the time when the underwriters became aware of the assured's criminal record has been solved by the Court of Appeal decision which held that the knowledge was acquired before the second interim payment was made.[297] The main issue to be decided by this court was whether the interim payment made by the brokers was done as the agent of the insurers and

[295] [1979] R.T.R. 130.

[296] [2000] C.L.C. 360.

[297] [1998] W.L. 1042490.

represented the insurers' election to affirm the insurance contract after they knew the non-disclosed criminal record of the assured.

David Steel J. held that 'Manson's [the broker's] status was as agents of the insured, both in respect of placement of risk and collection of claims. This status remained unaffected by the existence of the binder which rendered by special agreement Mason the agents of the defendants for some limited purposes.'[298]

The judge did not give his reasons in so held but cited a few cases[299] in supporting his decision. As a result, the interim payment cannot be taken as an unequivocal election by the insurers to affirm the insurance contract; it was only a payment made by the assured's own agent. Moreover, the 'without prejudice' expression should be construed as a complete reservation of rights.

5.1.1.3 Conclusion

In the Stockton case, the decision was based on the specific statement made by the broker. It cannot be taken as forming any principle; and the Callaghan case is only a first instance decision, therefore, the issue of the broker's agency when he places the risk under the binding authority is still left open. In the Callaghan case, the judge was justified to hold that the broker is not the insurer's agent in paying the interim settlement, because the binder only gave the broker the authority to accept risks on behalf of the insurers, it did not give him the right to settle any claim. But to say generally that the broker, who deals with an assured under a binding authority, is always the agent of the assured in placing the risk and collection of claim may be a little assertive, because the broker performs different functions during the course of business, sometimes he may undertake obligations to the insurers, especially under a binding authority. It may be reasonable to determine the broker's role by the tasks taken on by him in the material time in each case.

5.1.2 The broker's duty of disclosure

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[298] [2000] C.L.C. 360, at 367.

[299] *Rozanes v Bowen* (1928) 32 Ll Rep. 98; *Pryke v Gibbs Hartley Cooper Ltd* [1991] 1 Ll Rep. 602; *Johnston v Leslie &Godwin Financial Services Ltd* [1995] LRLR 472.

Section 19 (b) of MIA 1906 stipulated that the broker has a duty to pass on to the insurers the information communicated by the assured. If the broker failed to do so, the insurers are entitled to avoid the insurance contract. But when a broker also acts as a cover holder under a binding authority, it is questionable on whose behalf does the broker hold the material facts.

In *Woolcott v Excess Insurance Co,*[300] a broker effected an insurance contract for the assured covering his house and contents for all risks under a binding authority the broker held. Later, the house and contents were destroyed by fire. The insurer acknowledged the contract but declined the assured's claim on the ground of non-disclosure of material facts-the assured's criminal record. In an action against the insurers, the assured asserted that the broker, as the agent of the insurer, knew that the assured has a criminal record, and his knowledge should be imputed to that of the insurers. Therefore, the insurers were not allowed to use the non-disclosure defence. The defendant insurer issued a third party notice against the broker claiming indemnity, if the assured's assertion can be upheld by the court. The broker denied any knowledge of the assured's criminal record.

At first instance, the judge held that the broker did know about the assured's criminal record before the accident happened, and this knowledge of the broker, as the agent of the insurers, should be imputed to the insurers. Therefore, the insurers were not entitled to avoid the policy, but they were entitled to be indemnified by the broker for their failure to disclose the material facts.

The broker appealed both on the finding of facts and the applicable law. As to the issue of facts, the main dispute is whether the broker has known the assured's criminal records during his ordinary business transactions with the assured. The Court of Appeal found that first instance judge was wrong in finding the facts of the case, so the conclusions drawn on these facts were not sustainable. The broker deserved a new trial.

[300] [1979] 1 Lloyd's Rep. 231.

In considering the issue of law, it was agreed that it should proceeded on the presumption that the broker knew that the assured had a criminal record. With this hypothesis, Megaw L.J. held that,

‘I can only conclude by inference from the business relationship Mr. Smith [the broker] had with Marshall Development [the assured’s company] and the plaintiff [the assured] that this knowledge of the plaintiff’s past he [the broker] obtained in his employment as agent for the defendants [the insurers].’[301] He went on to say that this knowledge was ‘entirely adequate to prevent the defence of non-disclosure from succeeding.’[302]

The issue that on whose behalf the broker holds a material fact is important when he places a cover under the binder he obtained from the insurer, since the outcome for the brokers breach of duty of disclosure is different. If the broker holds the information as the assured’s agent, when it is not disclosed to the insurers, the insurers are entitled to avoid the insurance contract; if the broker holds the information as the agent of the insurers, the insurer are not allowed to avoid the contract on the ground of non-disclosure, but only to claim against the broker for indemnity after he had paid the assureds. Although Megaw L.J.’s statement in the Woolcott case was only *obiter dicta*, that makes it possible to argue that when a broker places a risk under a binding authority, the broker acts as the agent of the insurers in receiving information from the assured.

Section 19 (a) can make the question more complicated. As discussed in Chapter 2, the broker has an independent duty to disclose material facts which is known to him but not to the assured. Under a binder, should this kind of information still be treated as the extended duty for the assured, or should it be considered as information under section 18 (3) (b), the information which is known or presumed to be known to the insurer, and need not be disclosed? This has not been tested in any case.

5.2 Duty to produce documents

[301] [1979] 1 Lloyd’s Rep. 231, at p. 240, col.2.

[302] [1979] 1 Lloyd’s Rep. 231, at p. 240, col.2.

In *Goshawk Dedicated Ltd v Tyser & Co Ltd,*[303] the Lloyd's underwriters who were in run off sought some documents from the Lloyd's brokers to assess the extent of exposure to their principal's risks. These documents included placing documents, claims documents and premium accounting documents. Some of them were given to the underwriters with the permission from the assured, but some were not. The underwriter's contended that they were entitled to see the documents in regard of the policies before 20th December 2001 on the ground of an implied contract by an established market practice and the custom of Lloyd's; and they were entitled to see the documents relating to the policies after that date on the ground of the express terms in the TOBA between the underwriters and the brokers. The brokers denied these claims.

At first instance, Christopher Clarke J. declined the underwriter's claim to see the documents in the possession of the brokers on the following grounds. First, the expert evidence showed that there was no such a customary practice of London market as alleged by the underwriters which could gave rise to an implied contract to the effect that the broker hold the documents for underwriters and should produce them on request. Even if there was such practice in the market, it would also be inconsistent with the best interest of the broker's clients; it was unreasonable and therefore not enforceable. Secondly, for the Terms of Business Agreement (TOBA) between the brokers and the underwriters, although there was a cl.8.1which allowed the underwriters to get access to these documents, cl2.2, which said 'Nothing in this Agreement overrides the broker's duty to place the interests of its client before all other considerations', trumped cl.8.1.

The Court of Appeal unanimously reversed this decision and held that the brokers are obliged, on reasonable notice, to allow the syndicates to inspect and copy the three kinds of documents sought by the syndicates. The Court of Appeal drew this conclusion by establishing an implied term in the insurance contract between the underwriters and the assured and an implied contract between the broker and the underwriters.

5.2.1 An implied term in the insurance contract between the assured and the underwriters

[303] [2006] 1 C.L.C. 198.

Firstly, the judge found that at Lloyd's the placing and claims documents were retained by brokers but not by underwriters, even in today's world, the claims documents were still generally maintained only by brokers. Moreover, cl.8.1 in the TOBA reinforced the need to make the documents available to underwriters. Based on this background, Rix L.J. held that 'in the Lloyd's market there has at all relevant times been a term to be implied in the insurance contracts between underwriters and insureds to this effect: that placing and claims documents which have been previously shown to underwriters, and premium accounting documents which are necessary to the operation of the contract, where retained by the insured's Lloyd's broker, should be available to underwriters in case of reasonable necessity.'[304]

5.2.2 An implied contract between the broker and the underwriters

Having decided that the assured was under a duty to disclose the relevant documents the underwriters, the court went on to consider whether there was a contract between the broker and the underwriters which obliged the broker to disclose the documents. This issue was discussed in two stages. One is the period before 20 December 2001 when TOBA was introduced in the Lloyd's market. The other is the period after that date.

The underwriters' and the Lloyd's opinion were that once a term can be implied in the insurance contract, there was no difficulty in establishing a direct contract between the broker and the underwriters. On the other hand, the brokers submitted that if the premise can be established, there was no need for a separate contract between the broker and the underwriters.

However, the court did not agree with the broker's view. Rix L.J. said that:

'Business necessity does require a contract directly between brokers and underwriters. At Lloyd's the underwriters deal with brokers and through brokers. … In circumstances where the documentation is retained in London with the brokers, it would be highly unbusinesslike to suppose that the parties contracted on the basis that underwriters would need to apply directly to the insureds where they were in the world in order to

[304] [2006] 1 C.L.C. 198, at p. 215.

obtain documentation which *ex hypothesi* they needed to obtain from their Lloyd's broker, rather than to the brokers themselves. It is the brokers who maintain contact with their clients and have their contact details. Because the contract between underwriters and their assureds is to provide disclosure through the Lloyd's brokers, and because business necessity requires that the disclosure be done in London, where the documents are, it would be absurd for the brokers to be able to say that the underwriters' rights must be pursued elsewhere by reference to their principals.'[305]

Therefore, the judge held that in the period before TOBA was introduced, business necessity required that a contract should be implied between the broker and the underwriter which obliged the broker, on reasonable notice, to allow the underwriters to inspect and copy the documents requested by the underwriters.

5.2.3 Terms of Business Agreement (TOBA) between the broker and the underwriters

Since the introduction of TOBA at Lloyd's, there had been an express contract between the broker and the underwriter which stipulated the broker's duty to disclose the documents to the underwriters. The issue which made the first instance judge declined the underwriter's demand to view the documents was that cl.2.2 trumped cl.8.1, that means the broker's duty to disclose the documents to the underwriter will not be enforceable because it rendered a conflict of the broker's duty with the assured's best interest.

In the court of appeal, a term had been implied in the insurance contract which made the assured also under a duty to disclose the documents. Therefore, no issue of conflict of interest will arise when the broker disclose the documents to the underwriters under cl.8.1. But the judge left open the question whether cl.2.2 overrode cl.8.1, because this issue did not arise in this case.

These had been said, the court will not permit unnecessary or unreasonably wide requests. There are some limits to this (1) The underwriters have no right to request

[305] [2006] 1 C.L.C. 198, at p. 217.

documents which they already have in their possession; (2) The documents that are requested should be those which are in the possession of the broker.; and (3) The request has to be reasonable.

It is also to be noted here that this principle only applies to Lloyd's brokers who have to comply with the special market practice at Lloyd's.

5.3 Duty of care owed to insurers by voluntary actions

5.3.1 Giving signing indication

5.3.1.1 The London marine insurance market

When the broker receives an order from the assured, he prepares a slip in accordance with the assured's requirement. Then he takes the slip to the leading underwriter. If the leading underwriter agrees to subscribe to the slip, he will write his line on a slip stating the size of the risk he is accepting. The most usual way to do this is to write a percentage of the risk he is being offered, and this will be followed by the underwriter's initials and reference stamp. Then the broker will go to the following underwriters to complete the cover the assured has ordered. It is not uncommon that the broker may go on and collect more lines then the assured has required. That makes a slip oversubscribed. Therefore the lines written by each underwriter have to be reduced to meet what the assured has required. This reduction of the written line is called 'signing down'.[306] For example, if the slip is oversubscribed for 250 per cent., each line will sign down to 40%. When the broker gives such a percentage to an underwriter it is called a 'signing indication'. If the line is signed down, the underwriter will have less of a desirable risk than he intended and fewer premiums. Thus, it is understandable that the underwriter wants to know what he will actually sign for before he writes a line. Sometimes the underwriter will ask for this kind of information, sometimes the broker will volunteer the information without being asked. This is what had happened in

[306] Market Reform Contract (MRC 2011), c. 2.5 Signing Provisions.

General Accident Fire and Life Assurance Corporation and others v Peter William Tanter and other (The Zephyr).[307]

In this case, a shipowner instructed an insurance broker to obtain suitable insurance for a vessel he had purchased. The normal marine perils would be covered by all risks hull and machinery insurance. Thinking that the all risks underwriters may want to reinsure the whole or part of the total loss risk, the broker first approached the reinsurers to obtain a quote on the reinsurance of the risk of the total loss of the vessel. When offering the reinsurance slip, the broker gave a one third signing indication to the leading underwriter and one of the following underwriters. After the leading underwriter initialled on the reinsurance slip, the broker began to solicit the underlying all risks policy. The broker gave a 40% signing indication to the all risks underwriters and nine of these underwriters had ordered the total loss reinsurance through the brokers. Later, the vessel was seriously damaged by strong wind and drifted ashore. When the casualty happened, the all risks slip had been oversubscribed and duly signed down to 40%, but the subscription for the total loss reinsurance slip was far from the level calculated by the one third signing indication. The broker gave notice of abandonment on the basis of constructive total loss to the all risks underwriter. The all risks underwriter accepted the abandonment after the survey reports were submitted and they agreed a special settlement with the shipowner. The current claim was made by the all risks underwriters who had ordered total loss reinsurance through the brokers against the reinsurers who repudiated their liability under the reinsurance policy. Alternatively, the all risks underwriters claimed against the brokers for the indemnity they have paid under the all risks policy if the reinsurers were found not responsible. The reinsurers also claimed against the brokers, in contract or in tort, for giving the wrong signing indication that caused the excessive liability under the reinsurance slip. The brokers denied their liabilities to either of the parties. They contended that the signing indication had only moral and no legal significance.

5.3.1.2 A tortious duty

[307] [1984] 1 Lloyd's Rep. 58.

Hobhouse J. said that, as a matter of construction, the signing indications were merely a representation of the broker's expectation or belief, they were not words of warranty or promise, and so they did not have contractual effect.

The expert witnesses were also of the opinion that it was not practical for a broker to warrant what a slip would sign. The signing indication only gave rise to an obligation on the part of the broker to use his best endeavours to achieve the indicated signing down.

Hobhouse J. recognised the market practice and categorised such a duty as tortious duty. He said that, 'In the present case the giving of a signing indication by a broker to an underwriter is a voluntary act by the broker as a result of which the underwriter to the knowledge of the broker is placed in a situation of reliance upon the broker exercising his professional function with reasonable skill and diligence as a professional man. It is this element of reliance by one person on another arising out of the voluntary assumption by the latter of a relationship to the former, which is of the essence of the duties of care.'[308]

The judge also pointed it out that the fact that the broker was the agent of the assured did not mean that he may not owe a duty of care to the underwriter. He quoted a dictum of Mustill J. in *The Skopas*,[309] in which he had to consider the scope of the Misrepresenation Act, 1967. He said:

'The purpose of the Act was to fill a gap which existed, or was believed to exist, in the remedies of one contracting party for an innocent misrepresentation by the other. But there was no such gap in the case of the agent; he was already subject to the ordinary liabilities in fraud and negligence, the doctrine of *Hedley Byrne* and *Heller* having been recognised before the Act was passed.'[310]

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[308] [1984] 1 Lloyd's Rep. 58, at p.85, col. 2.

[309] [1983] 1 Lloyd's Rep. 431.

[310] [1984] 1 Lloyd's Rep. 58, at p. 85.

Therefore, there is no legal reason to prevent the imposition of a duty of care on the broker to take reasonable steps to achieve the signing indication he gave to the underwriters.

5.3.1.3 A duty of utmost good faith?

In *The Zephyr* case, Hobhouse J. also indicated that a signing indication if false would render the insurance contract voidable.

'As representations they [the signing indications] were clearly material to the contracts entered into by the total loss underwriters. Notwithstanding the narrower wording of section 18 (2) of the Act any representation which affects (so as to increase) the size of line which an underwriter writes must be, and is material. I have held that any material representations made by the broker to total loss underwriters are made as agent for the all risks underwriters and therefore if false render avoidable the reinsurance contracts.'[311] He also added that such a representation was true if made in good faith.[312]

With all the respect to the judge, the author disagrees with this point of view for two reasons. First, the signing indication is not a representation about the risk which the broker offered the underwriter; it is simply an estimate about the market reaction about the risk, made by the broker, basing on his own experience. It is not that kind of information which will 'influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk.'[313]Therefore, it is not a material fact. Consequently, if the broker gives a false signing indication, it should not affect the effectiveness of the insurance contract; it only gives the underwriter a title to sue against the broker in tort.

Secondly, the assured does not have any concern about the signing down of each line the underwriter written, he is satisfied as long as the cover he required has been completed. So the representation cannot be said to be made on behalf of the assured. Giving a signing indication is personal to the broker.

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[311] [1984] 1 Lloyd's Rep. 58, at p.81.

[312] Section 20(5) of MIA 1906.

[313] MIA 1906 section 20 (2).

In light of these reasons, the act of the broker's giving a signing indication should not be dealt with as the broker's duty of utmost good faith.

5.3.1.4 No conflict of duties in giving a signing indication

One of the broker's arguments in disclaiming a duty of care owed to the underwriters in giving signing indication was that such a duty would lead to conflict of duty. The broker relied upon three classes of cases to support this argument, but they were all refused by Hobhouse J. as not being appropriate authorities for the current case. He said that:

'The giving of the signing indication creates no conflict. The indication is personal to the broker. It … will not in any way damage the assured's interests; indeed the oversubscription and signing down practice is believed to work to the benefit of the assured as well as of the broker.'[314]

5.3.2 Voluntary investigation

In *John W. Pryke v Gibbs Hartley Cooper Ltd,*[315] the broker facilitated the conclusion of the binding authority between London insurers, composed of Lloyd's underwriters and insurance companies, and U.S. cover holder. Acting beyond his authority, the U.S. cover holder issued policies of financial guarantee. Later, the insurers became aware of the issuance of these policies. They sent the broker to investigate the matter and asked the U.S. underwriter to cancel these policies *ab initio*. During the investigation, the broker found out that some policies were indeed financial guarantee policies, but the U.S. underwriters asserted that there were certain endorsements that changed the policy from one of financial guarantee to one of physical damage, that it had been unable to cancel the policy *ab initio* but that the policy had been cancelled and that there was no real risk of claims under the policy. A telex to this effect was sent by the American underwriter to the broker and a memorandum was sent to the broker at some point. On returning from U.S., the broker communicated the U.S. underwriters' argument to the insurers, but did not disassociate themselves from the position or communicate their

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[314] [1984] 1 Lloyd's Rep. 58, at p.83-84.

[315] [1991] 1 Lloyd's Rep. 602.

own conclusions. Thus, the insurers took no further action and the following market was not informed of the existence of the policy. In fact, these policies had not been cancelled and later, a claim of many millions of dollars was made under the policies. The insurers settled the claim with the insured and then claimed against the broker for an indemnity for the settled sum and associated costs.

Under their broad case, the insurers contended that there was a contract, between the insurers and brokers, under which the brokers agreed to administer the binding authority in return for the brokerage; or there was such a contract implied from a custom at Lloyd's. The brokers had breached their duty by failing to disclose or misrepresenting the fact that the cover holder had issued the policy of financial guarantee; and that the policy had not been cancelled. In addition or in the alternative, the broker had breached these duties in tort.

Under the narrow case, the insurers contended that the broker had voluntarily undertaken the responsibility of investigating the underwriting behaviour of the U.S. cover holder; and the broker know or ought to have known that the insurers will rely on the broker's information on the investigation. By failing to disclose the above facts accurately, the brokers had breached their duty of care owed to the insurers.

5.3.2.1 No implied contract between insurers and brokers for administering the contract

Waller J. rejected the insurers' argument that there was any contract between the broker and the insurers for administering the binding authority.

(A) No contract for paying the brokerage

Waller J. refused the argument that there was a contract between the insurer and broker by the payment of brokerage. The traditional view was that the brokerage was only paid for the broker's introduction of business; it was not paid for administering the binding authority. The broker's accepting the brokerage did not mean that they undertook to perform any duty in favour of the insurers. In support of this view, Waller J. cited the cases *Lord Norreys v Hodgson*[316] and *Great Western Insurance Co. v Cunliffe.*[317]

(B) No contract implied by custom

Waller J. also rejected the argument that there was a contract implied by a custom at Lloyd's that the broker was under any duty to administer the binding authority. He said that 'It may be possible for an agent by express agreement to place himself in the position in which he does act for two parties, but a custom to the effect that he is compelled to act in conflict or for two masters is not enforceable in law … It seems to me that the proposed custom would be uncertain and unreasonable and would thus not be enforceable in the Court.'

The judge went on to said that the evidence called by the insurers 'was simply directed at saying what brokers actually do in the market at Lloyd's. But since they could do those things remunerated by the cover holder, and since no one could say that it was the underwriters who had some binding legal right to insist on the brokers performing those tasks, it does not seem to me that custom could ever be established.'

5.3.2.2 No similar obligation arise in tort

For the broad based tort the insurers contended for, the judge held that if there is by implication no contract in the broad sense, it would be impossible to contend that precisely similar obligation should arise in tort.

5.3.2.3 Assumption of responsibility

Since the case *Hedley Byrne & Co. Ltd v Heller & Partners Ltd.,*[318] the concept of assumption of responsibility has been developed as a general basis of tort liability. By virtue of this principle, a duty of care will be owed by the party who voluntarily

[316] (1987) 13 T.L.R. 421.

[317] (1874) L.R. 9 Ch. App. 525.

[318] [1963] 1 Lloyd's Rep. 485.

supplies information or service, which he knows will be relied upon by the party who receives it.

In this case, Waller J. applied the principles enunciated in the Hedly Byrne case and said that:

‘I see no reason why, if an agent undertakes voluntarily personally to supply information, he should not be under an obligation when he does supply that information, to exercise reasonable care in so doing where he appreciates reliance will be placed on him personally.’[319]

Although it may be the normal role of a Lloyd’s broker to investigate a position like this, they were under no duty in law at all to any underwriters to carry out such investigation. But by choosing to do so, he must carry it out and report the outcome with such care as the circumstances require. Waller J. said that in this situation both proximity and foreseeability were established to the required standard and he thought it was just and reasonable to impose on the broker a duty of care.

The last element to establish a cause of action under the principle of assumption of responsibility is the reliance to their detriment by the other party. For the Lloyd’s underwriters, the evidence showed that if the broker had reported accurately, they would definitely inform the following market of the issuance of the policy of financial guarantee, cancel the binder and get rid of the risk written, because direct financial guarantee insurance was forbidden form of policy at Lloyd’s. With regard to the insurance company, they have seen the policy and appreciated that it was a policy of financial guarantee despite endorsement; and they would have wanted to consult U.S. lawyers. The judge held that the insurance company would actually have reacted no differently if the broker had reported accurately.

5.3.2.4 Conclusion

[319] [1991] 1 Lloyd’s Rep. 602, at p.616 col.2.

During the normal course of business, the broker may carry out some tasks which will benefit the underwriters, but it does not follow that the brokers are under any legal duty to do so. When faced with the insurer's request of any service, the broker can decline to provide such service; or he can provide the service with a clear qualification that he accepts no responsibility for it. If the broker accepts the task without any qualification, he must carry out the task with such care as the circumstances require, or he will be held liable for the insurer's loss or damages for assumption of responsibility. [320]

It should be noted here that these two cases are only examples of how the brokers may assume responsibilities upon themselves during the course of business; it is not an exhaustive list. There may be other situations where, although not imposed by contract, the brokers still need to exercise reasonable skill and care in carrying out the performances.

5.4 Duty of care owed to the following underwriters

In The *Zephyr*[321] and *John W. Pryke v Gibbs Hartley Cooper Ltd,*[322] there was another issue that need to be paid attention to. That was whether there was any duty of care owed by the broker to the following underwriters when the broker gave the signing indication to the leading underwriters but not to some of the following underwriters.

To answer this question, it may be easier to start from understanding how the brokers obtain subscriptions on the slip in the insurance market. As introduced in 3.1.1, the brokers will first take the slip to the leading underwriters and negotiate the terms of the insurance contract, the rate of premium and other important issues. Then they will show it to the following underwriters. Normally, the following underwriters have no scope to vary or amend the terms of the insurance contract they are being offered. When they come to write the slip they will do so at least in part in reliance on the leader's judgment in agreeing to the terms and rate on the slip. If the leading underwriters write lines with

[320] [1963] 1 Lloyd's Rep. 485, at p. 492 col.1.

[321] [1984] 1 Lloyd's Rep. 58.

[322] [1991] 1 Lloyd's Rep. 602.

high percentage, that means they have more confidence in the risk being underwritten. This may leads to the following underwriters writing high percentage of the risk, too.

Seen from these practices it is not hard to say that it is foreseeable by the broker that any failure to perform the duties with reasonable care and skill to the leading underwriter would have detrimental effect on the following underwriters. But one hard issue to establish a duty of care owed by the broker to the following underwriter is the proximity between the two parties, because the following underwriter had not been supplied with any information or service by the broker. But the judge did not find it hard to establish the proximity between the broker and the following underwriter in those situations.

In *The Zephyr* case, Hobhouse J. held that: ‘the absence of an express signing down indication to Mr. Posgate [the following underwriter] does not make any relevant difference. In my judgment the element of reliance is still there and Mr. Baxter [the broker] knew or ought to have known that Mr. Posgate was relying on him as well.’

There was a similar paragraph by Waller J. in *John W. Pryke v Gibbs Hartley Cooper Ltd,*[323] he said that: ‘The necessary proximity will arise where the advisor appreciates that there will be reliance on him providing accurate information to the recipient [the leading underwriter] by the plaintiff [the following underwriter], and the advisor appreciates that the recipient will act in a way that directly affects the plaintiff.’[324]

In both of the two cases, the courts also held that it was just and reasonable that the following market should be entitled to recover their losses against the brokers. Therefore a duty of care was found owed by the broker to the following underwriters in giving signing indication and carrying out the investigation.

As can be seen from these decisions, the real issue in imposing a duty of care on the broker to the following underwriters in regard of the voluntary service the broker agree to provide is to establish a relationship between them; and the key elements to establish such a relationship is to find out whether the following underwriters rely upon the

[323] [1991] 1 Lloyd’s Rep. 602.

[324] [1991] 1 Lloyd’s Rep. 602, at p.619, col.2.

broker's service and whether the broker knows or should have known of such reliance. These two matters will depend upon the fact of each case.

5.5 Conflict of duty during claims handling process

Under general agency law, the agent is not allowed to act on behalf of the competing parties for the same transaction, unless he received acknowledged consent from both parties, or it will give rise to conflict of duties. The Lloyd's broker's practice of acting for both the assured and insurer in the claims process has been criticised in the 1970s cases.

5.5.1 Common law

In *Anglo-African Merchants Limited v Bayley*,[325] the assured company placed all risks insurance for some unused elderly army leather jerkins through two firms of brokers with Lloyd's underwriters. But on the policy, the goods were described as 'new men's clothes for export'. The underwriters declined the assured's claim for short delivery on the ground of non-disclosure. In the course of the litigation, the brokers made the files, including the assessor's report regarding the claim, available to the underwriters, but refused to make them available to the assured. Counsel for the underwriters asserted a world-wide practice in the insurance business that the insurers will instruct the brokers who placed the insurance to obtain a report from assessors when a claim arises. The broker need not ask permission from the assured for acting on behalf of the underwriter in respect of this matter, since the broker was the agent of the assured only when he is placing the risk on behalf of the assured. If a claim arises, the broker may act for both parties. The counsel also asserted that the broker was not allowed to disclose the contents of the report to the assured without the underwriter's consent, because the report was the insurer's property.

Megaw J. first stated the law as summarised by Scrutton L.J. in *Fullwood v Hurley*,[326] 'No agent who has accepted an employment from one principal can in law accept an

[325] [1970] 1 Q.B. 311.

[326] [1928] 1 K.B. 498, at p. 502.

engagement inconsistent with his duty to the first principal . . . unless he makes the fullest disclosure to each principal of his interest, and obtains the consent of each principal to the double employment.'

Then he applied the law in the current case. He said 'If an insurance broker, before he accepts instructions to place an insurance, discloses to his client that he wishes to be free to act in the way suggested, and if the would-be assured, fully informed as to the broker's intention to accept such instructions from the insurers and as to the possible implications of such collaboration between his agent and the opposite party, is prepared to agree that the broker may so act, good and well. In the absence of such express and fully informed consent, in my opinion it would be a breach of duty on the part of the insurance broker so to act.'[327]

With regard to the market practice alleged by the broker, the judge held that it would not make any difference. Megaw J. held that 'even if it were established to be a practice well known to persons seeking insurance - not merely to insurers and brokers - I should hold the view, in conformity with the passage which I have cited from Bowstead, that a custom will not be upheld by the Courts of this country if it contradicts the vital principle that an agent may not at the same time serve two masters - two principals - in actual or potential opposition to one another: unless, indeed, he has the explicit, informed, consent of both principals. An insurance broker is in no privileged position in this respect.'[328]

As to Megaw J.'s decision, consent must be sought from the assured if the broker wants to act for both parties. However, Megaw J.'s remarks on this issue were only *obiter dicta.*

In *North & South Trust Company v Berkeley,*[329] the broker's due agency role in the claim process became the fundamental issue to be decided by the court. During the course of action by the assured against Lloyd's underwriters in regard of a short delivery claim under the cargo policy, the assured's request to the broker to see the

[327] [1969]1 Lloyd's Rep.268, at p.280, col.1.

[328] [1969]1 Lloyd's Rep.268, at p.280, col.2.

[329] [1971] 1 W.L.R. 470.

assessor’s report he obtained for the underwriters was refused. The assured issued a writ against the broker claiming declarations that they were entitled to possess or inspect any documents in the broker’s possession; and the insurer issued a writ against the broker claiming an injunction restraining the broker from delivery up or revealing to the assured the documents. The judge was invited to decide whether the assured or the underwriters were entitled to the delivery up or inspection of the documents.

In his judgement, Donaldson J. pointed out the problems that may be faced by brokers in acting for both parties in the claim process. He said:

‘The underwriter will in many cases wish the assessor to investigate the character, reliability and honesty of the assured and the broker must instruct the assessor accordingly. What happens then? Is it really to be thought that the broker can simply pass on the instructions and say nothing, although he knows that the assured is of the highest character? Of course not. But what if he knows of something to the detriment of the assured? Is he then to remain silent and, if so, will the assessor fail to draw his own conclusions? In some cases the activities of the brokers do not stop at the instruction of the assessors, but include the instruction of solicitors to resist the assured's claim. The claim itself will by then have been defined by letters from the assured's solicitors, so that the broker can add nothing on behalf of the assured. But he, above all, knows the full background of the claim, including its weaknesses. Is he to mislead underwriters' solicitors by giving them only half the story?

In the context of settlement negotiations it is said to be a positive advantage to the assured that his broker shall have confidential information on the strength of underwriters' defence. But how can he use this information when advising his client? Again, underwriters may be denying liability on the basis of a wholly misconceived, but apparently correct, appraisal of the facts by the assessors. The broker must treat this appraisal as confidential and is therefore unable to inquire from the assured whether there may not be a fallacy. And what happens if the assured, taking a pessimistic view of the strength of his claim, indicates to his broker that he is prepared to accept a low figure in settlement, when the broker, having seen the assessor's report in confidence, knows that underwriters must be prepared to settle for a high figure.'[330]

However, Donaldson J. did find out this practice at Lloyd's that the Lloyd's underwriters instructed Lloyd's brokers to obtain assessment report from claim assessors when a claim arose under the policy which the broker placed with them. The judge said that such a practice was inconsistent with the general principles laid down in previous cases. Besides, it was not well known in the market, at least for the assureds who were affected by it; and totally unreasonable. Therefore, it cannot be a legal usage or custom. This been said, the assured were still not allowed to the delivery up or inspection of the documents which the brokers obtained in a confidential capacity, in this case, the assessment report. What he can do was only to claim damages against the broker for their failure, because of the conflict of duties, to discharge his duty to the principal.

5.5.2 Model form TOBAs in London market

In 2005, Lloyd's introduced model form TOBAs (Risk Transfer and Non Risk Transfer), drafted by the International Underwriters Association (IUA), Lloyd's Market Association and London and International Insurance Brokers' Association, for managing agents and brokers. Use of the model form TOBAs by Lloyd's brokers is not mandatory and the parties are free to negotiate the terms of the TOBA, providing these meet FSA requirements.

In the agreement, clause 11.3.1 stipulated the relationship between the brokers and the managing agents when the brokers appoint loss adjusters on behalf of the managing agents; and clause 11.3.2 stipulated the managing agents' right on the documents created in the performance of such function.

11.3 In the event that the Managing Agent requests the Broker to carry out any functions or duties on its behalf, such as the appointment of loss adjusters, lawyers or

[330] [1971] 1 W.L.R. 470, at p.483.

others, or the Broker otherwise acts as an intermediary between the Managing Agent and its representatives or agents:-

11.3.1 The Broker accepts the Managing Agent's appointment or instructions on the basis that the information received by it in respect of a claim made upon any Insurance Business is *disclosable* to the Broker's client.

11.3.2 All documentation and records created or received by the Broker in the performance of such functions or duties shall be and remain the property of the Managing Agent, other than documents over which the Broker has a proprietary commercial interest.

In 2011, London market trade bodies who drafted TOBA 2005 agreed a new model non-risk transfer terms of business agreement (NRT TOBA) for managing agents, insurers and brokers to replace the TOBA 2005. In the new agreement, cl. 11.3.1 and cl.11.3.2 remains unchanged.

5.5.3 FSA handbook

In FSA hand book, Principles for Business,[331] Senior Management Arrangements, Systems and Controls (SYSC)[332] and Insurance Conduct of Business Sourcebook (ICOBS)[333] all require a firm to take all reasonable steps to manage conflicts of interest fairly. In ICOBS 8.3.3 (3) (4), more specific requirements are made in relation to claims handling.

ICOBS 8.3.3

(3) If a firm acts for a customer in arranging a policy, it is likely to be the customer's agent (and that of any other policyholders). If the firm intends to be the insurance undertaking's agent in relation to claims, it needs to consider the risk of becoming

[331] Principle 8.

[332] SYSC 10.

[333] ICOBS 8.3.3 (1).

unable to act without breaching its duty to either the insurance undertaking or the customer making the claim. It should also inform the customer of its intention.

(4) A firm should in particular consider whether declining to act would be the most reasonable step where it is not possible to manage a conflict, for example where the firm knows both that its customer will accept a low settlement to obtain a quick payment, and that the insurance undertaking is willing to settle for a higher amount.

When considering whether the broker has taken reasonable steps to manage the conflict of interest, the court may take into consideration of the FSA rules.

5.6 Broker's duties owed to the insurers under reinsurance contract

Broker's duties owed to insurers as reinsured is similar to that owed to the normal insured. But when the broker who arranged insurance on behalf of the assured with the insurer also arranged reinsurance for the same insurer, the broker will owe duties of care to both parties. Sometimes a conflict of duties will arise in this situation. Will this restrict the broker's duty owed to the insurers?

In *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins Ltd,*[334] the brokers arranged both the underlying cover, a fac/oblig treaty, and the excess of loss reinsurance cover. The insurer of the underlying cover agreed to subscribe to the treaty only when the excess of loss reinsurance cover was available. The broker obtained the reinsurance cover by misrepresenting the nature of the underlying cover as quota share reinsurance rather than fac/oblig. The fact was that if the broker had presented the treaty as fac/oblig, no reinsurance cover for this risk would be obtainable in the market. The insurer suffered a loss of $ 35 million on the underlying treaty, $11 of which would have been recovered if the reinsurance cover had not been avoided for misrepresentation. The insurers claimed against the broker for the full amount of their losses. The claim was supported by the majority of the Court of Appeal. It was held that the broker's breach of duty was their negligent advice on the availability of the reinsurance cover, not only the failure to provide information. Therefore the broker is

[334] [2001] UKHL 51.

liable for the full amount of the insurers' loss. The broker appealed to the House of Lords.

The brokers argued that the conclusion of the majority of the Court of Appeal placed a broker in a position of dual capacity in holding that the broker, who owes a duty to the insured to place the insurance, was also under a duty of care to the insurer to provide advice to him on whether or not to write the insurance at all.

To this point, Lord Steyn said, in the House of Lords, that 'Any problem of the brokers arising from the performance of their dual functions in this case was entirely of their own making. It cannot divert the House from arriving at the inescapable conclusion on the facts that the brokers assumed a duty to advise Aneco (the insurer/reinsured) as to what course to take.' [335]

In *HIH Casualty and General Ins v JLT Risk Solutions*,[336] the Court of Appeal held that a broker owed a duty of care to insurers to keep them informed of information that might threaten recovery under the reinsurance. The fact that the broker owed much the same duty of care to the assured, and that the information if provided to the insurers might prejudice the assured's ability to recover under the direct policy, did not preclude the imposition of a duty of care towards the insurers.[337]

These decisions show that if the broker takes on the responsibility to act for both the assured and the insurer. The scope of his duties owed to the insurers will not be restricted because of the potential of conflict of duties that will arise.

On the other hand, will the potential conflict of duties affect the broker's duties owed to the assured and what the broker should do when he intended to act for both the assured and the insurer? Hobhouse J. answered this question in The Zephyr case. He said that 'A broker is not at liberty to accept an agency for the underwriters without the consent

[335] [2001] UKHL 51, para.42.

[336] [2007] Lloyd's Rep. I.R. 717.

[337] [2007] Lloyd's Rep. I.R. 717, para.62.

of his client. If he does so that does not in any way relieve him of his duties to his client.'[338]

Donaldson J. held in *North and South Trust Co. v Berkeley* that '[The brokers] wore the…[insured's] hat and the underwriter's hat side by side and in consequence, as was only to be expected, neither hat fitted properly. The …[insured] had a legitimate complaint on this account and can claim damages if and to the extent that the partial dislodgement of their hat has caused them loss or damage.' [339]

All in all, when the marine insurance brokers place both original cover and reinsurance cover, it gives the broker a dual agency role. Although this is not uncommon in the London insurance market, the court will not show sympathy to the brokers if the broker's conduct does not conform to the general principles of agency law. The broker should always ask for permission from both the assured and insurer if he wants to act for both parties. Moreover, it should be noticed that the dual agency role will not restrict the broker's scope of duty owed to each party; and if the assured or insurer suffered any loss or damage because of the broker's acting in such a way that gives rise to conflict of duties and interest, the assured or insurer are entitled to claim against the broker for any damages they suffered from this breach.

[338] [1984] 1 Lloyd's Rep.58, at p.84 col.2 .See also *North and South Trust Co. v. Berkeley* [1970] 2 Lloyd's Rep.467.

[339] [1970] 2 Lloyd's Rep.467, at p.481, col.2.

Chapter 6 Broker's Duties under Reinsurance Contract

Generally speaking, the broker's legal position during reinsurance transactions is the same as that under insurance transactions. However, the way the brokers place the reinsurance cover and the varied forms of reinsurance contract raise peculiar issues. Firstly, the agency issue. The various roles undertaken by the brokers posed some challenges to the general principles of the law of agency. For example, the broker who places insurance with the insurers on behalf of the assured may also act for the insurer to place reinsurance. In other circumstances, the broker may design and promote insurance and reinsurance programmes without having an existing insured. In these situations, it will be asked whose agent the broker is when effecting the reinsurance contracts. Secondly, there are different categories of reinsurance facilities. Some are taken to be contracts *of* insurance; some are regarded as contracts *for* insurance. This requires a reconsideration of the broker's duty of utmost good faith and the broker's duty to pay premium under different kinds of reinsurances.

6.1 The agency problem when the broker places both the insurance and reinsurance cover

It is a commonplace situation in insurance and reinsurance business, and not just at Lloyd's, that the brokers place both insurance and reinsurance contracts for the same risk. Sometimes, the broker arranges the reinsurance cover by the instructions from the insurer, with whom the broker placed the insurance cover. Sometimes the broker may, knowing that a fixed reinsurance cover will make it easier to place the insurance cover, approach the reinsurers first with or without having a specific insurer in mind; and when the reinsurers signed the slip, the brokers will go to see the insurers and offer both the insurance and reinsurance covers to them.

Agency issues will arise when the same broker placed both insurance and reinsurance covers even if the broker has received express instructions from the insurers, let alone in the situation where the insurers, the principal of the broker, is unknown when the reinsurance is made.

6.1.1 Reinsurance by the insurer's instruction

In *SAIL v Farex Gie and Others,*[340] the claimant (SAIL), as the in-house brokers of the AIG group, intended to arrange a facility for reinsurance of risks underwritten by the member companies of the AIG group. SAIL instructed London brokers (Heath Fielding) to arrange the desired facility. Heath Fielding approached a U.S. insurance company (St. Paul) through a Mr. Kearney who was an underwriter and the manager of the international facultative department of a reinsurance company within the St. Paul group. Mr. Kearney said that St. Paul was not prepared to accept the reinsurance business but would be willing to share in retrocession cover. Then Heath Fielding approached Farex, but Farex would only consider a lineslip if retrocession can be concluded by Heath Fielding to protect Farex's against his own risks. Heath Fielding managed to arrange retrocession cover with, among others, St. Paul; and Farex subscribed to a document entitled 'SAIL lineslip', by which Farex would reinsure such risks as companies in the AIG group declared and it accepted. During the cover period SAIL made and Farex accepted hundreds of declarations in two years.

Later St. Paul commenced proceedings in New York against Heath Fielding and Farex claiming that it was entitled to repudiate liability under the retrocession on the ground that Mr. Kearney had no authority to accept on behalf of St. Paul the retrocession placed by Heath Fielding on behalf of Farex and that Heath Fielding had known that Mr. Kearney had no authority. In response Farex claimed to repudiate all liability to SAIL on the ground of misrepresentation and non-disclosure.

On the other hand, SAIL sought to recover from Farex the reinsurance losses which SAIL had paid under risks declared by SAIL and accepted by Farex in the first and second year. SAIL issued proceedings against Farex in the Commercial Court claiming summary judgment under R.S.C., O. 14 and 14A.

At first instance, Farex contended that Heath Fielding, when it told Farex that a retrocession agreement had been concluded with St. Paul, were acting as agents for

[340] [1995] L.R.L.R. 116.

SAIL and making a representation on its behalf. If St. Paul's allegations of Mr Kearny's lack of authority were true, the representation was false. Therefore, Farex was entitled to repudiate the reinsurance contract on the ground of the broker's misrepresentation of the validity of the retrocession cover.

Following the judgments of Hobhouse J. in *The Zephyr*[341] and of Phillips J. in the *Superhulls Cover Case*[342] and of Hobhouse J. in *Trinity Insurance Co. Ltd. v Singapore Aviation & General Insurance* (unreported), Evans J. held that whether or not the statement turned out to have been false, it was not made as an agent for the reinsured SAIL. In arranging the retrocession slip, Heath Fielding was acting as agents for Farex. He said that 'the broker may know, however, before he approaches the reinsurer that some form of retrocession will be required. He therefore anticipates the reinsurer's request and his first approach is to a prospective retrocessionaire. He does so in the interests of his original clients, because it is their instructions to obtain reinsurance cover which cause him to take the initiative in negotiating the prospective reinsuers' retrocession requirements. But this does not mean that he approaches the retrocessionaire as agents for his original clients. He does so as agents for the proposed reinsurers if he has received their instructions, or on his own behalf, as in The *Zephyr*, if he has not.'[343]

Farex appealed against the judgment of Evans J. on this issue.

In the Court of Appeal, Dillon LJ. confirmed Evans J's decisions. He said 'there is not a shred of evidence that SAIL gave any express instructions or authority to Heath Fielding to arrange retrocession for the reinsurer if that would help to place the reinsurance of SAIL's risks with a suitable reinsurer. There is equally not a shred of evidence that SAIL held Heath Fielding out to Farex as having any such instructions or authority. Farex would therefore have to show, to establish the supposed agency, that to arrange retrocession was something within the class of acts which a broker placing

[341] [1984] 1 Lloyd's Rep. 58.

[342] [1990] 2 Lloyd's Rep. 431.

[343] [1995] L.R.L.R. 116, at p122, col2.

reinsurance for an insurer is usually authorised to do. But so far from that being shown, the decisions on the topic at first instance are precisely to the contrary effect.'[344]

The counsel for Farex accepted that Heath Fielding was its agent to enter into the retrocession agreement. But he said that informing Farex that the agreement had been concluded was a different matter. The lineslips which Heath Fielding negotiated on behalf of SAIL were subject to reinsurance and in communicating to Farex that such reinsurance had been arranged, Heath Fielding were acting as agents for SAIL.

Hoffmann L.J. did not accept the distinction between Heath Fielding's authority as agents to contract and agents to inform. 'In my judgment Heath Fielding acted as agents for Farex either when it concluded (or purported to conclude) the retrocession agreement and when it informed Farex that it had done so. The statement is therefore not one for which SAIL can be liable.'[345]

Saville L.J. agreed with both Dillon L.J. and Hoffmann L.J. on each point they made. He said 'a broker carrying out instructions on behalf of an intending assured may have to undertake obligations to others in order to perform his mandate. In the present case it is to my mind clear that in obtaining (or purportedly obtaining) retrocession from St. Paul and informing (or misinforming) Farex that this had been done, Heath Fielding were acting as brokers to Farex and carrying out (or purporting to carry out) instructions that they had received, not from SAIL, but from Farex. There is simply nothing to suggest that SAIL gave any authority to Heath Fielding to act on behalf of SAIL in making or reporting the making of retrocession for Farex. The knowledge of SAIL that this would be done does not amount to authority from SAIL to do it on their behalf.' [346]

It is made clear that when the broker arranged both the insurance and reinsurance contracts, the brokers acted as agents for insurers not the assureds when they effect the reinsurance contract; the knowledge of the assured that this would be done in the ordinary course of business does not amount to authority from the assured to do it on their behalf.

[344][1995] L.R.L.R. 116, p. 141, cols. 1 and 2.

[345] [1995] L.R.L.R. 116 , p.149, col.1.

[346] [1995.L.R.L.R. 116, p.156, col.1.

6.1.2 No instructions when the reinsurance contract was made

Sometimes, the brokers arrange reinsurance cover prior to the insurance contract is made. It raises issues such as that in what capacity the broker acts when he approaches the reinsurer and arrange the reinsurance; and that in what capacity the broker acts when he approaches the insurer and offers both the insurance and reinsurance contracts. These were the issues that had been raised in The Zephyr case.

6.1.2.1 The agency issue

(A) The broker's role when he approaches the reinsurer before insurance is made

(a) Not the agent of the assured

In *The Zephyr* case, a reinsurance contract was made by a broker with an underwriter before any original insurance was placed and before the broker could have any principal on whose behalf he could place any reinsurance. [347]

Hobhouse J. held that the broker was not the agent of the assured in procuring a reinsurance contract. 'The shipowners (the assureds) were in no way parties to or interested in any reinsurance contract or contracts…a broker's operations in the market, although originating from instructions from an external client, the shipowners, may involve the broker in undertaking transactions or assuming obligations in the market which are not the concern of the original client.' [348]

(b) In the broker's own interest

When considering the broker's role when he approached the reinsurer, Hobhouse J. said 'On Dec. 17 Mr Baxter [the broker] had no relevant principal and was known to have none. Therefore he must have been dealing with Mr Tanter [reinsurer] on his own

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[347] See 5.3.1.1 for more details of the fact of The Zephyr case.

[348] [1984] 1 Lloyd's Rep. 58, at p.67.

behalf. If any contract came into existence on that day it was not a contract of insurance but at best a contract between the brokers and Mr. Tanter for the provision of insurance.'[349]

(B) The broker's agency when he approaches the insurer

The next step is to consider in what capacity the broker acts when he approaches the prospective insurer and offers both the insurance and reinsurance covers. There are two issues under this title. First, on whose behalf the broker is acting under the reinsurance contracts, the reinsured or the reinsurer. Secondly, whether the reinsurance contract is binding even if there is no principal on whose behalf the broker may act when the broker negotiated the contract.

(a) Sufficient reinsurance cover

In The Zephyr, It was argued that after the reinsurer agreed to provide reinsurance, the reinsurer constituted the broker his contracting agent to offer the total loss reinsurance to the all-risk underwriters. It follows that the broker was the agent of the reinsurer rather than the reinsured.

Hobhouse J. did not agree, he said that 'the contractual machinery which was throughout being used was facultative reinsurance on a slip. The actual contract of insurance was the contract (or contracts) in the slip. As I have said earlier the nature of this contract both in accordance with the practice of the market and the law is that the broker was the agent of the assured not the insurer.'[350]

(b) Insufficient reinsurance cover

Hobhouse J. also considered the situation where the broker did not have sufficient cover on the total loss reinsurance slip. It may be argued that the fact that the broker was able to decline to offer reinsurance in this situation, or was able to refuse to accept orders for reinsurance showed that the broker was acting on behalf of the reinsurer.

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[349] [1984] 1 Lloyd's Rep. 58, at p80, col.1.

[350] [1984] 1 Lloyd's Rep. 58, at p.80, col.2.

Hobhouse J. gave the answer that ‘the choice made by the broker is whether or not he is willing to act as the facultative reinsurance broker for this risk for a given all risks underwriter and, if so, what he is prepared to say about his ability to fill the commission he is so accepting. The relationship of principal and agent is in the present context a voluntary one. Mr. Baxter [the broker] does not have to agree to be an all risks underwriter’s broker unless he is willing to; if he agrees, he accepts obligations to the all risks underwriter. He does not have to say he has reinsurance available unless he considers it proper to do so; he can simply say that he will try to get it for the underwriter. If Mr. Baxter says he has reinsurance when he has not or if he says he will get it when he knows he cannot, he will be in breach of his obligations to his client, the all risks underwriter.’[351]

On either of the situation in (a) or (b), the broker’s agency remains the same; the broker is the agent of the reinsured not of the reinsurer.

This was followed by Phillips J. in the ‘Superhulls Cover’ case. Phillips J. was concerned with the duties of the brokers towards insurers whom they had approached with an offer of reinsurance cover. After citing Hobhouse J’s above statement in The Zephyr,[352] he said ‘this passage supports Mr. Sumpton’s submission that the broker who approaches an insurer with an offer of reinsurance is offering to act as agent of the insurer. If the insurer accepts the reinsurance offered he thereby constitutes the broker his agent to obtain the cover offered.’[353]

6.1.2.2 The contract issue

Another relevant issue arose in The Zephyr case was whether the total loss reinsurance underwriters could be bound by his initialling of the total loss slip.

The reinsurers argued that since the broker procured the subscription of reinsuring underwriter to the slip in advance of the broker obtained any order, there was not an effective reinsurance contract.

[351] [1984] 1 Lloyd’s Rep. 58, at p.81, col.1.

[352] [1984] 1 Lloyd’s Rep. 58, at p.81, col.1.

[353] [1990] Lloyd’s Rep. 431, at p.446, col.1.

The expert evidence showed that there was a binding reinsurance contract according to the market practice. It was said that ‘where however the total loss only leader actually writes a line on the slip at a quoted rate he is from that moment bound to accept reinsurance orders falling within the terms of that slip and up to the value of his subscription; he is in effect making an offer to reinsurer any underwriter falling within the class or category described in the slip, whether or not the broker has at that time obtained a subscription to the original line or an order for reinsurance; when the broker receives a total loss reinsurance order from an ‘eligible’ all risks underwriter, the contract of reinsurance is in my view agreed.’[354]

Hobhouse J. accepted this evidence. However, he held, independently of the proof of this usage, that ‘(1) the initialling by Mr Tanter [the reinsurance underwriter] on Dec. 17, and (2) Mr. Baxter’s [the broker] telling a person coming within the description of reinsured in the slip that such reinsurance was available to him, and (3) the giving to and acceptance by Mr. Baxter of a reinsurance order complying with the terms of the slip from a person, sufficed to complete a binding legal contract of reinsurance between such person and Mr. Tanter.’[355]

The possible objection to such a conclusion could be that there was no further communication between the reinsured and reinsurer, which means there was no consensus. The judge cited a few cases[356] to demonstrate that further communication between the two parties was not necessary if it has been waived.

After referring to *New Zealand Shipping Co. Ltd. V Sattherthwaite* [357], Hobhouse J. said that contract between A and B can bind B to third parties who at the time of the making of the contract were unknown and unascertainable. … The analysis of the transaction may be relevant for the purpose of ascertaining whether there is a consensus between the relevant parties upon a mutual bargain and for answering other consequential

[354] [1984] 1 Lloyd’s Rep. 58, at p.71, col.2.

[355] [1984] 1 Lloyd’s Rep. 58, at p.71, col.2.

[356] *Carlill v Carbolic Smoke Ball Co.*, [1893] 1 Q.B. 256; The Satanita, [1897] A.C. 59, and *New Zealand Shipping Co. Ltd. V Sattherthwaite* [1974] 1 Lloyd’s Rep. 534; [1975] A.C. 154.

[357] [1974] 1 Lloyd’s Rep. 534; [1975] A.C. 154.

questions, but once the consensus upon a mutual bargain has been demonstrated that suffices.'[358]

This was followed by Moore-Bick J. in *Kingscroft & others v Nissan Fire & Marine (No 2)*,[359]where the judge was concerned with the contractual relationship between the new member of the pool which provided underwriting capacity and the reinsurer of that pool.

The judge said that 'in my view, both as a matter of business common sense and as a matter of law, the treaty is to be treated as containing an offer on the part of the reinsurers to any new member of the pool to enter into contractual relations on the terms of the treaty... In my judgement the offer was intended to be capable of acceptance without communication simply by a company's becoming a member of the pool and accepting risks falling within the scope of the treaty. Communication of acceptance was waived by the reinsurers.'[360]

These decisions showed that the court will treat the reinsurer's initialling on the reinsurance slip as forming a unilateral contract, once an insurer subscribes to the underlying insurance contract, he can accept the offer and make it a binding reinsurance contract.

6.2 Duty of utmost good faith

6.2.1 The principle of utmost good faith applies under reinsurance contract

The principle of utmost good faith was codified in the Marine Insurance Act 1906, however, it did not confine the application of the rule to marine insurance contract. It has long been established that the rule also applies to non-marine insurance and reinsurance contracts.

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[358] [1984] 1 Lloyd's Rep. 58, at p.72, col.1.

[359] [1999] Lloyd's Rep. I.R. 603.

[360] [1999] Lloyd's Rep. I.R. 603, at p. 621, col.1.

In *Lambert v Co-operative Insurance Society Ltd*,[361] which concerned the assured's non-disclosure of his previous criminal convictions under a jewellery insurance contract, the judges unanimously held that there was no difference in applying the rule of utmost good faith in any form of insurance. Mackenna J., after quoting section18 of MIA 1906, said that 'here is no obvious reason why there should be a rule in marine insurance different from the rules in other forms of insurance and, in my opinion, there is no difference.'[362]

Cairns L.J. agreed and stated that 'In providing by statute that the test should be that of the insurer in marine insurance cases, I think that Parliament was doing no more than inserting in its code of marine insurance law what it regarded as the general rule of all insurance law.'[363]

In *Highlands Insurance Company v Continental Insurance Company,*[364] where the retrocessionaire tried to avoid the contract on the ground of misrepresentation, Steyn J. followed the decision in *Lambert v Co-operative Insurance Society Ltd*.,[365] and added that 'the Marine Insurance Act, 1906, was a codification of the common law; that the common law should be presumed to be the embodiment of common sense; and that common sense rebels against the idea that there should be a difference between marine and non-marine insurance in relation to non-disclosure and misrepresentation.'[366]

This was confirmed in the House of Lords decision in *Pan Atlantic Insurance Company Ltd v Pine Top Insurance Co*.[367] In that case the reinsurer tried to avoid the reinsurance contract on the ground of non-disclosure of material facts. Lord Mustill said that 'although the issues arise under a policy of non-marine insurance it is convenient to

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[361] [1975] 2 Lloyd's Rep. 485.

[362] [1975] 2 Lloyd's Rep. 485, at p.487, col.2.

[363] [1975] 2 Lloyd's Rep. 485, at p.493, col.1.

[364] [1987] 1 Lloyd's Rep. 109.

[365] [1975] 2 Lloyd's Rep. 485.

[366] [1987] 1 Lloyd's Rep. 109, at p.131, col.2, p.132 col.1.

[367] [1994] 2 Lloyd's Rep. 427(HL).

state them by reference to the Marine Insurance Act, 1906 (hereafter 'the Act') since it has been accepted in argument, and is indeed laid down in several authorities, that in relevant respects the common law relating to the two types of insurance is the same, and that the Act embodies a partial codification of the common law.'[368]

This was followed by in *PCW Syndicates v PCW Reinsurers*[369] and *Manifest Shipping Company Limited v Uni-Polaris Insurance Company Limited* (The Star Sea).[370]

6.2.2 Different categories of reinsurance facility

The broker's duty of utmost good faith under reinsurance contract is determined by the nature of the reinsurance facility. There are two broad types of reinsurance: facultative and treaty reinsurance.

6.2.2.1 Facultative reinsurance

Facultative reinsurance is the reinsurance of a single risk. This type of reinsurance is nearly always proportional. That means when ceding the risk, the reinsured retains an agreed proportion of the risk and passes some or all of the remainder to the reinsurers. The facultative reinsurance is written by means of a slip policy which consists, *inter alia*, of a 'full reinsurance' clause.[371] A typical full reinsurance clause is as follows: 'being a reinsurance of and warranted same terms and conditions as original, and to follow the settlements.' This form of reinsurance is commonly used to bring to the London market risks which cannot be insured directly, because of local regulatory requirements. The reinsured will act as a 'front' by underwriting the risk and reinsuring most or all of it with reinsurers.[372]

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[368] [1994] 2 Lloyd's Rep. 427, at p. 432, col.1.

[369] [1996] 1 WLR 1136 at p 1139.

[370] 2001 Lloyd's Rep. I.R. 247(HL).

[371] For more information about the full reinsurance clause, please refer to 'Reinsuring Clauses' by Gürses, Özlem, London : Lloyd's List, 2010.

[372] Colinvaux's Law of Insurance 9th ed. Sweet & Maxwell 2010, 17-001.

6.2.2.2 Treaty reinsurance

Treaty is a framework arrangement under which risks falling within its scope may be ceded to the reinsurers. A treaty is usually used for insuring a portfolio of risks. The reinsurance may cover the reinsured's entire business (the 'whole account' reinsurance) or it may be confined to a part of the reinsured's business, for example, it only covers the reinsured's marine account.

(A) Obligatory and non-obligatory

Treaty may be obligatory or non-obligatory. The non-obligatory treaty is usually called facultative treaty. Under obligatory treaty, the risks accepted by the reinsured are automatically ceded to the reinsurer with neither party having any discretion in the matter. There may be obligation on the reinsured to keep the reinsurer informed of the risks accepted, but failure to notify the reinsurers will not prevent the risk from attaching even if notification is not made until after the loss has occurred.[373]

Under the facultative treaty, the reinsured has the discretion to declare individual risks and the reinsurers have the right to accept or refuse them. This kind of treaty is more of an agreement between the reinsured and the reinsurer about the reinsured's submission of offers to the reinsurer.

A hybrid is called facultative obligatory treaty, under which the reinsureds have the right to decide what kind of risks they want to submit to the reinsurer; however the reinsurers have no choice but to accept whatever the reinsureds ceded. This form is not commonly in use, because the reinsurers may run the risk of receiving only unfavourable risks.

(B) Proportional and non-proportional

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[373] *Glencore International AG v Ryan (The Beursgracht)* [2002] 1 Lloyd's Rep. 574.

Treaties can be proportional or non-proportional. Under the proportional treaties the reinsured cedes to the reinsurer an agreed proportion of all risks accepted. The most common forms of proportional treaties are quota share and surplus treaties.

The most common form of non-proportional treaty is excess of loss reinsurance, under which the reinsurers accept liability for sums in excess of the reinsured's 'ultimate net loss'[374], a figure defined as the total aggregate of liabilities, excluding fixed costs and subrogation recoveries arising out of an event or occurrence.

6.2.3 The broker's duty of utmost good faith under different reinsurance facility

6.2.3.1 Facultative reinsurance and the duty of utmost good faith

In the case of a facultative reinsurance, there is not much dispute that it is a contract *of* insurance, and is subject to the rules of the duty of utmost good faith.[375] When a broker made misrepresentation or non-disclosure to the reinsurers when he places the facultative reinsurance contract, the reinsurers are entitled to avoid the reinsurance contract.

In fact, the authoritative case which gave rise to the broker's independent duty of disclosure was a case of facultative reinsurance. In *Blackburn, Low & Co. v Thomas Vigors*,[376] the underwriters had underwritten a steamship for £1,500. They then use two different brokers to reinsure £700 and £800 of the risk with two different reinsurers respectively. The brokers for the £800 reinsurance had acquired information material to the reinsurance risks but they did not pass on the information to the insurance underwriters nor the reinsurance underwriters. The insurance underwriters and the broker for the £700 reinsurance placed the £700 reinsurance contract with good faith. The issue raised for the court to decide was whether the reinsurers were entitled to avoid the £700 reinsurance contract on the ground of the reinsured's and the broker's breach of duty of disclosure. The House of Lords held that the broker for the £800 reinsurance

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[374] The ultimate net loss clause used in excess of loss reinsurance.

[375] *Highlands Insurance v Continental Insurance* [1987] 1 Lloyd's Rep. 109; *Groupama Insurance Co Ltd v Overseas Partners Re Ltd* [2003] EWHC 34 (Comm).

[376] (1887) L.R. 12 App. Cas. 531.

contract had an independent duty of disclosure under that contract. His knowledge cannot be imputed to that of the reinsured's.

6.2.3.2 Treaty reinsurance and the duty of utmost good faith

The application of the doctrine of utmost good faith to reinsurance treaties is not that straight forward as the facultative reinsurance. Section 17 of MIA 1906 had stipulated that the Act applies to contract *of* insurance. However, there are discussions on the issue as to whether the treaties are contract *of* insurance or contract *for* insurance. There are two stages involved in creating a reinsurance contract under a treaty: First, the making of the treaty; and secondly the making of declarations to the treaty. The treaty simply provides a framework for making declarations to the treaty, it is the declaration that forms the reinsurance contract, and therefore the treaty is considered as a contract *for* reinsurance not a contract *of* reinsurance. As a matter of strict law, there is no duty of utmost good faith in relation to a contract *for* insurance.

The case, *HIH Casualty & General Insurance Company & Others v Chase Manhattan Bank & Others*,[377] concerned with slips for two facultative policies and a slip for a line slip facility, which was a contract for insurance. The reinsurers intended to avoid the line slip facility and the declarations made under that facility on the ground of the broker's breach of duty of disclosure and misrepresentation. In resolving the issue whether there were duties of utmost good faith in relation to the line slip facility, Aikens J. said that 'I do not accept that the Phoenix line slip facility, as a contract *for* insurance, is a contract of the utmost good faith. The contracts 'upon speculation' are made when the individual declarations are made under the line slip and the underwriters become bound. It is clear in this case that individual declarations had to be agreed by leading underwriters and could be rejected when presented. Therefore in principle I think that the Phoenix facility, which is a contract only to grant authority to contract insurance, does not have the necessary qualities to make it a contract of the utmost good faith.'[378]

However, the question is not that whether any duty of utmost good faith will arise under reinsurance contracts made through treaty. The reinsurers under reinsurance treaty

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[377] [2003] 2 Lloyd's Rep. 61.

[378][2003] 2 Lloyd's Rep. 61, para. 49.

should be entitled, as those under facultative reinsurance contracts, to avoid the reinsurance contract if the brokers or the assureds make any misrepresentation or failed to disclose material facts under facultative reinsurance. The right question to ask is when the broker's duty of utmost good faith will arise in the process of the making of the treaty reinsurance contract.

(A) Obligatory and fac/oblig treaty

Obligatory and fac/oblig treaties create binding obligations on reinsurers to offer reinsurance. The reinsurers must accept any risk which is accepted and declared by the reinsured, they have no right to refuse the cover or change the rate of the premium in respect of any individual risk when it was declared or ceded by the reinsured. In this situation it is hard to say that any duty of utmost good faith will arise when the broker makes a declaration or cession.

In *Glencore International AG v Ryan*, The Beursgracht,[379] the dispute concerned with a contract of charterer's liability insurance. The assured charterer was insured by the underwriter under an open cover against his liabilities to the owners of the chartered vessel. The assured later chartered the vessel named Beursgracht within the terms of the open cover. Liability was incurred by the assured to the owner of the vessel and they sought to be indemnified by the insurers. The insurers denied the liability and contended that there was not contract of charterer's liability insurance in relation to the vessel, because no declaration was made to or accepted by the insurer. In fact the declaration was made more than three years after the accident which caused the charterer's liability. The issue submitted to the Court was whether the open cover against charterer's liability provided by the underwriters to the assured gave cover automatically when the assured chartered a vessel and so assumed such a risk or when the underwriter received a declaration of the risk to the cover from the assured. At first instance, Hallgarten J. held that 'granted that the requirement that the claimants do make declarations represented a term of the open cover, does that mean that no relevant contract in relation to *Beursgracht* existed until such time as a declaration was made? I see no reason why one should reach so artificial a result. As I see it, once the charter fell to be declared within

[379] [2002] 1 Lloyd's Rep. 574.

the ambit of the cover, underwriters were immediately on risk… A declaration serves, perforce retrospectively, to *declare* the true position under the cover, it is not *creative* of any rights and obligations.'[380]

It was upheld by the Court of Appeal. The decision indicated that the risk under an obligatory insurance/reinsurance contract attached automatically when the assured/reinsured themselves became bound. There is no duty of utmost good faith in respect of each new risk at declaration. However, it is strongly arguable that the duty of utmost good faith arises when the obligatory and fac/oblig treaties are concluded.

The case *Limit No. 2 Ltd v Axa Versicherung AG*[381] concerned with two fac/oblig treaties of reinsurance relating to construction and operating risks in connection with oil rigs. When placing the reinsurance the brokers attached a front cover to the draft slip and information sheet provided by the reinsured which stated that: 'As a matter of principle they maintain high standards and would not normally write construction unless the original deductible were at least £500,000 and preferably £1,000,000.' The reinsurance turned out badly for reinsurers who discovered on inspection that most of the relevant risks ceded by the syndicates had deductibles considerably lower than £500,000, let alone £1,000,000. It was held by the Court of Appeal that the reinsurers were entitled to avoid one of the reinsurance treaties on the ground of the brokers' misrepresentation of the deductibles when placing the risk. The other one was held to be a renewal policy and it was a new contract. Therefore the representation made by the brokers when placing the previous treaty was irrelevant.

(B) Facultative treaty

By contrast, if the treaty is facultative, under which the reinsurers can refuse individual declarations or cessions, then it is plainly the case that the treaty is not of itself a contract of reinsurance; it is simply a framework facility under which risks falling within its scope may be ceded to the reinsurers. It is each declaration or cession that makes a contract of reinsurance to which the broker's duty of utmost good faith applies.

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[380] [2001] 2 Lloyd's Rep. 602, at p. 606, col.1.

[381] [2008] EWCA Civ. 1231.

In *Société Anonyme d'Intermediares Luxembourgeois v Farex Gie*,[382] SAIL, the in-house broker of AIG group, arranged a facility for reinsurance of risks underwritten by AIG companies. It was a facultative arrangement: there was no legal obligation upon SAIL to put forward any reinsurance and, subject to the 'hold covered' provision, no obligation upon Farex to accept any that were put forward. When claims were presented to Farex, they refused them on the ground that material facts were not disclosed both at the time when the arrangement was made and when the declarations were made. It was not argued that the usual disclosure obligations applied to each individual declaration. But it was disputed whether specific facts were material and should be disclosed at declaration. The question which is relevant here is whether the duty of disclosure of material facts arose when the arrangement was entered into.

Gatehouse J. said that 'I have little doubt that, absent the 'hold covered' provisions, no disclosure obligations arose at the time of entering into the 1989/1990 arrangement, and for the reasons given by Mr. Boswood. It was not a binding contract 'of' or 'for' insurance; there was no transfer of risk; it was simply a procedural mechanism which, if operated as both parties no doubt hoped and expected, would secure considerable commercial benefit to both sides. The clear intention of the parties was that individual reinsurances under it would be offered by SAIL and considered by Farex on a wholly facultative basis.'[383]

In the document recording the arrangement, there were two 'hold covered' provisions, by which the SAIL was authorised on making a declaration of new business to hold the reinsured covered for 7 days, or for 30 days when pending the renewal instructions. That means SAIL had the power to bind Farex for 7 days or 30 days when declarations was made.

The further question was whether the 'hold covered' provisions made SAIL subject to duty of disclosure when entering into the arrangement.

Gatehouse J. held the 'hold cover' provision made no difference. He said

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[382] [1995] L.R.L.R. 116.

[383] [1995] L.R.L.R. 116, at p.135, col.2.

‘the disclosure required by section 19 of the Marine Insurance Act 1906 is before an insurance contract is concluded i.e., as Mr. Boswood contends, when the risk is transferred to the insurer. This clearly requires disclosure at the time when a particular piece of business is declared by an AIG company for consideration by Farex, but it makes no sense to require disclosure at the time of setting up the procedural mechanism which does not itself involve any particular declarations or transfers of risk.’[384]

Besides, imposing a duty of disclosure at the time of entering into the arrangement may involve a bizarre result that if there was a failure to disclose material facts, the arrangement itself and all declarations made under it were voidable, even if a particular reinsured had made full disclosure at the time of declaration.

The decision indicated that under a facultative reinsurance treaty, no duty of utmost good faith will arise when entering into the facility. The duty only arises when each declaration is made. Under a facultative treaty, each declaration makes a distinct contract of reinsurance, so that if there is misrepresentation or non-disclosure in relation to a particular declaration, that declaration could be avoided; but the treaty itself and other declarations made under it are unaffected and remained valid.

6.2.4 Reinsurance before insurance

As has been discussed earlier, it was held, in The Zephyr, that when the broker place the reinsurance contract prior to the insurance contract, the broker was acting on his own behalf at the time of the negotiation with reinsurers, but once the reinsured had agreed to take the benefit of that reinsurance protection, he was affected by any misrepresentation and/or non-disclosure made by the broker in bringing about the reinsurance contract.

In The Zephyr, Hobhouse J. agreed that such a practice was a reversal of the normal market practice. However, the judge ruled that the nature of a facultative reinsurance contract, both in accordance with the practice of the market and the law, was still a contract of insurance. The broker was still the agent of the reinsured not the reinsurer.

[384] [1995] L.R.L.R. 116, at p.135, col.2., p136 col.1.

Once the broker has taken the instruction from the reinsured to order the reinsurance cover, '[i]t follows that from that moment Mr. Charman [the reinsurered] is potentially affected by any act or omission of Mr. Baxter [the broker] in bringing the contract about. For example if there had been any misrepresentation by Mr. Baxter to Mr. Tanter [the reinsurer] then Mr. Charman's contract with Mr. Tanter is affected by that misrepresentation. The converse argument, which I reject, involved that any misrepresentation by Mr. Baxter to Mr. Tanter would be contractually irrelevant and that the only duty of disclosure would arise between Mr. Charman and Mr. Baxter.'[385]

6.3 The broker's liability to pay premium under reinsurance

6.3.1 Facultative reinsurance

MIA 1906 itself has not stated whether section 53 applies to marine reinsurance, but there are authorities supporting the proposition that section 53 should apply at least to facultative marine reinsurance contract.

In *Universo Insurance Co. of Milan v Merchants Marine Insurance Co. Ltd*, the issue whether the reinsurers can sue the reinsured for premiums due to him, or must he look to the broker and to him alone for payment was raised. Smith L.J. held that 'although the present case arises out of reinsurance by the plaintiff company of marine risks therefore undertaken by the defendant company, it may be treated as if the plaintiff company were the underwriters of a policy of marine insurance upon the defendants' ship effected in the ordinary course of business in London through the instrumentality of a broker.'[386] Therefore, the broker was held liable for the premium under the facultative marine reinsurance contract.

This principle was followed by in *Heath Lambert Limited v Sociedad de Corretaje de Seguros,*[387] where it was held that the reinsurance broker was under a legal liability to pay the premium under English law, and was entitled to be indemnified against that liability by its principal, whoever that was.

[385] 1984 1 Lloyd's Rep. 58, atp.80, col.2.

[386] [1897] 2 Q.B. 93 at p.96,

[387] [2004] EWCA Civ. 792.

6.3.2 Reinsurance Treaty

There is no clear legal authority which determines whether the broker is liable for premium in respect of marine treaty reinsurance. However, the characteristics of treaty reinsurance suggest that it is not sensible to adopt the rule of broker's payment of premium liability in this area. First, reinsurance treaty is contract *for* insurance not contract *of* insurance as stated in the Act. Secondly, reinsurance treaties are generally long-term contracts. When the premium is due, the agency may have expired or terminated.

Chapter 7 Measure of Damages and Limitation of Liability

7.1 Measure of Damages

7.1.1 The usual measure of damages

A marine insurance broker may owe various duties to the assured, and thus breaches can arise in various ways. When the broker breaches any contractual duty or makes some mistake by negligence, by which the assured suffers losses, the broker will be held liable for all the foreseeable consequences which fall within the scope of the broker's duty of care. The broker's scope of duty is a matter of fact of each case, while the measure of damages is a matter of law. Generally, in an action in contract, the injured party is entitled to damages to put him in the same position as if the contract had been properly performed, and this include any potential profit the injured party was bound to make under the transaction.[388] In an action in tort, the injured party is entitled to damages that put him in the same position as if the tort had not been committed against him.[389] Since the most common result of the marine insurance broker's breach is that the insured is left with an invalid claim against the insurer under the insurance policy, the two different tests may come to the same result. There is authority for the proposition that the normal measure of damages for insurance broker's breach of duty is the amount which the insurance would have paid to the assured but for the broker's breach. In *Mander and Others v Commercial Union Assurance Company plc and Others,*[390] Rix J. said:

'*prima facie,* the loss of effective insurance gives rise to a claim against a negligent broker in the sum which the client would have recovered under the insurance, if it had been effective.'

7.1.2 Damages exceeding the indemnity under the policy

7.1.2.1 Superhulls Cover case

[388] *Robinson v Harman* (1848) 1 Ex. 850.

[389] *Livingstone v Rawyards Coal Co.* (1880) 5 App.Cas. 25.

[390] [1998] Lloyd's Rep. I.R. 93, at p. 146.

In *Youell and Others v Bland Welch & Co Ltd and Others* (The 'Superhulls Cover' Case) (No2.),[391] the insurers instructed the brokers to place excess of loss reinsurance cover for their potential liability in respect of the construction risks which they intend to underwrite for three liquified gas carrying vessels being constructed in the United States. The reinsurance cover was duly placed but it included a 48 months cut-off clause which was not included in the direct cover. The vessels became a constructive total loss as a result of perils insured against at a time when the direct cover was in force but over 48 months after each vessel had come on risk. The insurers paid out the indemnity but cannot recover under their reinsurance cover. The insurers claimed against the brokers for damages incurred in consequence of being induced by the brokers' misrepresentation of the back-to back reinsurance cover. Phillips J. found that none of the insurers would have accepted the reinsurance cover had they appreciated that it was subject to a 48 month cut-off clause. Without such cover the insurers would not have increased their exposure under the original insurance. In light of this fact, he held that the measure of damages should be the difference between what the insurers had been obliged to pay out under the underlying policy and what they would have been obliged to pay had they subscribed for a smaller line. The decision was subsequently approved by the Court of Appeal.

7.1.2.2 SAAMCO case

The House of Lords decision in *South Australia Asset Management Corporation v York Montague Ltd* ('SAAMCO'),[392] although not a broking case, has had profound effect on the measure of damages in claims against all categories of professionals, including marine insurance brokers.

In this case, the valuers were required by the banks to make assessment of the properties on the security of which they were considering advancing money on mortgage. The property was too overvalued to the extent that the banks would not have made the loan if they knew the true value of the property. The borrowers subsequently defaulted, and with the market fall at the same time, great losses were eventually suffered by the

[391] [1990] 2 Lloyd's Rep. 431.

[392] [1997]A.C. 191.

banks. Not surprisingly, the banks brought actions against the valuers for damages for negligence and breach of contract. But the two parties had different view on the way the damages should be measured. The banks argued that the amount should be the difference between what they have advanced to the borrower and the proceeds of the sale of the securities. This means the valuer is not only liable for the amount which they have overvaluated the property, but also the financial losses caused by the fall of the property market. But the valuers argued that if they were held liable they should only be liable for the sum of the overvaluation. In determining the measure of the damages, Lord Holffmann distinguished between two duties that could be owed by the valuer to the banks:

'The principle thus 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 advise whether or not a course of action should be taken, the adviser must take reasonable care to consider all the potential consequences of that course 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 only 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.'[393]

7.1.2.3 Aneco case

One example of this principle being applied in marine insurance cases was illustrated in *Aneco Reinsurance Underwriting Ltd (In liquidation) v Johnson & Higgins Ltd*.[394]In that case a marine insurance broker discussed with a Lloyds' underwriter a treaty to reinsure the marine excess of loss business he has underwritten for four syndicates at Lloyds ('the Bullen treaty'). The broker found Aneco as potential reinsurers of the Bullen treaty. Aneco made it clear to the broker and the underwriter that his willingness to participate on the lines was subject to the brokers being able to obtain satisfactory excess of loss protection for Aneco. The broker duly placed excess of loss cover for

[393] [1997]A.C. 191, at p.214.

[394] [2002] 1 Lloyd's Rep. 157.

Aneco and Aneco then subscribed to the Bullen treaty. Great losses were suffered by the Lloyd's underwriter's business. Aneco paid the indemnity under the Bullen treaty but cannot recover from their excess of loss reinsurance because of the broker's misrepresentation of the Bullen treaty as a quota share treaty, while in fact it was a 'fac/oblig' treaty, and it turned out that if the proper presentation of the risk was made, the reinsurance which met Aneco's needs was never available in the market. Therefore, Aneco sued the broker in damages for breach of contractual duty and negligence. Both the trial judge and the Court of Appeal found the broker liable, but they have different decisions on the amount of the damages. The issue appealed to the House of Lords was what the correct measure of damages should be in this case.

The broker submitted that the correct measure of damages was the value of the retrocession cover, US$11m, which the reinsurer lost when the cover was avoided. While the reinsurer argued that if the brokers had made full disclosure to the underwriters, as a reasonably competent broker would do, they would have discovered that reinsurance cover of the kind which the reinsurers required was not available in the London market, either at all or alternatively on terms which made commercial sense, and they would have had to report this outcome to the reinsurers. If the reinsurers knew this situation, they would not enter into the Bullen treaty, and they would not have incurred the losses of U.S.$35 m. which they have suffered as the result of what proved to be an imprudent venture. Hence, they submitted that the whole of their losses was caused by the broker's breach of duty towards them.

The House of Lords held that, on the facts of the case, the broker's duty was not limited to obtaining the excess of loss cover for Aneco, it also extended to advising them what course to take. It was foreseeable that Aneco would not take part in the treaty if the reinsurance of the risk was not available, because that meant that the market assessment of the risk was negative. Therefore the broker should be liable for the whole of the losses which Aneco has suffered in consequence of entering into the Bullen treaty.

Lord Lloyd, when discussing the applicable law, clarified the relationships between the Superhulls Cover case and the SAAMCO case:

‘It would, I think, be a mistake to regard the Superhulls Cover case, if correctly decided, as being an ‘exception’ to some general exclusionary rule established in SAAMCO. It is rather the other way round. The Superhulls Cover case represents the ordinary rule, whereby brokers (and others) are liable in contract for the foreseeable consequences of their negligence, including the adverse consequences of entering into a transaction with a third party, provided such consequences can fairly be held to fall within the scope of the defendant’s duty of care. SAAMCO is an example of a special class of case - typically that of a valuer, but not confined to valuers - where a scope of the defendant’s duty is confined to the giving of specific information.’

As can be seen from Aneco case, there is nothing new for the way the damages are measured, the broker is liable for all the foreseeable consequences which is caused by his negligence. But he is not liable in damages in respect of losses which fall outside the scope of his duty of care. When assessing the damages the brokers owed to their client, the first thing is always to find out the broker’s scope of duty, which is a matter of fact of each case.

It is also to be noted that, for a marine insurance risk to be placed in the London insurance market, it is not unusual for a marine insurance broker to persuade the reinsurer to agree to the reinsurance contract before he can successfully place the insurance cover with the insurer for the assured. It is also not surprising that the broker will explore new market and design some new insurance covers and then sell the product to the market. Therefore, it is quite easily for a marine insurance broker to transcend the boarder from the more traditional role of obtaining information about the price and availability of insurance cover to that advising his client on the potential merits of a transaction or the types of cover that ought to be purchased. This imposes an inherent danger to those brokers that advising, in light of the principles decided in the above cases, may expose them to a wider scope of damages if they made any mistakes during that process.

7.2 Limitation of Liability Clause

7.2.1 The purpose of a limitation of liability clause

As can be seen from the way of measuring damages caused by the broker's breach of duty, the brokers are likely to face with potential dangers of higher liabilities than the indemnity recoverable under the policy he effected for the assured, if he crosses the information/advice boarder. Moreover, the amount of the professional indemnity insurance the broker bought may well be limited. If a client brings a successful claim against the broker firm to the extent that it is not covered by the professional indemnity insurance, it has to be met out of the firm's own resources. Depending on the scale of the claim, it could cause severe financial difficulty, even, in some cases, insolvency. The brokers only consider themselves as intermediaries, sometimes as advisers, but they do not expect themselves to be insurers.[395] They are not willing to accept unlimited liability for very limited amounts of remuneration. In short, the risks and the benefits may be disproportionate. Therefore, the brokers may seek to manage the risk they may be exposed to by limiting their potential liabilities to his clients through contractual agreements.

7.2.2 The way to limit

There are two ways for the broker to limit their liability in the written agreement with the assured. One is that they can narrow the scope of their duty to the assured. The other way is to include a limitation of liability clause which imposes a monetary cap on the potential liability they may owe to his client. The limitation of liability clause can either be a clause included in the terms of engagement or be a standalone agreement.

The broker's scope of duty to his client will be determined by the functions the broker is retained to perform. Therefore the clause relating to the broker's duties will be varying from case to case. While a limitation of liability clause is a common concern for all marine insurance brokers and therefore it should be the main focus of the following discussion.

7.2.3 A limitation of liability clause for marine insurance broker

[395] Daniel section Glaser, CEO of Marsh Inc. in Marsh Seeks to Put Limit on Its Own Liability, Business Insurance, 23rd March 2009.

A limitation of liability clause is a clause agreed between the broker and the assured to exclude or limit the extent of potential liabilities owed by the broker to the assured. The purpose of this clause is to allocate risk in reasonable proportion to the benefits to be derived from the service contract. Many professions in the U.K. include a limitation of liability clause in their service contract, for example the auditors, solicitors, accountants, architects and surveyors. However, it is not a common practice for marine insurance brokers. With the increase of the assured value and the assured's potential liabilities owed to third parties, the broker's potential liabilities owed to the assured will also be raised. In March 2009, Marsh Inc. began asking their clients to sign off on new client service agreements that include a $10 million cap on the New York based broker's professional liability. Some larger brokers operating in the U.K. imposed these limitations too, but their names were not disclosed.[396] In the same year, the British Insurance Brokers' Association began to study the pros and cons of such liability caps and published their research in their publication in April 2010 titled Professional Indemnity Initiative: Facts about limitation of liability.[397]

7.2.4 The legal and regulatory framework

When considering the inclusion of a limitation of liability clause, the biggest concern for the broker is the enforceability of such a clause, and whether it is enforceable or not depends upon the current legal regime under which such clauses operate. For U.K. marine insurance brokers, Unfair Contracts Terms Act 1977 and rules of the Insurance Conduct of Business Sourcebook (ICOBS) have had some restrictions on limitation of liability clauses for insurance brokers.[398]

7.2.4.1 Unfair Contracts Terms Act 1977

The Unfair Contracts Terms Act 1977 is a statute of general application. This act derives substantially from recommendations made by the Law Commission and the

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[396] Business Insurance, 23 March 2009, p.22.

[397] Professional Indemnity Initiative: Facts about Limitation of Liability, British Insurance Brokers' Association, 2010 volume 4.

[398] Insurance Contracts are excluded from the UCTA 1977, see UCTA 1977 schedule 1 section 1 (a). However, the Act is being discussed in the case of an agency agreement in this part.

Scottish Law Commission in their Second Report on Exemption Clauses. It applies to terms that purport to exclude or restrict liabilities. Therefore it is relevant when considering the enforceability of a limitation of liability clause.

Restrictions are placed by section 2 (2) of this Act on the power of one party to exempt his liability for negligence which results in damage other than personal injury or death.[399] The term 'negligence' embraces both the tort of negligence and breach of any contractual obligation to exercise reasonable skill or care.[400]

Section 2(2) stipulates that :

'a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness.'

The test of reasonableness is explained in section 11.

Section 11- The 'reasonableness' test

(1) In relation to a contract term, the requirement of reasonableness for the purposes of this Part of this Act, section 3 of the Misrepresentation Act 1967 and section 3 of the Misrepresentation Act (Northern Ireland) 1967 is that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.

(2) In determining for the purposes of section 6 or 7 above whether a contract term satisfies the requirement of reasonableness, regard shall be had in particular to the matters specified in Schedule 2 to this Act; but this subsection does not prevent the court or arbitrator from holding, in accordance with any rule of law, that a term which purports to exclude or restrict any relevant liability is not a term of the contract.

…

(4) Where by reference to a contract term or notice a person seeks to restrict liability to a specified sum of money, and the question arises (under this or any other Act) whether the term or notice satisfies the requirement of reasonableness, regard shall be had in particular (but without prejudice to subsection (2) above in the case of contract terms) to—

(a) the resources which he could expect to be available to him for the purpose of meeting the liability should it arise; and

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[399] This are dealt with by section 2(1).

[400] Unfair Contract Terms Act 1977 section 1(1).

(b) how far it was open to him to cover himself by insurance.
(5) It is for those claiming that a contract term or notice satisfies the requirement of reasonableness to show that it does.'

As can be seen from this section, the burden of establishing the reasonableness of the limitation of liability clause will be on the broker and the court will take into account 'the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.'

According to section 11 (2) of the Act, five guidelines are laid down in Schedule 2, and regard is to be had to these in determining whether a contract term satisfies the requirement of reasonableness. The guidelines are stated to be of particular relevance to section 6 and section 7 which relate to sale of goods and hire-purchase agreements and contracts under which goods pass, but they are frequently regarded as being of general application.[401] Therefore, they are also relevant to contracts for services, like a retainer for marine insurance broker.

Schedule 2 'GUIDELINES' for application of reasonableness test
The matters to which regard is to be had in particular for the purposes of sections 6(3), 7(3) and (4), 20 and 21 are any of the following which appear to be relevant—
(a) the strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met;
(b) whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having to accept a similar term;
(c) whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);

[401] *Flamar Interocean Ltd v Denmac Ltd* [1990] 1 Lloyd's Rep. 434; *Stewart Gill Ltd v Horatio Myer & Co Ltd* [1992] W.B. 600; *Granville Oil and Chemicals Ltd v Davis Turner & Co Ltd* [2002] EWCA Civ. 570.

(d) where the term excludes or restricts any relevant liability if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable.'

7.2.4.2 The Insurance Conduct of Business Sourcebook (ICOBS)

The conduct of insurance intermediaries is regulated by statute as well as rules and guidance drawn up by the Financial Services Authority (FSA). There are two groups of rules. The rules in the Conduct of Business Source Book (COBS) apply to investment insurance, mainly life insurance; the rules in the Insurance Conduct of Business Source Book (ICOBS) apply to all general insurance except large risks and reinsurance.[402] The rules in ICOBS also distinguish between consumer and commercial customer for the reason that commercial customers need less protection. For marine insurance brokers, the relevant rules are those governing commercial customers in ICOBS.

In ICOBS 2.5.1, it stipulates that:

'a firm must not seek to exclude or restrict, or rely on any exclusion or restriction of, any duty or liability it may have to a customer or other policyholder unless it is reasonable for it to do so and the duty or liability arises other than under the regulatory system.'

This shows that the FSA rule also adopts a 'reasonableness' test for the broker's limitation of liability clause.

7.2.5 The 'term' that should satisfy the reasonableness test

When considering the reasonableness of a term, the term as whole should be reasonable not only part of it which the claimant need to rely on in one action. This was held in *Stewart Gill Ltd. v Horatio Myer & Co. Ltd.*[403] This case is about supplying of goods and services. The price was agreed to be paid by instalment. The contract was also subject to the supplier's general conditions of sale, where a cl. 12.4 said that:

[402] ICOBS 1 Annex 1, Part 2.

[403] [1992] Q.B. 600.

‘The customer shall not be entitled to withhold payment of any amount due to the company under the contract by reason of any payment credit set off counterclaim allegation of incorrect or defective goods or for any other reason whatsoever which the customer may allege excuses him from performing his obligations hereunder.’

When the supplier tried to recover the final 10 per cent of the price by summary judgment, the buyer argued that they were, by way of set-off, entitled to claim against the supplier for a greater sum than that claimed against them. Cl.12.4 was rendered ineffective by the Unfair Contract Terms Act 1977.

The court held that preventing a payment or credit to be set off against the price claimed was unreasonable and the concluding words ‘or for any other reason whatsoever’ is unlimited and may be extended to fraud, the whole clause was rendered ineffective by the Act. During the process, the supplier submitted that as the buyer did not rely on a ‘payment’ or ‘credit’, this part of the clause could be ignored. This argument was rejected by the court. Stuart-Smith L.J., with whom Donaldson L.J., Balcombe L.J. agreed, gave the following reasons why it was the whole not only part of the clause which the plaintiff relied on in the action should be reasonable:

(1) The expression used in the Act was ‘ by reference to any contract term’, ‘the contract term satisfies the requirement of reasonableness’;

(2) The parties should be able to judge the reasonableness of the clause when the contract was made and it was impossible for the parties to know whether some, if so which part of the clause will only be relied upon;

(3) If the reasonableness test was not applied to the whole exclusion clause, paragraph (b) and (c) of Schedule 2 to the Act would become unworkable;

    For paragraph (b), if there was an inducement, it would be difficult to say the inducement only related to some of the words but not others.

For paragraph (c), the customer would hardly know the extent of the term if the vendor will be allowed to rely on part of the clause to satisfy the reasonableness test.

(4) Applying the test of reasonableness only to the part of the clause which was relied upon in an action was inconsistent with the policy and purpose of the Act.

However, in *Regus (UK) Limited v Epcot Solutions Limited,*[404] the court had struck out part of the clause which was held unreasonable while leaving the remaining part intact. This case was concerned with the provision of serviced office accommodation. The plaintiff claimed against the defendant for service fees. While the defendant counter claimed various damages caused by, among other reasons, the inadequacy of air-conditioning provided by the plaintiff, and he claimed that the exclusion and limitation clause in the plaintiff's standard term has not satisfied the reasonableness test in the UCTA 1977. The relevant part of the exclusion and limitation clause is as follows:

23 Our Liability

…

…

[23(3)] We will not in any circumstances have any liability for loss of business, loss of profits, loss of anticipated savings, loss of or damage to data, third party claims or any consequential loss. We strongly advise you to insure against all such potential loss, damage expense or liability.

[23(4)] We will be liable:

• without limit for personal injury or death;

• up to a maximum of £1 million (for any one event or series of connected events) for damage to your personal property;

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[404] [2008] EWCA Civ. 361.

• up to a maximum equal to 125% of the total fees paid under your agreement up to the date on which the claim in question arises or £50,000 (whichever is the higher), in respect of all other losses, damages expenses or claims.

At first instance, the judge held that cl.23 (3) was unreasonable and since it was not open to the court to sever a clause which fails to meet the requirements of the Act clause 23 as a whole was of no effect.

In the Court of Appeal this decision was reversed, Rix L.J. held that clause 23(3) could be severed so as to leave clause 23(4) intact. He said that:

'It is true that clause 23 was not divided up into separate sub-clauses in the way that, for the sake of convenience, I have treated it by introducing the numbers (1), (2), (3) and (4). I bear that fully in mind. Nevertheless, it is plain that clause 23(4) is independent of clause 23(3). It is a limitation clause, rather than an exemption clause, and thus serves a different purpose, as was recognised in Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd [1983] 1 WLR 964 at 966. In Watford Electronics this court was prepared to sever the clause in question, which again contained one sentence dealing with a complete exclusion in respect of 'indirect or consequential losses whether arising from negligence or otherwise' and another sentence limiting liability 'in any event … [to] … the price paid.'[405]

In *Lobster Group Ltd v Heidelberg Graphic Equipment Ltd,*[406] the high court judge did not mention *Regus (UK) Limited v Epcot Solutions Limited*[407], but followed the decision in *Stewart Gill Ltd. v Horatio Myer & Co. Ltd.*[408]

Children's book publisher Lobster Group sued Heidelberg Graphic over the supply of a £1.2 million printing press. Lobster claimed that the speed and quality of the 'Heidelberg Speedmaster' had been misrepresented. Heidelberg sought to rely on a clause in its contract that limited liability:

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[405] [2008] EWCA Civ 361.

[406] [2009] EWHC 1919.

[407] [2008] EWCA Civ 361.

[408] [1992] Q.B. 600.

'[In no circumstances shall Heidelberg be liable] (i) for any increased costs or expenses (ii) for any loss of profit, business contracts, revenues or anticipated savings; or (iii) for any special, direct or consequential damage of any nature whatsoever said to have occurred consequent upon the supply or the circumstances of the supply of the goods or services...'

Ramsey J. said that the attempt to exclude liability for increased costs and expenses was unreasonable. Because the exclusion in sub-clause (i) was unreasonable, he ruled that the entire clause should be void, including the exclusions in sub-clauses (ii) and (iii) that would otherwise have been reasonable.

In Regus (UK) Limited v Epcot Solutions Limited,[409] although the paragraphs in cl.23 had not been divided into sub-clauses, they were able to be severed for being used for different purposes (one for exclusion, one for limitation); while in *Lobster Group Ltd v Heidelberg Graphic Equipment Ltd,*[410]although the exclusions were separately listed in sub-clauses. They were considered as one clause and cannot be severed. Seen from these cases, the question whether the clause can be severed or not for the satisfaction of reasonableness test really depends on what the court considers to be the 'term' to be assessed in a contract. Therefore, when drafting a limitation of liability clause, it should be born in mind that the whole clause should be made correctly. If some of the clause was unreasonable, it will rendered the entire clause invalid. If a term is thought to be risky but necessary, it should be written in a separate term.

7.2.6 The main elements to be considered for a limitation of liability clause

7.2.6.1 The parties that may have the burden and benefit of the clause

(A) The contracting party

There is no doubt that the broker and his client as the contracting party of the limitation of liability clause have the benefit and burden imposed by that clause. But issues can

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[409] [2008] EWCA Civ. 361.

[410] [2009] EWHC 1919.

arise where broking services are performed by different companies within the same global broking group. Can one broking firm avail themselves of the limitation of liability clause in the contract between another broking firm within the same broking group and his client when servicing that client? Moreover, since the marine insurance policy is assignable, can the assignee of the policy be subjected to the burden of the limitation of liability clause?

(B) The third party

(a) Who can have the benefit

In *BP plc v Aon Ltd & Anor*,[411] a global construction all risks open cover was placed by Aon for BP with U.S. and London underwriters. A service agreement was signed between BP and Aon Texas office. In that agreement, there was a clause 12 which said:

'Aon Risk Services [the Texas office] hereby agrees to indemnify AMOCO [who merged with BP] against all loss, damage, costs and other expenses of any nature whatsoever incurred or suffered by AMOCO, its directors, officers and employees or by a third party as a result of any and all representation, statements, tortious acts or omissions including negligence or breaches of obligations arising under or in connection with this Agreement by Aon Risk Services *to a maximum amount of Aon Risk Services remuneration* noted in Clause 6 above except in the case of third parties where Aon Risk Services will be liable for all loss, damage, injury or death to the full extent of their negligent or fault.'

Another Illinois choice of law and exclusive jurisdiction clause was included in the agreement. The management of the open cover was later transferred to Aon's London office and the London brokers handled declarations to the open cover arising from BP's London office. A large number of declarations were made to the open cover. However, the London broker only made declarations to the leading underwriters but not to the following market. Some of the following market declined to indemnify BP under the cover arguing that the declarations were invalid. This was upheld by the court. BP then

[411] [2006] 1 C.L.C. 881.

claimed against Aon London in tort for failing to make proper declarations to each of the underwriters.

The main issues were whether Aon London owed a tortious duty of care to BP, if they did whether they can avail themselves of the cap on liability in clause 12 of the service agreement between Aon Texas and BP.

Colman J. held that Aon London owed a duty of care in tort to BP, but they cannot benefit from the limitation of liability clause in the service agreement. Because, according to the governing law of the service agreement, the Illinois law, the Aon Texan was the only party that was bound by its terms. It did not direct itself to the rights or liabilities of any other members of the Aon group. Therefore the limitation of liability clause in that agreement did not extend to the London brokers.

What would be the outcome if the governing law was English law?

Common Law

At common law the general rule is that the doctrine of privity of contract prevents the application of an exemption clause to third parties, although this general rule is subject to a number of exceptions.[412] At common law, two persons cannot by contract confer the benefit of an exemption clause on one who is not a party to that contract. Therefore the employee,[413] the agent[414] and sub-contractor[415] of the contracting party are not eligible for the benefit of the exemption clause.

The Contracts (Rights of Third parties) Act 1999

The common law rule has, however, been fundamentally affected by the Contracts (Rights of Third parties) Act 1999 (the 1999 Act). The 1999 Act enables a third party, subject to certain conditions, to take advantage of an exemption clause inserted in a

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[412] Bailment and building and construction contracts. See Chitty on Contract 30th ed. 14-054-057.

[413] *Cosgove v Horsfall* (1945) 62 T.L.R.

[414] *Adler v Dickson* [1955] 1 Q.B. 158.

[415] *New Zealand Shipping Co Ltd v A.M Sastterthwaite & Co Ltd* (The Eury medon) [1975] A.C. 154.

contract for his benefit. section 1 of the Act sets out the circumstances in which a person who is not a party to a contract may in his own right enforce a term of a contract.

‘1.— Right of third party to enforce contractual term.

(1) Subject to the provisions of this Act, a person who is not a party to a contract (a ‘third party’) may in his own right enforce a term of the contract if—

(a) the contract expressly provides that he may, or

(b) subject to subsection (2), the term purports to confer a benefit on him.

(2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.

(3) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.

…

(6) Where a term of a contract excludes or limits liability in relation to any matter, references in this Act to the third party enforcing the term shall be construed as references to his availing himself of the exclusion or limitation.’

The Government’s Explanatory Notes to this Act said that ‘Subsection (6) makes it clear that the Act is to apply so as to enable a third party to take advantage of an exclusion or limitation clause in the contract, as well as to enforce ‘positive’ rights. The Act, for example, allows a term of a contract which excludes or limits the promisee’s liability to the promisor for the tort of negligence and expressly states that the exclusion or limitation is for the benefit of the promisee’s ‘agents or servants or subcontractors’ to be enforceable by these groups.’ But, the premise is that the third party must be expressly identified in the contract by name, class or description, although they need not be in existence when the contract entered into.

Therefore, for the BP case, even if the governing law of the service agreement was English law, the outcome is the same that the Aon London which is not named either by name or class or description in the service agreement cannot avail themselves of the limitation of liability clause.

Seen from the above, it is advisable to clearly list all the possible beneficiaries in the limitation of liability clause, for example the broker's employee, other broker firm in the same broking group which may be involved in servicing the client.

(b) Who should bear the burden

Since the marine insurance policy is assignable, the policy holder will be changing from time to time. Can the assignee of the policy be subjected to the burden of the limitation of liability clause?

The first question to ask is whether the broker could owe a duty of care to the assignee, breaching of which will give rise to a liability. This was considered in *Punjab National Bank v De Boinville*,[416] where a bank tried to recover under four policies covering the risk of non-payment under the letters of credit. The insurers declined the claims on the ground of material non-disclosure or misrepresentation when placing the risk. Then the bank sought alternative remedy against the brokers. Among the four policies, two of them named the bank as the assured, the other two policies did not mention the bank. Hobhouse J. held that even for the two policies which had not named the bank as assured, there was a contractual relationship between the bank and the brokers; even in the absence of a contractual relationship, the brokers owed a duty of care to the bank. This was confirmed by the Court of Appeal. Staughton L.J. said that:

'Whether a non-contractual duty of care was owed by the brokers to the bank depended on whether the relationship between the parties (a) fell within a recognised category in respect of which it had been held that a duty of care existed; or (b) should fall within a recognised category by a justifiable increment to an existing one; … it was a justifiable increment to hold that an insurance broker owed a duty of care to a specific person who

[416] [1991] 1 Re LR 91.

he knew was to become an assignee, at all events if, as in the present case that person actively participated in giving instructions for the insurance to the broker's knowledge.'[417]

That means a broker may owe potential liabilities to a third party. Then it should be asked whether it is possible for the brokers to raise the defence of limitation of liability against that third party.

Common Law

At common law, two persons cannot by contract impose the burden of an exemption clause on one who is not a party to the contract. [418]

The Contracts (Rights of Third parties) Act 1999

The act does not alter the common law rule. But where, by virtue of the provisions of the Act, a contract confers upon a third party a right to enforce a contractual term, that right may be affected by an exemption clause in the contract which excludes or limits the liability of one of the parties for breach of that term. This is stated in section 3 of the Act.

'3.— Defences etc. available to promisor.

(1) Subsections (2) to (5) apply where, in reliance on section 1, proceedings for the enforcement of a term of a contract are brought by a third party.

(2) The promisor shall have available to him by way of defence or set-off any matter that—

(a) arises from or in connection with the contract and is relevant to the term,'

However, the third party may choose to sue the broker in tort rather than in contract. In this situation, the limitation of liability clause will not aid the broker in reducing his liabilities.

Although, the broker cannot avail himself of a limitation of liability clause when a third party sues him in tort, he may be able to avoid undertaking any duties to third parties in the first place, by an adequate disclaimer of responsibility. Thus in *Hedley Byrne & Co*

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[417] [1991] 1 Re LR 91, at p. 92.

[418] *Leigh and Sillavan Ltd v Aliakmon Shipping Co Ltd* [1986] A.C. 785.

Ltd v Heller & Partners Ltd,[419] it was held that, since the references of the company's financial stability were given with express disclaimer of liability, 'without responsibility', by the defendant bank, no duty of care would be implied. 'A man cannot be said voluntarily to be undertaking a responsibility if at the very moment when he is said to be accepting it he declares that in fact he is not. The problem of reconciling words of exemption with the existence of a duty arises only when a party is claiming exemption from a responsibility which he has already undertaken or which he is contracting to undertake.'[420] But it is to be noted that the existence of a disclaimer is not decisive. It should also satisfy the requirement of reasonableness under the Unfair Contract Terms Act 1977.

7.2.6.2 Types of wrongdoing

(A) Negligence

Liability for negligence may be excluded or restricted if the limitation of liability clause use clear and unambiguous wording to limit the compensation payable by one party for loss or damage caused by his negligence, like a cap on the liability. But since it is 'inherently improbable that one party to the contract should intend to absolve the other party from the consequences of the latter's own negligence',[421] more strict standards are applied to the clauses which intend to have that effect. The courts have attempted to use rules of construction to correct the imbalance caused by the exemptions clauses.

Three guidelines as to how to ascertain the intention of the parties to a contract was summarised in the opinion of the Privy Council delivered by Lord Morton in *Canada Steamship Lines Ltd v The King.*[422] These guidelines have been subsequently approved and applied both by the Court of Appeal and the House of Lords:

'(1) If the clause contains language which expressly exempts the person in whose favour it is made (hereafter called 'the proferens') from the consequences of the negligence of his own servants, effect must be given to that provision…

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[419] [1964] A.C. 465.

[420] [1964] A.C. 465, at p.533 *per* Devlin L.J.. See also p.493, *per* Reid L.J.; at p.504 *per* Morris L.J.; at 511 *per* Hodson L.J.; at p.540 *per* Pearce L.J..

[421] *Gillespie Bros Ltd v Roy Bowles Transport Ltd* [1973] Q.B. 400, at p. 419.

[422] [1952] A.C. 192, at p.208. For a criticism of these propositions, see Palmer [1983] *L.M.C.L.Q.* 557.

(2) If there is no express reference to negligence, the court must consider whether the words used are wide enough, in their ordinary meaning, to cover negligence on the part of the servants of the proferens…

(3) If the words used are wide enough for the above purpose, the court must consider whether 'the head of damage may be based on some ground other than that of negligence'… The 'other ground' must not be so fanciful or remote that the proferens cannot be supposed to have desired protection against it; but subject to this qualification… the existence of a possible head of damage other than that of negligence is fatal to the proferens even if the words used are prima facie wide enough to cover negligence on the part of his servants.'

For the first criterion, the word 'negligence' or a synonym for it should be used. If no such express reference to negligence can be found in the clause, it is necessary to proceed to the second test.

For the second criterion, the following words are considered by the courts as wide enough to cover negligence: 'at sole risk',[423] 'at their own risk',[424] 'no liability whatsoever'[425] or 'under no circumstances.'[426] But it is not advisable to disclaim liability for 'any loss', because attention will be given to the kinds of losses, but not to their cause or origin. As a consequence, liability for negligence will not necessarily be excluded. But if it is said 'however arising' or 'any cause whatsoever,' these words can cover losses by negligence. Other similar wordings like 'howsoever caused',[427] 'from whatever other cause arising,'[428] 'howsoever arising',[429] 'arising from any cause

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[423] *Forbes, Abbott & Lennard Ltd v G.W. Ry* (1927) 44 T.L.R. 97.*Norwich City Council v Harvey* [1989] 1 W.L.R. 828.

[424] *Burton & Co v English & co* (1883) 12 QBD 218, at p.223; *Exercise Shipping Co Ltd v Bay Maritime Lines Ltd* [1991] 2 Lloyd's Rep. 391.

[425] *Reynolds v Boston Deep Sea Fishing & Ice Co Ltd* (1921) 38 T.L.R. 22.*HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6 ('no liability of any nature').

[426] *Haigh v Royal Mail Steam Packet Co* (1883) 52 L.J.Q.B. 640.*Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 827, at p.846.

[427] *Austin v Manchester, Sheffield & Lincs. Ry* (1852) 10 C.B. 454; S*tag Line Ltd v. Tyne Shipreair Group Ltd* [1984] 2 Lloyd's Rep. 211.

[428] *Ashenden v L.B. & section C. Ry* (1880) 5 Ex.D. 190.

[429] *Pyman S.Co v Hull & Barnsley Ry* [1915] 2 K.B. 729.*Frans Maas (UK) Ltd v Samsung Electronics (UK) Ltd* [2002] EWHC 1502(Comm).

whatsoever'[430] have been held to be effective. It is also to be noted here that the intention of the parties must be ascertained from the entire wording of the clause, and in construing the clause other parts of the contract which throw light on the meaning of the clause should be taken into consideration.[431]

For the third test, the Court was cautioned against a too literal approach of applying it. In *Lamport & Holt Lines Ltd v Coubro & Scrutton (M.& I.) Ltd*. May L.J. said:

'In seeking to apply Morton's L.J. third test, we should not ask now whether there is or might be a technical alternative head of legal liability which the relevant exemption clause might cover and, if there is, immediately construe the clause as inapplicable to negligence. We should look at the facts and realities of the situation as they did or must be deemed to have presented themselves to the contracting parties at the time the contract was made, and ask to what potential liabilities the one to the other did the parties apply their minds, or must they be deemed to have done so.'[432]

(B) Fraud

There is no rule of law to prevent the exclusion or restriction of liability arising from even a deliberate act or omission by one party or his servants if the parties so intend. In the *Suisse Atlantique* case, [433] Lord Wilberforce said: 'Some deliberate breaches… may be, on construction, within an exceptions clause. This is not to say that 'deliberateness' may not be a relevant factor: depending on what the party in breach 'deliberately' intended to do, it may be possible to say that the parties never contemplated that such a breach would be excused or limited.' Thus, 'to create a special rule for deliberate acts is unnecessary and may lead astray.' [434] It is the duty of the court to construe the wording of the clause in question to see what it means in the context.

7.2.6.3 Types of losses

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[430] *A.E.Farr Ltd v Admiralty* [1953] 1 W.L.R. 965.

[431] Chitty on contract 30th edn. 14 -011.

[432] [1982] 2 Lloyd's Rep. 42, at p.50.

[433] [1967] 1 A.C. 361.

[434] Suisse Atlantique case [1967] 1 A.C. 361, at p.435.

According to section 11(1) of the Unfair Contract Terms Act 1977, the time for determining the reasonableness of the term is the time at which the contract was made. Therefore the reasonableness is not affected by the nature or seriousness of the loss or damage caused by the broker's wrongdoing, except to the extent to which such events were or ought reasonably to have been in the contemplation of the parties at that time. Therefore, the parties can make express reference to any kind of losses they want to exclude.

7.2.6.4 The cap amount

This could be by reference to a fixed sum or the way it is to be calculated. According to section 11(4) of Unfair Contract Terms Act 1977, regard should be had to the resources that the broker could expect to be available to him to meet the liability if it arise and the level of professional indemnity cover available to him. The size of the broking firm may therefore be taken into account and it could be less reasonable for a large broking firm to seek to limit its liability to a low amount. It may be reasonable for the broker to seek to cap his liability at the limit of his professional indemnity cover.

7.2.7 Other things to consider

7.2.7.1 Use clear and unambiguous wording

In order to be effective, a limitation of liability clause must be expressed clearly. Any ambiguity in the wordings will be construed against him, as a consequence of the *contra proferentem* rule. However, if the clause is expressed clearly and unambiguously, there is no justification for placing upon the language of the clause a strained and artificial meaning so as to avoid the exclusion or restriction of liability contained in it.[435]

7.2.7.2 Consistency with main purpose of contract.

An exemption clause may be so broad and general in scope that to apply it literally would create an absurdity or defeat the main purpose of the contracts which the parties

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[435] *Mitchell(George) (Chesterhall) Ltd v Finney Lock Seeds Ltd*[1983] 2 Lloyd's Rep. 272.

had in mind. It is the duties of the courts to give effect to the intentions of the parties as exhibited in their agreement. Likewise, the court will be reluctant to ascribe to an exemption clause a meaning which effectively absolves one party from all duties and liabilities.

7.2.7.3 Draw attention to the limitation of liability clause

Establish a means to show that the contracting parties knew of the clause's presence, For example, writing the limitation of liability clauses in bold letters. This is important because it indicates that the broker has not attempted to hide the effect of the limitation of liability clause from the client, but rather have been open and honest about the existence of the clause and its effect.

Conclusion

There are a number of cases which demonstrate the importance of upholding the exclusion clauses where experienced businessmen are involved and the parties are equal bargaining power in terms of size and resources. In *Watford Electronics Ltd v Sanderson CFL Ltd*,[436] where the Court of Appeal, reversing the decision of the trial judge, held reasonable a term in a contract for the supply of an integrated software system which excluded the liability of either party for indirect and consequential losses, whether arising from negligence or otherwise, and limited the liability of the supplier to the amount of the contract price. Chadwick L.J. said:

'Where experienced businessmen representing substantial companies of equal bargaining power negotiated an agreement, they may be taken to have had regard to the matters known to them. They should, in my view, be taken to be the best judges of the commercial fairness of the agreement which they have made; including the fairness of each of the terms of that agreement.'[437]

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[436] [2001] EWCA Civ. 317.

[437] [2001] EWCA Civ 317, para. .63.

Therefore, for a marine insurance broker firm, if a limitation of liability clause is drafted properly, it will probably be upheld by the court, and it will work effectively to protect the marine insurance brokers from potential unaffordable liabilities arising from performing his duties.

Chapter 8 Conclusion

The conduct of marine insurance broker is subject to the general principles of agency law. However, it is also affected by the traditional customs and contemporary market practices in the field of marine insurance. As a result, the marine insurance broker's duties and liabilities have unique features which are different from other general agents.

8.1 Exceptional duties

Marine insurance brokers have some duties that will not be observed by other general agents who effect contracts on behalf of their principals. For these peculiar duties the main question is that is it time that they should be abolished; and that the broker's duties should be brought into line with those of the general agents. If not, is there any reform that can be made to improve the clarity, certainty and fairness of these duties.

<u>Broker's liability for the premium</u>

One duty of this kind is the broker's personal liability to pay the premium. The Law Commissions said that the mechanism of section 53 (1) produced an unsatisfactory result when the policy holder or the broker went insolvent. It was provisionally proposed, in the Law Commission's Issues Paper 8, that a broker should not usually owe a personal liability to the insurer for the premium. The default position should be that policyholders are liable for the premium due under their insurance policies.

In fact, the broker's liability to pay the premium is still needed for a fundamental reason—the assignability of marine insurance policy. As opposed to non-marine policy, 'A marine policy is assignable unless it contains terms expressly prohibiting assignment.'[438] As a consequence, the policyholder of a marine policy may be changing from time to time, especially under cargo insurance. If the broker's payment of premium rule is abolished, as under other non-marine insurance contract, the assured is liable for the payment of the premium, problems will be met by both the assured and the insurer. Take CIF sale as an example, if the goods had lost or damaged in transit and the

[438] MIA 1906 section50 (1).

CIF seller failed to pay the premium, the CIF buyer as the assignee of the insurance cover, may face with the insurer's defence to set off the loss money against the unpaid premium. But this is unfair for the buyer who had paid the premium to the seller as part of the price. In a worse case, if the insurance contract has a payment of premium warranty, the buyer may have lost his cover. If the law changes to abolish the broker's payment of premium rule, the buyer will be more hesitate to trade by document sale, or he might be willing to insist on the seller rendering an old fashioned insurance policy in which the insurer acknowledges the receipt of premium from the assured.[439] The abolition of the broker's payment of premium rule is not good news for the insurers either. The insurer may not be able to find out who the assured is, if no claim arises. Since the policy can be assigned several times without notification to the insurers.[440]

In terms of the risk of insolvency, the broker's lien and the broker's cancellation clause will provide protection to the broker against the assured's non-payment of the premium.[441] For the insurers, they can make special agency agreement with the brokers to impose fiduciary duty on them in dealing with the premium. [442]

It was concluded that as long as the assignability is still of importance to marine insurance policy, it is not advisable to repeal section 53 (1) of MIA1906. Some of the replies to Issues Paper 8 also supported the position that the broker's payment of premium rule should be retained.

The proposals made later in the consultation paper 2, which made the assured and broker jointly and severally liable for the premium, may be effective in resolving the insolvency issue and the problem met by the insurers with the assignable policy. However, the possibility of an assignee, like CIF buyer, facing with a set-off defence was still there.

The author's proposal for revising section 53(1) are as follows: First, it should be made clear that it is the broker's 'personal' liability, or the broker is 'solely' responsible, to

[439] See para. 3.7.1.1.

[440] See para. 3.7.1.2.

[441] See. para.3.7.2.1.

[442] See. para. 3.7.2.2.

pay the premium to the insurer, even if the broker fails to do so, the insurer cannot turn to the assured for payment. Secondly, the assured's duty to reimburse the broker should be included in the Act, and the wording should be clear that the assured is the one who instructed the broker to effect the policy (the principal), not other assureds who get the policy by assignment, unless otherwise agreed in the marine insurance contract. If not, the problem for the insurer to find out who the assured is will still arise, only the broker takes the place of the insurer.

Moreover, if the payment of premium liability between the broker and underwriter and between the assured and broker can be made clear as suggested above, there is no need to have section 54 to protect the assured against non-payment by the broker.

Broker's duty of disclosure

Another duty of this kind is the broker's independent duty of disclosure. Under section 19 (a) of MIA 1906, where an insurance cover is placed through an agent, the agent to insure has an independent duty to disclose material information within his knowledge, although the same information is not known or ought to be known by the assured. The breach of section 19 (a) does not give rise to a cause of action against the broker, the only remedy is the avoidance of the assured's insurance contract.

The same question to be asked was whether the section is still needed at all. For consumer insurances, the duty of disclosure has been displaced by the duty not to misrepresent. Under business insurance contract, like marine insurance contract, it was said that section 19 (a) was still needed where Lloyd's syndicates delegate their affairs to a managing agent. This point was said to have been made in both *Group Josi* case and *PCW Syndicates* case. [443] For the author's understanding, they were decided in the two cases that the managing agents and underwriting agents are not agent to insure under section 19 (a). Therefore, the author cannot be convinced of retaining the broker's independent duty of disclosure on this ground. However, the broker's role as 'the

[443] Law Commissions' Consultation Paper 3 p. 91, para. 7.18. http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm.

servant of the market'[444] entitled the insurers to benefit from his professional knowledge and skills.

If this duty is to be kept, there are three areas need to be clarified or reformed: (1) who can be the agent to insure. According to the *PCW* case and Group Josi case, three elements should be considered in determining whether an agent is the agent to insure under section 19 (a): (i) whether the agent is outside the business of the assured; (ii) whether the agent is in direct contact with the insurers; and (iii) whether the agent effected the contract of insurance in question. It was criticized to be a narrow interpretation for not including the producing broker who may have more information about the insured risk. In fact, this was not left out by the section. The information known to the intermediate agents, including the producing broker, could be argued to be the deemed knowledge of the agent to insure. Although the agent to insure is not limited to the broker, it is the most obvious example. Therefore, the discussions focused on issues arise from broker's situations.

(2) What is the scope of the broker's knowledge? The wording of section 19 (a) may include information which the broker acquired in any capacity not limited to the agent of the assured. There are conflicting observations in the case law. Some suggested that the section does require an agent to disclose any information he held, regardless of the capacity in which it was received.[445] Others suggested that the broker was only obliged to disclose the information he held or received as an agent for the assured.[446] The Law Commissions proposed, in the 2012 Consultation Paper, that the broker's knowledge only applies to information which is received or held by agents in their capacity as agents for the policyholder.[447] In that Paper, several hypothetical cases were given as illustrations. One of them was that a major international broker acted for E, which manufactured medical implants. If the broker is told of risks associated with the implants, he did not need to disclose it to the insurers of his other client, which is a clinic using the implant. The author cannot see any reason why the information should

[444] *General Accident v Tanter (The Zephyr)* [1984] 1 Lloyd's Rep. 58, at p.85, col2.

[445] Hoffmann L.J. in *El Ajou v Dollar Land Holdings Pl*c [1994] 2 All ER 685; Hoffmann L.J. and Saville L.J. in *SAIL v Farex* [1995] L.R.L.R. 116.

[446] Staughton L.J. in *PCW v PCW* [1996] 1 Lloyd's Rep. 241.

[447] Law Commissions' Consultation Paper 3, at p. 91, para. 7.38.

not be disclosed to the insurers of the clinic. The brokers are the ‘servants of the market’[448]; the insurers prefer to deal with brokers because of their professional skills and knowledge. The author suggested that as long as it is a material fact, the broker should disclose it no matter in what capacity he received it. The only exception is that disclosing the fact will result in the broker’s breach of his duty of confidentiality to his other clients.

(3) The remedy for the broker’s breach of the duty of disclosure. Under current law, when the broker breached his independent duty of disclosure, the only remedy available for the insurers is the avoidance of the insurance contract. They do not have any cause of action against the broker or the assured to claim damages. Two aspects of the law were being considered to be changed: the responsible party and the remedy. For the responsible party, the Law Commissions proposed in the 2007 Consultation Paper 1 that the remedy should be that the insurers claim damages from the broker rather than avoiding the assured’s insurance contract. However, this kind of shifting the responsible party has no ground in law or in practice.[449] This position was also strongly opposed by the consultees. As a result, it was proposed, in the 2012 Consultation Paper 3, that the law would not change in this respect.

The other reform was the remedy available for the insurers when the broker breached his independent duty of disclosure under section 19 (a). This has not been discussed in any Issues Papers or Consultation Papers. However, the remedy for the assured’s breach of duty of disclosure under section 18 has been proposed to be changed from the only remedy of avoidance of the insurance contract to a proportionate remedy. In the 2007 Consultation Paper 1, it was proposed to apply different remedies in different situations categorised by the assured’s state of mind. If the assured’s non-disclosure is made fraudulently or recklessly, the insurers are entitled to avoid the insurance contract; if the non-disclosure is made negligently, the remedy should depend on what the insurer would have done had it known the full facts; if it is an innocent non-disclosure, the insurers cannot refuse to decline the assured’s claim on the ground of breach of duty of disclosure. The author agrees with the Law Commissions proposal for the remedies for

[448] *General Accident v Tanter* (The Zephyr) [1984] 1 Lloyd’s Rep. 58, at p.85, col.2.

[449] See para. 2.7.4.2 of the thesis.

the fraudulent and negligent non-disclosures, but disagrees with the remedies for innocent non-disclosure. This approach only pays attention to the assured's state of mind, but did not consider the impact of the non-disclosed information on the insurer. It may cause unfairness to the insurers. The author suggested that the remedies for the assured's innocent non-disclosure should be assessed in the same way as that for negligent non-disclosure. This is the approach which had been adopted in the 2012 Consultation Paper 3.

Since the broker's duty of disclosure is an extension of the assured's duty of disclosure, it is appropriate to introduce the proportionate remedies to the broker's breach of duty of disclosure. One difference should be the remedy for the broker's fraudulent non-disclosure. It is right to punish the assured for his own fraudulent conduct. It is not proper to avoid the assured's insurance contract just because the broker's non-disclosure is fraudulent. The assured do not know about the non-disclosed information, let alone any fault on their part. If the law makes that the insurers can avoid the insurance contract when the broker refrains from disclosing material fact on purpose, it will result in abnormal outcomes, which is that the proportionate remedy will apply when the assured is negligent; but only avoidance of the insurance contract is available when the assured is innocent. Therefore, the proportionate remedy should be applied even if the broker has committed fraud.

The proportionate remedy is also beneficial to the insurers. As a reaction against the harsh penalty of avoiding the insurance, when there is no fault on the part of the assured, the courts tend to restrain the interpretation of the law to say that no non-disclosure has taken place, even there is some fraud on the broker's part. In this situation, the insurers have to pay the full claim. It was decided in the *PCW* case that the Re Hampshire rule applied to section 19 (a), that means an insurer will not be able to avoid the contract on the ground that the broker has not disclosed his own fraud against the assured when he places the risk. If the proportionate remedy can be applied, the insurers will be put back to the position where he had known the facts. For example, if the insurers would have declined the risk altogether, the policy can be avoided; if he would have charged higher premium, the claim can be reduced proportionately.

Therefore, the author suggested that the remedy for the broker's fraudulent non-disclosure should depend on what the insurer would have done had it known the full facts. If this is accepted, the broker's state of mind is, in fact, irrelevant in assessing the remedies for the broker's breach of duty of disclosure. It is always decided by the impact of the non-disclosed facts upon the insurer's decision to cover.

8.2 Duties which may raise the issue of conflict of duty and interest

The broker's multiple roles in the course of its business frequently raise the issue of conflict of duty and interest. The thesis identified the broker's duties that are inclined to give rise to conflict of duty and interest and analysed how the issues are being treated by the court. Then the author made some recommendations on how to avoid the conflict of duties and interest in those situations.

Broker's Commission

When a broker is the effective cause of the conclusion of an insurance contract, he is entitled to be remunerated for his services. There are mainly two ways to pay the brokers. One is that the assured pays an agreed fee to the broker when the insurance contract is concluded. The other way, which is more commonly used, is that the broker, agreed by the insurers, deducts his commission from the premium paid by the assured. The fee arrangement between the broker and the assured is more straightforward and less controversial. But the broker's commission received from the insurers has raised the issue of lack of transparency and the potential for conflict of duty and interest between the broker and the assured.

The broker, as the agent of the assured, has a fiduciary duty owed to the assured to always act in his principal's best interest and not to place himself in a position where his interest may conflict with his duty. The conflict of interest will arise if the broker receives any commission from the insurers without the assured's informed consent. Because the broker will be interested in looking for the insurer who gives him the biggest commission; not the one who will provide the best possible deal for the assured.

Under general fiduciary principles, the broker has to disclose the amount of commission he received from the insurers, no matter how small it is. If the court finds that the payment of the commission is not known to the assured, the broker has to account for it to the assured, even if the conflict is only a potential one; even if the agent acted in good faith, even if the assured suffered no loss. The assured is also entitled to avoid the insurance contract.

However, the common law held that insurance brokers did not have a duty to disclose the amount of the commission he received from the insurers unless it exceeded the normal rate in the relevant market. This is also the position taken by the current FSA regulations which said that the broker only has a duty to disclose when requested by the customers. The Bribery Act 2010, which had come into force on 1 July 2011, has not changed the common law position that the commission paid by an insurer did not constitute an illegal profit unless it was in excess of what was normally paid.

There were calls for greater disclosure of insurance commissions and avoiding conflicts of interest in U.K. and E.U. in the wake of the Spitzer enquiry in US in 2004, which focused on contingent commissions which were in effect bonuses to brokers for selling high volumes or more profitable products.[450] In June 2005, the European Commission initiated a sector inquiry into the provision of insurance products and services to businesses in the Community and published a report on Business Insurance Sector Enquiry in 2007. In the U.K., CRA International (CRA) carried out an independent research on behalf of the Financial Services Authority (FSA) and produced a report (the CRA report) which focused primarily on commission disclosure in 2007. Both pieces of work found evidence of a lack of transparency in the commercial insurance market in relation to intermediary remuneration and services, which could give rise to customer detriment and impair market efficiency.

In March 2008, the FSA published the Discussion Paper 08/2 on Transparency, Disclosure and Conflicts of Interest in the Commercial Insurance Market, in which three

[450] It is to be noted here that in February 2010, officials in New York, Connecticut and Illinois agreed to lift the ban on the largest brokers accepting contingent commissions, a ban that had been in place since the beginning of 2005. However, none of the three largest brokers seem keen to pick up contingent commission again.

options for reform were proposed. They were (1) a more rigorous enforcement of existing rules; (2) enhancing the current 'on request' regime; or (3) mandatory commission disclosure.

Following various consultations with the industry participants it was found out in the Feedback Statement 08/7 on Transparency, Disclosure and Conflicts of Interest in the Commercial Insurance Market, that mandatory disclosure of commissions was unpopular amongst respondents. It is also to be noted here that in the CRA report it was found out that 'the cost of mandatory commission disclosure would outweigh the benefits'[451] Therefore, it was agreed that an industry-led solution should be made to achieve five outcomes for commercial customers.[452]

The Industry Guidance was later drawn up by the British Insurance Brokers' Association (BIBA), the London and International Insurance Brokers' Association (LIIBA), the Institute of Insurance Brokers (IIB) and the Association of British Insurers (ABI) and was published on 1st April 2009. The Guidance was confirmed by FSA, which means that, although it is not compulsory, the FSA will not take action against a firm that acted in compliance with the guidance. The guidance has, in fact taken the second approach in the discussion paper which is an enhanced 'on request' scheme. The broker still has the obligation to disclose the commission only when requested by the customer. Besides, the guidance suggested that the firms should remind the customers in writing at least every twelve months about their right to ask for this information. The guidance also suggested the way the commission should be disclosed and provided a standard form for remuneration disclosure.

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[451] CRA International, *Commercial insurance commission disclosure: Market Failure Analysis and high level Cost Benefit Analysis*, at p. 109.

[452] Feedback Statement 08/7 on Transparency, disclosure and conflicts of interest in the commercial insurance market para. 3.3 (a) customers should have clear and comparable information about the commissions intermediaries receive; (b) customers should have clear and comparable information about the services intermediaries are providing; (c) customers should have clear information about the capacity in which an intermediary is acting; (d) customers should be alerted to their right to request commission information; and (e) customers should be made aware where there is a chain of intermediaries.

At Lloyd's, the market guidance titled Distribution Costs, Broker Remuneration and Additional Charges was published in Lloyd's Market Bulletin on 22nd February 2012. In that guidance, no contingent commission[453] was allowed in Lloyd's market.

The European Commission also took the broker's commission disclosure as part of the review of the current Insurance Mediation Directive 2002/92/EC (IMD). The current IMD does not contain information requirements relating to the remuneration for intermediaries, In its Consultation Document on the Review of the Insurance Mediation Directive (IMD), which was published on 26th November 2010, the Commission asked for views on how a revised directive, IMD2, could address the problems of lack of transparency and conflicts of interest.

The European Commissions considered three options for remuneration disclosure: the mandatory 'full disclosure'/ on request disclosure, ban on commission or soft law which include issuing guidelines, self-regulation, ethical codes, etc. It is highly controversial among the consultess. The mandatory full disclosure scheme was strongly opposed by insurance intermediaries, because they are concerned with vertical integration, which means the customer will deal with the insurers directly to avoid the commissions. They advocated a disclosure regime on request by the customer or the adoption of ethical codes (the soft law option). On the other hand, mandatory disclosure is supported by consumer groups (FSUG, BEUC, German association of consumers, etc.).

In the Impact Assessment document, it was said that both mandatory disclosure and on request disclosure would have positive effects on competition in insurance distribution at a low cost. It will mitigate the conflicts of interests and the information asymmetry between the seller and the buyer.

IMD II legislative proposal was published on 3rd July 2012. In article 17 titled Conflicts of interest and transparency, it proposed in section 1 (f) that the intermediaries, either for life or non-life insurance, should disclose, prior to the conclusion of any initial insurance contract, and, if necessary, upon amendment or renewal thereof, the amount

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[453] Commissions based on the volume the broker brought to the insurers and the profitability of the introduced business.

of remunerations paid as fees or commissions, if the amount is not known, the way how the remuneration would be calculated should be disclosed to the client; according to section 1 (g), the contingent commission should be disclosed as well. This is in fact a mandatory 'full disclosure' regime. In section 2, a transitional period of five-year was proposed for the remuneration disclosure for non-life intermediaries. During this period, the intermediaries soliciting non-life insurance covers will be remained under the ‘on request’ scheme, but they have a proactive duty to inform the customer of his right to request the remuneration information. After the expiry of this transitional period, the mandatory ‘full disclosure’ regime will automatically apply for the intermediaries who sell non-life products.

It was said in the Impact Assessment that for the mandatory ‘full disclosure’ and ’on request’ disclosure, the preferred option was to introduce an on-request regime for the sales of non-life products with a 3 years transition period. ‘This will allow SMEs [micro, small and medium-sized enterprises] to prepare and adjust themselves to the legislative change and measure the impact of the suggested change in real life. This is in line with the views of most stakeholders (intermediaries, insurance industry) as well as EIOPA and, at the same time, insures proportionality and flexibility towards SMEs. It will provide a useful midway balancing consumer groups' and intermediaries' as well as SME's interests.’[454]

In summary, the information requirement for insurance brokers in U.K. will still be within the enhanced ‘on request’ scheme for some time. Whether it will switch to the mandatory disclosure scheme may subject to a further review and evaluation of the impact of these disclosure rules on non-life insurance intermediaries in the IMD II after its entry into force.

Broker’s duties owed to the insurers

In the marine insurance market, the broker is the agent of the assured, but he may also owe duties to insurers under an agreed contract, like Terms of Business Agreement

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[454] Impact Assessment Accompanying the document Directive of the European Parliament and of the Council on Insurance Mediation, at p.43.

(TOBA), or even without a contract between them. Sometimes, the broker's performance is conducted in the mutual interest of both the assured and the insurers, for example, to keep the placing and claiming documents. The broker's role as 'the servant of the market'[455] facilitates the insurance business transactions, but on the other hand, these multi-functions may cause problems like the broker's agency in conducting the performance or conflict of duty and interests. As Auld L.J. said in *HIH Casualty and General Insurance Co v JLT Risk Solutions*, 'the role of an insurance broker is notoriously anomalous for its inherent scope for engendering conflict of interest in the otherwise relatively tidy legal world of agency.'[456]

(1) One problem that may arise with a broker placing risks under the binding authority is that in which capacity the broker is acting in conducting a performance. Whether he is acting as the agent of the assured or he is acting as the agent of the insurer. There were conflicting decisions. It may be reasonable to determine the broker's role by the tasks taken on by him in the material time in each case.

Section19 (b) of MIA 1906 stipulated that the broker has a duty to pass on to the insurers the information communicated by the assured. If the broker failed to do so, the insurers are entitled to avoid the insurance contract. But when a broker also acts as a cover holder under a binding authority, it is questionable on whose behalf does the broker hold the material facts. It is possible to argue, in light of Megaw L.J.'s *obita* in *Woolcott v Excess Insurance Co,*[457] that when a broker places a risk under a binding authority, the broker acts as the agent of the insurers in receiving information from the assured.

Section 19 (a) can make the question more complicated. As discussed in Chapter 2, the broker has an independent duty to disclose material facts which is known to him but not to the assured. Under a binder, should this kind of information still be treated as the extended duty for the assured, or should it be considered as information under section

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[455] *General Accident v Tanter (The Zephyr)* [1984] 1 Lloyd's Rep. 58, at p85, col2.

[456] [2007] Lloyd's Rep. I.R. 717, at p.730, col.1.

[457] [1979] 1 Lloyd's Rep. 231.

18 (3) (b), the information which is known or presumed to be known to the insurer, and need not be disclosed? This has not been tested in any case.

(2) Another issue was whether the insurers are entitled to view the insurance documents held by the brokers. It was once argued that the broker could not disclose the documents to the insurers without the assured's consent. It was inconsistent with the best interest of the broker's clients. However, in *Goshawk Dedicated Ltd v Tyser & Co Ltd*,[458] the Court of Appeal unanimously held that the brokers are obliged, on reasonable notice, to allow the syndicates to inspect and copy the placing documents, claims documents and premium accounting documents when requested by the syndicates. This duty arises from an implied term in the insurance contract between the underwriters and the assured and an implied contract between the broker and the underwriters.

(3)The brokers may also owe duties of care to the insurers by assumption of responsibilities. The signing indication given by the broker to the insurers during the placing of the insurance contract and the broker's voluntary investigation activity done on behalf of the insurers are two good examples. In these situations, the court will not prevent the imposition of a duty of care on the broker to take reasonable steps to perform on the ground that it will conflict with the assured's interest.

It is also to be noted here that during the normal course of business, the broker may carry out some tasks which will benefit the underwriters, but it does not follow that the brokers are under any legal duty to do so. When faced with the insurer's request of any service, the broker can decline to provide such service; or he can provide the service with a clear qualification that he accepts no responsibility for it. If the broker accepts the task without any qualification, he must carry out the task with such care as the circumstances require, or he will be held liable for the insurer's loss or damages for assumption of responsibility.

(4) The next issue is when the broker owes a duty of care to a leading underwriter by assumption of responsibility, whether the same duty will be owed to the following underwriters. Take the signing indication as an example. If the broker failed to achieve

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[458] [2006] 1 C.L.C. 198.

the signing indication as represented to the leading underwriter when he placed the risk, the leading underwriter can claim damages from the broker for breach of duty of care. Can the following underwriters claim damages from the brokers on the same ground? One hard issue to establish a duty of care owed by the broker to the following underwriter is the proximity between the two parties, because the following underwriter had not been supplied with any information or service by the broker. However, considering the practice of the insurance market, the court established the proximity between the broker and the following underwriter on the ground that the following underwriters rely upon the broker's service and that the broker knows or should have known of such reliance.

(5) Under general agency law, the agent is not allowed to act on behalf of the competing parties for the same transaction, unless he received acknowledged consent from both parties, or it will give rise to conflict of duties. However, in the London market, especially at Lloyd's, the insurer will instruct the brokers who placed the insurance cover to obtain a report from assessors when a claim arises under the policy. The Lloyd's broker's practice of acting for both the assured and insurer in the claims process has been criticised in the 1970s cases.

The court held that such a practice was inconsistent with the general principles of agency law, it cannot be a legal usage or custom. However, if the broker acted on behalf of the insurers without the acknowledged consent from the assured, the assured were still not allowed to the delivery up or inspection of the documents which the brokers obtained in a confidential capacity for the insurers, because the report was the insurer's property. What he can do was only to claim damages against the broker for their failure, because of the conflict of duties, to discharge his duty to the principal.

In the model form TOBAs in London market, it was suggested that the broker can accept the insurer's appointment or instructions to obtain information on the basis that the information should be *disclosable* to the broker's client. However, all documentation and records created or received by the broker in the performance of such functions or duties should remain the property of the Managing Agent. In FSA handbook it was also suggested the brokers should manage the conflict of interest in this situation.

(6) Broker's duties owed to insurers as reinsured are similar to that owed to the normal insured. But when the broker who arranged insurance on behalf of the assured with the insurer also arranged reinsurance for the same insurer, the broker will owe duties of care to both parties. Sometimes a conflict of duties will arise in this situation. Will this restrict the broker's duty owed to the insurers and the assured? The decisions made by the courts show that when the marine insurance brokers place both original cover and reinsurance cover, it gives the broker a dual agency role. Although this is not uncommon in the London insurance market, the court will not show sympathy to the brokers if the broker's conduct does not conform to the general principles of agency law. The broker should always ask for permission from both the assured and insurer if he wants to act for both parties. Moreover, it should be noticed that the dual agency role will not restrict the broker's scope of duty owed to each party; and if the assured or insurer suffered any loss or damage because of the broker's acting in such a way that gives rise to conflict of duties and interest, the assured or insurer are entitled to claim against the broker for any damages they suffered from this breach.

Broker's duties owed to the reinsurers

Generally speaking, the broker's legal position during reinsurance transactions is the same as that under insurance transactions. However, the way the brokers place the reinsurance cover and the varied forms of reinsurance contract raise peculiar issues.

Firstly, the agency issue. It is a commonplace situation in insurance and reinsurance business, and not just at Lloyd's, that the brokers place both insurance and reinsurance contracts for the same risk. Sometimes, the broker arranges the reinsurance cover by the instructions from the insurer, with whom the broker placed the insurance cover (reinsurance after the insurance). Sometimes the broker may, knowing that a fixed reinsurance cover will make it easier to place the insurance cover, approach the reinsurers first with or without having a specific insurer in mind; and when the reinsurers signed the slip, the brokers will go to see the insurers and offer both the insurance and reinsurance covers to them (reinsurance prior to insurance).

It is clear law that when the same broker placed both insurance and reinsurance covers, the brokers acted as agents for insurers not for the assureds when they effect the reinsurance contract. The knowledge of the assured that reinsurance would be arranged in the ordinary course of business does not amount to authority from the assured to make the reinsurance contract on their behalf. As a result, the insurers cannot avoid the assured's policy on the ground of non-disclosure of the facts held by the brokers for placing the reinsurance contract.

The agency issue is more controversial where the brokers arrange reinsurance contract prior to the insurance contract. First, in what capacity the broker acts when he approaches the reinsurer and arranges the reinsurance contract? It cannot be said that the broker is acting on behalf of the insurers/ reinsured in negotiating the reinsurance contract when they are still unknown to the brokers. Besides, the assureds are in no way parties to or interested in any reinsurance contract. It cannot be said that the brokers acted on behalf of the assured either. The court held that when the broker approaches a reinsurer in that situation, he is acting on his own behalf.

The next step is to consider in what capacity the broker acts when he approaches the prospective insurer and offers both the insurance and reinsurance covers. There are two relevant issues. First, on whose behalf the broker is acting under the reinsurance contracts, the reinsured or the reinsurer. The court held that both in accordance with the practice of the market and the law the broker was still the agent of the reinsured not that of the reinsurer under the reinsurance contract, although the reinsurance contract was negotiated without the reinsured's instruction, but when the insurers accepted the reinsurance contract, he rectified the broker's agency in arranging the reinsurance contract. The second issue is whether the reinsurance contract is binding upon the reinsurers even if there is no principal on whose behalf the broker may act when the broker negotiated the contract. Hobhouse J. decided, in the *Zephyr* case, that the initialling by the reinsurer on the reinsurance slip created a binding offer to provide reinsurance. Once the person coming within the description of reinsured in the slip accepted the offer, it sufficed to complete a binding contract of reinsurance between such person and the reinsurer.

Secondly, the duty of utmost good faith under different reinsurance facilities. There are different categories of reinsurance facilities. Some are taken to be contracts *of* insurance; some are regarded as contracts *for* insurance. This requires a reconsideration of the broker's duty of utmost good faith and the broker's duty to pay premium under different kinds of reinsurance.

In the case of a facultative reinsurance, there is not much dispute that it is a contract *of* insurance, and is subject to the rules of the duty of utmost good faith.[459]

The application of the doctrine of utmost good faith to reinsurance treaties is not that straight forward. MIA 1906 had stipulated that the Act applies to contract *of* insurance. However, there are discussions on the issue as to whether the treaties are contract *of* insurance or contract *for* insurance. There are two stages involved in creating a reinsurance contract under a treaty: First, the making of the treaty; and secondly the making of declarations to the treaty. The treaty simply provides a framework for making declarations to the treaty, it is the declaration that forms the reinsurance contract, and therefore the treaty is considered as a contract *for* reinsurance not a contract *of* reinsurance. As a matter of strict law, there is no duty of utmost good faith in relation to a contract *for* insurance. However, the question is not that whether any duty of utmost good faith will arise under reinsurance contracts made through treaty. The reinsurers under reinsurance treaty should be entitled, as those under facultative reinsurance contracts, to avoid the reinsurance contract if the brokers or the assureds make any misrepresentation or failed to disclose material facts under facultative reinsurance.

The right question to ask is when the broker's duty of utmost good faith will arise in the process of the making of the treaty reinsurance contract. This depends on the nature of the treaty. For obligatory and fac/oblig treaties, they create binding obligations on reinsurers to offer reinsurance; the reinsurers must accept any risk which is accepted and declared by the reinsured; they have no right to refuse the cover or change the rate of the premium in respect of any individual risk when it was declared or ceded by the reinsured. In this situation it is arguable that the duty of utmost good faith will arise when the treaty is made. By contrast, if the treaty is facultative, under which the reinsurers can refuse individual declarations or cessions, then it is plainly the case that the treaty is not of itself a contract of reinsurance; it is simply a framework facility

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[459]Highlands Insurance v Continental Insurance [1987] 1 Lloyd's Rep. 109; Groupama Insurance Co Ltd v Overseas Partners Re Ltd[2003] EWHC 34 (Comm).

under which risks falling within its scope may be ceded to the reinsurers. It is each declaration or cession that makes a contract of reinsurance to which the broker's duty of utmost good faith applies.

Thirdly, the broker's duty to pay premium under marine reinsurance contract. MIA 1906 itself has not stated whether section 53 (1) applies to marine reinsurance, but there are authorities supporting the proposition that section 53 should apply at least to facultative marine reinsurance contract.

There is no clear legal authority which determines whether the broker is liable for premium in respect of marine treaty reinsurance. However, the characteristics of treaty reinsurance suggest that it is not sensible to adopt the rule of broker's payment of premium liability in this area. First, reinsurance treaty is contract *for* insurance not contract *of* insurance as stated in the Act. Secondly, reinsurance treaties are generally long-term contracts. When the premium is due, the agency may have expired or terminated.

8.3 Measure of damages and limitation of liability

The broker's role in placing the cover makes it hard to put the line between the broker's service of providing information and the service of providing advice. This directly affects the way of assessing the damages when the broker failed to obtain the cover as required by the assured. The thesis discussed the different ways of measure of damages for broker's breach of duty of obtaining a proper cover. Moreover, it analysed the possibility of inserting a limitation of liability clause in the retainer; and suggested the main elements to be considered when drafting a limitation of liability clause.

<u>Measure of damages and limitation of liability</u>

Since the most common result of the marine insurance broker's breach is that the insured is left with an invalid claim against the insurer under the insurance policy, the normal measure of damages is the amount which the insurance would have paid to the assured but for the broker's breach. However, there are situations where the damages may exceed the indemnity under the policy.

The House of Lords decision in *South Australia Asset Management Corporation v York Montague Ltd* ('SAAMCO')[460] 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 advise whether or not a course of action should be taken, the adviser must take reasonable care to consider all the potential consequences of that course 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 only 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.[461] This principle was applied in a marine insurance case *Aneco Reinsurance Underwriting Ltd (In liquidation) v Johnson & Higgins Ltd*.[462]

For a marine insurance risk to be placed in the London insurance market, it is not unusual for a marine insurance broker to persuade the reinsurer to agree to the reinsurance contract before he can successfully place the insurance cover. It is also not surprising that the broker will explore new market and design some new insurance covers and then sell the product to the market. Therefore, it is quite easily for a marine insurance broker to transcend the boarder from the more traditional role of obtaining information about the price and availability of insurance cover to that advising his client on the potential merits of a transaction or the types of cover that ought to be purchased. This imposes an inherent danger of exposing the brokers to a wider scope of damages if they made any mistakes during the broking process.

In addition to the above risk, the broker's potential liabilities owed to the assured will also be raised with the increase of the insured value and the assured's potential liabilities owed to third parties. However, the amount of the professional indemnity insurance the broker bought may be limited. If a client brings a successful claim against the broker firm to the extent that it is not covered by the professional indemnity insurance, it could cause severe financial difficulty, even, in some cases, insolvency.

[460] [1997]A.C. 191.

[461] [1997]A.C. 191, at p. 214.

[462] [2002] 1 Lloyd's Rep. 157.

Although the use of limitation of liability clause is common in many professions in the U.K., for example the auditors, solicitors, accountants, architects and surveyors, it is not used by marine insurance brokers until recent years.

When considering the inclusion of a limitation of liability clause, the biggest concern for the broker is the enforceability of such a clause. Whether it is enforceable or not depends upon the current legal regime under which such clauses operate. For U.K. marine insurance brokers, Unfair Contracts Terms Act 1977 and rules of the Insurance Conduct of Business Sourcebook (ICOBS) should be considered when thinking of inserting a limitation of liability clause. The law and regulation have some restrictions on limitation of liability clauses for insurance brokers.

Finally, the author suggested the main elements to be considered when drafting a limitation of liability clause. These include: (1) the parties that would have the burden and benefit of the limitation of liability clause; (2) the types of wrongdoing; (3) the types of losses; and (4) a reasonable cap amount.

8.4 Outcomes

The main outcome of the research is that it examined the broker's duties with peculiar characteristics. First, the thesis proved that there were still strong reasons for retaining the exceptional duties owed by marine insurance brokers. The assignability of marine insurance policy requires that the broker should still be responsible for the payment of premium under the marine insurance contract. The broker's role as 'the servant of the market'[463] entitled the insurers to benefit from his professional knowledge and skills which include the broker's duty of disclosing material facts which is not known to the assured. The thesis also recommended the reform that can be made to improve the clarity, certainty and fairness of these duties.

Secondly, the thesis identified the various situations where the broker's activity may raise the concern of conflict of duty and interest. These include the broker's receiving commissions from the broker, the broker's dual agency role under the insurance and

[463] *General Accident v Tanter (The Zephyr)* [1984] 1 Lloyd's Rep. 58, at p.85, col.2.

reinsurance contract. Although these activities are widely practiced in the market, the courts are reluctant to recognise them as customs in the market, because it goes against legal principle. Besides, the court will not show sympathy for the broker's when he breaches his duty to either party. Damages will be imposed against the broker for their failure, because of the conflict of duties, to discharge his duty to the principal. The FSA regulations urged the brokers to manage the potential conflict of duty and interest during the process of conducting business. As Chitty L.J. said in *Shipway v Broadwood* regarding the commission issue, 'the real evil is not the payment of money, but the secrecy attending it.'[464] If the broker fully and properly discloses the potential conflict of duty and interest to the principal, and receives the principal's acknowledged consent, he is entitled to receive any commission from the insurers and act on behalf of the insurers during the business process. If the conflict of duty and interest is irreconcilable, the brokers should consider turn down the request to act on behalf of the insurers.

Finally, the thesis pointed out the possibility of the broker's exposure to extensive liabilities and considered the enforceability of a limitation of liability clause under the current legal framework. The thesis also suggested the main elements to be considered when drafting a limitation of liability clause.

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[464] [1899] 1 QB 369, at p.373.

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