Does a broker owe a 'duty to nanny'?

A summary of the case of ABN Amro Bank N.V. v Royal & Sun Alliance plc and 13 Underwriters and Edge Brokers (London) Limited.

With the nature and extent of the fall-out for insurance brokers from the FCA test case yet to fully emerge (though anecdotal evidence suggests the volume of precautionary notifications are substantial), the Commercial Court recently took the opportunity to look again at the general duties owed by insurance brokers to policyholders. Whilst a significant proportion of Mr Justice Jacobs' decision considered the factual background and explored the related witness evidence, the Judgment provides a further reminder, if one were needed, of the obligations imposed upon brokers when placing insurance.

Background

ABN Amro (the "Bank"), via an SPV, had entered into commodities repo transactions in respect of cocoa beans and associated products stored worldwide. Initially, the Bank had procured, via its brokers, Edge, cover with Underwriters specialising in insuring marine cargo in warehouses and in transit, to include risk of physical loss and damage.

In mid-2015, prior to the inception of the relevant 2016-17 Policy, Edge were instructed by the Bank to procure cover for risks which were not dependent upon physical loss and damage to include (as the Court later held) in relation to the prospect of the Bank's customers defaulting in relation to the commodities transactions. The clause (the text of which was drafted by the Bank's solicitors) presented by Edge to the lead Underwriter, RSA, later known as the Transaction Premium Clause ("TPC"), provided that the Bank:-

> *"is covered under this contract for the Transaction Premium that the Insured would otherwise have received and/or earned in the absence of a Default on the part of the Insured's client.*
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> *'Default' means a failure, refusal or non-exercise of an option, on the part of the Insured's client (for whatever reason) to purchase (or repurchase) the Subject Matter Insured from the Insured at the Pre agreed Price."*

The wording formed an endorsement to the 2015-16 policy before being incorporated into the 2016-17 Policy document (as signed for by all subscribing Underwriters) – with the substantive discussions between RSA and Edge that gave rise to both being the subject of much scrutiny by the Court. In substance, the clause amounted to a trade credit risk – not something typically covered by a marine cargo wording.

In 2016, the Bank was left holding substantial quantities of cocoa products under the terms of the repo agreements when two of its clients defaulted. Whilst the Bank, by way of mitigation, was able to dispose of some of the product at the best achievable price, as a result of the surplus being of poor quality, there was a significant disparity between the sums recovered and the amounts owed

to the Bank. Despite the absence of physical loss or damage, the Bank sought cover under the 2016-17 Policy for losses totalling £33.5m.

Underwriters denied liability for a variety of reasons, including that they had not agreed to underwrite credit risks which would typically be insured by trade credit policies rather than by the marine / cargo markets. In addition, Underwriters also argued that statements given by Edge during the course of introducing the TPC (both in 2015 and at renewal) gave rise to rectification or estoppel; that the TPC and a non-avoidance clause ("NAC") had not been specifically drawn to their attention when introduced to the 2016-17 Policy and, moreover, the purpose and intention of the clause had not been disclosed at any stage.

Construction of the clause

The parties agreed that the principles governing the construction of marine insurance policies are those applicable to contracts generally. These principles have been set out in a number of recent Supreme Court decisions[1]. In short, the Court must determine what a reasonable person – being someone possessing all the background knowledge which would reasonably have been available to the parties at the time of the contract – would have understood the contracting parties to have meant by the language used. This means reaching an *objective* result - disregarding any evidence of the parties' subjective intentions[2]. The Bank accepted that if the 2016-17 Policy was to be found to provide cover for financial (non-physical) loss then the TPC needed to comprise clear words to that effect.

Underwriters argued that the factual matrix, the contract as a whole, and the commercial consequences of finding in the Bank's favour should be assessed by the Court in circumscribing the ordinary and natural meaning otherwise to be given to the wording of the TPC. In rejecting that position, the Court concluded it was not appropriate to read in words of limitation which are not there where there is a carefully drafted clause in existence and which would then operate to deprive the existing language of its natural and ordinary meaning. Applying the test set out in *Rainy Sky*, the Court agreed that where unambiguous language has been used, the Court must apply it.

In reaching its conclusion as to the ambit of the clause, the Court recognised that such would extend cover beyond the scope previously granted by the London cargo market. However, the Court noted that the market is renowned for expanding cover where brokers seek terms on behalf of clients and whilst the TPC was unusual and unique, it was presented and agreed to by Underwriters.

Non-disclosure and misrepresentation

The Underwriters argued that (developing the terms of s.18 Marine Insurance Act), Edge ought to have disclosed not only the new TPC wording but also explained the *nature* of the unusual risk (effectively, trade credit) to which it gave rise. They also argued the same was true of the NAC.

Underwriters asserted that, in broad terms, the marine market operates on a repeat-business basis – risks are ostensibly similar, as is the policy wording adopted. The Judge accepted that the TPC amounted to a "material" clause given the prospect of it increasing risk for a prudent Underwriter. However, where the TPC wording had been inserted at an early stage in the renewal, and the wording had been available to Underwriters they therefore knew, or ought to have known the terms to which they had signed and agreed. As if any reinforcement were needed, the Court noted that "*It is a remarkable feature of the case that, despite a large number of underwriters writing this risk, and*

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[1] *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50; *Arnold v Britton* [2015] UKSC 36; and *Wood v Capita Insurance Services Ltd.* [2017] UKSC 24

[2] These principles have recently been applied by the Commercial Court in *The Financial Conduct Authority v Arch and Others* [2020] EWHC 2448.

despite a large number of peer reviews, no-one involved on the defendants' side raised any questions about the …TPC".

Non-disclosure of the NAC

Whilst the focus of Underwriters' challenges was upon the alleged non-disclosure of the TPC, they also argued that the NAC was unusually restrictive – since it prevented avoidance for anything other than fraudulent non-disclosures or fraudulent misrepresentations. Such a restrictive clause, Underwriters argued, should have been expressly disclosed such that the Bank could not rely upon it to prevent avoidance. The Bank and Edge contended that, where there had been no allegation of fraud against the Bank, such provided a complete defence to the avoidance case.

Adopting a similar approach to its consideration of the TPC, the Court concluded that the NAC was clear, comprehensive and appeared within a document which had been reviewed and signed by multiple Underwriters. The clear ambit was that any avoidance had to be founded upon fraudulent non-disclosures or fraudulent misrepresentations and that, absent such an allegation, the defences of non-disclosure and misrepresentation would fail.

Further, in any event, the Court found that Underwriters had affirmed the validity of the 2016-17 Policy by filing their original Defence and Counterclaim without raising an avoidance case nor reserving their rights to do so.

Inducement

Three of the subscribing Underwriters alleged that Edge had misrepresented the terms of cover to them as being "as expiry", despite the following market being unaware of the 2015 endorsement (first introducing the TPC) which had been signed by the slip Lead alone. On the facts, the Court concluded that two of the three Underwriters would not have written the 2016-17 Policy on the terms they did absent such misrepresentation. By contrast, the third Underwriter had read a version of the Policy containing both TPC and NAC and was, therefore, bound by their terms.

Duties owed by Edge

Given the nature of the estoppel, rectification and collateral contract defences raised by Underwriters to the Bank's claim, the Bank brought a claim against Edge that, to the extent any of those defences succeeded, it was (and had been) incumbent upon Edge to explain the TPC to Underwriters at renewal. Where two of the Underwriters had succeeded on the basis of inducement, Edge was liable for losses flowing from the resultant lack of cover. However, the Court also had to consider whether, and if so to what extent, the Bank's unrecovered costs would be payable by Edge.

In assessing this aspect, the Court had to determine Edge's liability to the Bank for failing to obtain cover which did not, incontrovertibly, accord with the Bank's requirements and placed the Bank at unreasonable risk of litigation.

The Bank asserted that Edge's duties in relation to the broking of the risk included obligations: (i) not to broke a clause that the broker did not understand or for a client whose insurance needs the broker did not understand; (ii) to use in-house expertise and advise the client (the Bank) to seek specialist advice; (iii) to take all reasonable steps to ensure that the effect of the cover obtained was clear; (iv) to communicate the client's requirements for cover clearly to the Underwriter; and (v) to take reasonable care to ensure that there was a fair presentation of the risk, including asking questions of the client to elicit material information.

Summarising the Bank's case, its Counsel asserted that had Edge acted competently, then by one route or another, the Bank would have received advice that credit risk cover was available from the

credit risk market (rather than marine cargo) and would have acted upon that information accordingly.

As for the Underwriters' argument that Edge ought to have explained their own, or the Bank's, subjective understanding of the import of the clause, Edge argued there was no *"duty to nanny"* imposed upon brokers, in particular where it was dealing with a number of experienced Underwriters. Those Underwriters ought to be able to form their own judgment and assess risk without requiring the broker to take on responsibility to do so.

The Court found there were a number of examples of Edge assuming responsibility to the Bank and, in turn, the Bank relying upon that input. Accordingly, and notwithstanding the drafting assistance provided by the Bank's lawyers in relation to the TPC, the Court concluded Edge did owe a duty to advise. The question for the Court then became what steps Edge ought to have taken in order to fulfil the duty to arrange cover which met the Bank's requirement, so as to avoid any risk of litigation.

Having been assisted by expert evidence, the Court found that, from the outset, Edge had fallen below the standard of a competent broker – since it failed to inform the Bank that the import of the TPC demanded that Edge ought to approach trade credit underwriters, rather than pursue cargo underwriters to place the risk. Delivering that advice would, of itself, have allowed the Bank to assess its options and provide positive instructions to Edge as to which market(s) to approach.

Once Edge had elected, without seeking such authority/input from the Bank to approach cargo underwriters, it had an obligation to ensure Underwriters understood what cover it was that the Bank desired. In reaching its decision, the Court found it was not the case that the language of the TPC was unclear, rather the ambiguity created by seeking to place the risk with the cargo market, arguments as to construction and whether the writing of the risk lay outside the authority of marine Underwriters ultimately placed the Bank at risk of a challenge / litigation from Underwriters – amounting to a breach of the duty owed by Edge.

CPB Comment

The decision considered in detail a number of insurance concepts including non-disclosure, misrepresentation and inducement – with the specific findings being of relevance for both underwriters and brokers. However, whilst those issues were the subject of much scrutiny, the Court was clear to highlight that clear and unambiguous drafting is essential and, notwithstanding factors such as the factual matrix of a dispute and/or commercial considerations, the Courts will be slow to imply limitations or otherwise interfere with clauses which are, on their face, drafted clearly and unambiguously. Unsurprisingly, underwriters who provide cover where they have not fully read or understood the policy wording do so at their peril.

As for the role of the broker, the Court concluded that it did not seek to introduce an all-encompassing *"duty to nanny"* upon them. There was, in its view, *"nothing … which is intended to suggest that brokers generally owe duties to their clients to explain particular clauses, including unusual clauses, to underwriters".*

The duties owed by brokers will be determined on the facts and will comprise the need to obtain the cover that was sought, and to procure cover that clearly and indisputably meets the client's requirements so as not to expose the client to an unnecessary risk of litigation. There were no rules prescribed by the Court as to how a broker is to achieve such certainty, as each matter will turn on its own facts. In certain instances (as in the present case) that will require the broker, in order to protect its client's position, to impart information to underwriters, and to discuss the implications of language in the policy wording.

Any questions?

If you have any questions regarding the insurance-related issues highlighted in this article, please get in touch with Simon or Dean.

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