

## THE NATURE OF BROKERS' (CONTINUING) DUTIES IN REINSURANCE

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The nature and duration of brokers' duties, post-placement, have proved controversial. A trend of cases now establishes that certain duties, such as the retention of records and remitting monies, are continuing. As a result, brokers cannot rely on a defence of limitation. The recent handing down of another judgment in this area provides an opportunity for reflection.

### Duty to monitor reinsurance arrangements

Unless otherwise agreed a broker, as agent, is duty-bound to keep its principal continually informed about matters which are of concern to the principal. This fundamental obligation persists throughout the period of the agency. Post-placement, this means that the reinsurance broker is required to monitor the reinsurance arrangements the broker has placed to ensure the integrity of the reinsurance programme, looking out for materially changed circumstances that could lead to coverage problems if there is no agreed variation of the reinsurance terms. If such changed circumstances arise, the broker is required to bring the issue to the attention of its principal. This was settled in the Court of Appeal's judgment in *HIH Casualty and General Insurance Limited v JLT Risk Solutions Limited*.<sup>1</sup> The HIH case arose out of financing for the production and marketing of films where the broker performed several key roles in arranging the insurance and reinsurance which was written in a form equivalent to a guarantee of the film finance arrangements.

### Duty to retain documentation

It is common for brokers to be appointed as intermediaries for channelling notifications and claims documentation on the business they have placed. In *Johnston v Leslie and Godwin Financial Services Limited*<sup>2</sup> the syndicate's broker had mislaid the reinsurance placing slips. The risks had been placed in the 1950s and the evidence suggested that the documents had been misplaced in storage around 20 years later. The absence of the placing slips meant that it was no longer possible to identify the reinsurers. The consequence was that when US asbestosis, DFS and DDT claims surfaced in the 1980s, the syndicate was powerless to notify the reinsurers. The syndicate succeeded in recovering from its broker a proportion of the losses it was unable to claim under its reinsurance arrangements.

The basis of the decision was that the broker was in breach of its duty to exercise reasonable skill and care in managing the storage of its documents to the extent they were necessary for it to facilitate notifications and collect claim payments on the policies it had placed. In today's low-cost digital storage environment, a similar situation is unlikely to arise as the reinsurers' details should be independently recorded by the broker and its principal. The continuing significance of the decision is limited to two elements. First, the period of time that the broker is required to retain its documents. The document retention period was held to be that which a reasonable broker would regard a claim as being possible. In this case, that period was at least 28 years. A broker seeking to destroy its archived files after a period of inactivity should seek its principal's consent to that course. Secondly, the broker's contractual obligation to retain its documents during the currency of its agency is a continuing one, to enable it to collect claims when instructed to do so. The decision attracted considerable attention at the time it was handed down, as it was a warning to the broking community that the obligations of brokers could in some instances be extremely onerous.

### Duty to remit monies

Brokers administer claims and premium payments as a necessary element of their customary role in Lloyd's market collections. *Equitas Limited v Horace Holman & Co Limited*<sup>3</sup> concerned a dispute arising out of the defendant's administration of the claimant's outwards reinsurance arrangements. Equitas initially sought an order

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<sup>1</sup> [2007] Lloyd's Rep IR 717.

<sup>2</sup> [1995] LRLR 472.

<sup>3</sup> [2007] Lloyd's Rep IR 567.

for delivery of ledgers and other documents held by its Lloyd's broker relating to the reinsurance placement and its subsequent administration along with an order requiring an account and payment of any monies due to Equitas. The accounting documents were delivered up on a consensual basis early in the proceedings but Equitas considered they were insufficient for it to form an account now of what it was owed. The Commercial Court agreed and in its judgment recorded that the broker owed its principal the following duties:

1. to take reasonable care to maintain proper and adequate records which would allow its principal at any stage to ascertain the true state of the account and to ascertain the sums owed to the principal by its reinsurers;
2. to preserve and be constantly ready with correct accounts of all its dealings and transactions on behalf of its principal;
3. to provide its principal with its records, or copies, regardless of whether or not such records are inseparable from records relating to other principals.

The law imposes additional controls in the form of obligations on the way an agent may behave towards the person that has entrusted its authority. Of the duties of loyalty that arise, the following are relevant:

1. a broker holding money as trustee that belongs to his principal must keep it separate from his own and from that of other persons. However, unless a trust is brought into existence the court will infer that the parties intended the relationship of debtor and creditor as this obligation would otherwise be an unintended restriction on the agent's commercial activity.
2. a broker must produce to the principal all books and documents in his hands relating to the principal's affairs at the termination of the agency.
3. a broker must pay his principal sums obtained on the principal's behalf without delay.
4. a broker must not make a secret profit from the agency.

The Commercial Court recently handed down its judgment in *Equitas Limited v Walsham Brothers & Company Limited*.<sup>4</sup> It considered the reinsurance arrangements of the Lloyd's Reconstruction and Renewal settlement package in 1996 and the continuing obligations of Lloyd's reinsurance brokers to remit monies collected for their principals. The decision is subject to a pending appeal.

The claim comprised funds received by Walsham both from reinsurers/retrocessionaires in payment of claims/returned premiums and from reinsureds in payment of reinstatement premiums. Equitas also claimed £11.8 million as compensation for the loss of the investment returns it would have realised had the remittance of funds been timely.

The court decided that the duties Walsham owed to Equitas in contract and restitution were strict. The strict nature of the duties imposes a high burden. A broker may be in breach even when it has behaved reasonably and diligently sought to perform its role. The duties in contract may apply alongside other duties such as the term implied by statute for the broker to carry out its service with reasonable skill and care.

Equitas successfully argued that the expert evidence demonstrated an assumption of responsibility and reliance, not only as to the prompt remittance of funds, but also as to the administration of reinsurance contracts in a professional and businesslike manner generally. The court held that there was no reason why a strict contractual duty should not co-exist with a duty in tort to exercise reasonable care.

The court endorsed the agreed evidence of the parties' broking experts as to the extent of the brokers' obligations, namely to:

1. collect reasonably promptly from the reinsured and pay reasonably promptly to the reinsurers all premiums, net of any brokerage (and claims refunds);

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<sup>4</sup> [2013] EWHC 3264 (Comm).

2. notify the reinsurers reasonably promptly of any potential claims advised by the reinsured and to notify the reinsured reasonably promptly of any questions raised by the reinsurers;
3. collect reasonably promptly from the reinsurers all valid claims (and returns of premium) and pay them reasonably promptly to the reinsured;
4. administer the reinsurance contract in a professional and business-like manner including the maintenance and preservation of proper and adequate records and the provision of the relevant records to the reinsured and/or to reinsurers if requested.

Finding for Equitas, the judge held that the continuing duties were breached on the first day when funds ought to have been remitted and breached afresh on every other day thereafter when no remittance was made. In concluding that Walsham's obligations were continuing, the judge considered two issues: the relationship between the parties and the nature of the obligation. In the present case, the parties were in a persisting agency relationship and the obligation was that of a Lloyd's broker to collect and remit funds.

The judge also attached significance to pre-action correspondence between the parties' lawyers in which Walsham acknowledged a continuing duty to remit funds, whether received in the past or in the future, given expressly on the basis that it would avoid the need for litigation. The exchanges took place on two separate occasions: in advance of the sixth anniversary of the Lloyd's Settlements and on the termination of Walsham's role as brokers.

An element of the claim related to lost investment income. The judge upheld this claim to the extent that any loss from Walsham's continuing failures to remit funds arose within the six year period before the start of the proceedings. As a consequence, Equitas would have to make its claim for its earlier investment income losses on the basis of the usual rules of limitation.

## **Conclusion**

The courts treat agency relationships differently from other contractual relationships. For now at least, limitation defences against brokers will remain difficult to maintain.

As the judge recognised in the Walsham case, the result accords with the reaction of a conscientious Lloyd's broker discovering, six years and one day after he ought to have remitted funds to his principal, that as a result of an oversight he had failed to do so. In the words of Mr Justice Males: "It is easy to imagine the reaction of the parties in such a case if the broker were to approach his principal to explain that he had just discovered that he had been sitting unknowingly on the principal's money for more than six years, but did not propose to pay it over because he was under no duty to do so". Further, the reinsured would have no way of knowing the monies had been collected and the broker had failed to pay them promptly.

We will have to wait and see whether the trend of cases considering brokers' continuing duties will continue. If it does, we can expect that process to lead to further refinement of the scope and substance of such duties. For now, the ruling in the pending appeal of the Walsham case is awaited.

There are a number of acknowledged difficulties with the law of limitation. The Law Commission has made recommendations for the introduction of a single, core limitation regime for claims for a remedy for a wrong, claims for the enforcement of a right and claims for restitution. In 2009 the government rejected them and the reforms have not progressed. If reform eventually occurs, it is likely to include consideration of the continuing nature of the contractual relationship between an agent and its principal, including insurance brokers.