The Aneco v Johnson & Higgins Decision – Brokers Beware

By Tim Brown and Catherine Brewer

On 18th October 2001, the House of Lords handed down an important decision for reinsurance brokers in the case of *Aneco Reinsurance Underwriting Limited (In Liquidation) (A body incorporate under the laws of Bermuda) v Johnson & Higgins Limited [2002] 1 Lloyd's Rep 157.* The case concerned the circumstances when a reinsurance broker will be held liable for negligent advice and the measure of damages payable by the reinsurance broker in such circumstances. The decision has potentially serious ramifications for reinsurance brokers and the reinsurance industry as a whole.

The factual background to the case concerned a claim by the liquidators of a Bermudan reinsurance company, Aneco Reinsurance Underwriting Limited ("Aneco") against the reinsurance brokers, Johnson & Higgins Limited ("J&H").

In 1988, an underwriter who wrote marine excess of loss business on behalf of four Lloyd's syndicates, Mr Bullen, requested that J&H obtain a proportional reinsurance of his excess of loss account. To facilitate such placement, J&H drafted a "fac/oblig" treaty (known as the Bullen Treaty), under which the Bullen syndicates could decide which risks to cede to their reinsurers which, in turn, their reinsurers were obliged to accept. Acting on behalf of the Bullen syndicates, J&H identified Aneco as a potential reinsurer of the treaty and offered Aneco a share in it. It is clear that J&H contemplated from the outset that Aneco's own risk under the Bullen Treaty should be subject to a retrocession. J&H suggested to Aneco that it should purchase retrocession cover, which J&H envisaged would be available at between 30-40% of the Bullen Treaty net premium income.

Aneco subsequently agreed to participate in the Bullen Treaty subject to J&H obtaining satisfactory retrocession protection for Aneco's net account. For these purposes J&H were acting as Aneco's brokers. J&H knew that if suitable retrocession cover was not available, Aneco would not enter into the Bullen Treaty. In the event, J&H confirmed to Aneco that they had obtained suitable cover and Aneco proceeded to subscribe to the Bullen Treaty.

During the course of placing the retrocession cover for Aneco, J&H had, however, described the Bullen Treaty as a "quota share" treaty instead of a "fac/oblig" treaty. This latter form of risk being a less attractive form of risk to the potential reinsurers of Aneco's retrocession contract. The difference between the two types of treaty is that in the case of a quota share treaty, the reinsured must cede a set proportion of

every risk that falls within the terms of the quota share contract. The reinsured therefore has no discretion over the risks that are ceded to his reinsurer, if they are qualifying risks under the terms of the quota share contract. In contrast, under a "fac/oblig" treaty, a reinsured can decide which risks to cede to his reinsurer and, in turn, his reinsurer is obliged to accept such risks. As acknowledged by the House of Lords, under a "fac/oblig" contract, a reinsured is able to cede his least attractive risks to his reinsurers and keep the more favourable risks for himself. Reinsurers therefore tend to only enter into such treaties if they have considerable trust in how their reinsureds will cede business to them under the "fac/oblig" treaty.

Following the placement of the retrocession contract, several of Aneco's reinsurers upon learning the true nature of the Bullen Treaty, avoided the retrocession contract on the basis of the material misrepresentation made by J&H (as they were entitled to do).

Aneco suffered substantial losses under the Bullen Treaty which included the Hurricane Hugo and Exxon Valdez losses. Faced with a total exposure of approximately $35 million, the liquidators of Aneco brought proceedings against J&H for negligence. Aneco's primary claim was for all the losses it had suffered by entering into the Bullen Treaty (i.e. $35 million). In support, Aneco argued that J&H had wrongly advised that suitable retrocession cover was available and Aneco had relied on this when entering into the Bullen Treaty. Further, it was argued that Aneco would not have entered into the Bullen Treaty if J&H has properly advised that reinsurance cover was not available in the market. In the alternative, Aneco claimed for all the sums it would have been able to recover under the retrocession contract (approximately $11 million) if the contract had not been avoided by several of Aneco's reinsurers.

The decisions of the lower courts

Aneco's claim was partially successful at first instance. Cresswell J held that J&H had been negligent. However, on his finding that alternative security could have been placed if J&H had not been negligent and had fairly represented the risk as a "fac/oblig" cover, Cresswell J limited Aneco's recovery to $10,847,752, the total sum that would have been payable if the retrocession contract had not been avoided.

Aneco appealed this decision on the basis that it should be entitled to succeed on its primary claim for damages and that Cresswell J's finding of fact that alternative cover would have been available was wrong. Indeed, it was apparent from J&H's file that during the course of their attempts to place the business as a "fac/oblig" cover,

a number of potential reinsurers had rejected the business commenting: *"no way"*; *"next year"*; *"thanks but......"*; *"not new XL"*; *"not this layer"* and *"needs this like a hole in the head"*. J&H, however, failed to pass on this information to Aneco.

Following a review of the evidence produced before the judge at first instance, the Court of Appeal unanimously found in Aneco's favour that alternative security would not have been available, or was not available on commercial terms to Aneco. The Court of Appeal was, however, divided over the correct measure of damages payable by J&H. Following an analysis of the scope of the brokers' duty to advise, the Court of Appeal held by a 2:1 majority that Aneco was entitled to recover all of its losses under the Bullen Treaty (i.e. $35 million). The majority view of the Court of Appeal was that J&H had wrongly advised Aneco that suitable retrocession cover was available in the market, thereby causing Aneco to enter into the Bullen Treaty. Faced with having to pay an additional $24 million to Aneco following the Court of Appeal's decision, J&H appealed to the House of Lords concerning the correct measure of damages to be applied.

The issue before the House of Lords

The House of Lords accepted the Court of Appeal's conclusions on the non-availability of alternative reinsurance. It followed that, in essence, the issue before the House of Lords was:

(i) whether J&H's duty of care was limited to the obtaining of satisfactory excess of loss protection on behalf of Aneco, in which case (as the brokers conceded during the proceedings), J&H would be liable for approximately $11 million; or

(ii) whether J&H had assumed a much wider duty of care, in which case they would be liable for the full extent of Aneco's loss which was the total sum of Aneco's losses under the Bullen Treaty (i.e. $35 million).

The House of Lords, by a 4:1 majority, agreed with the Court of Appeal's earlier decision that Aneco was entitled to recover the total sum of its losses under the Bullen Treaty amounting to $35 million from J&H and therefore rejected J&H's appeal.

The correct measure of damages applicable turned upon an evaluation of factual matters by the House of Lords rather than "high legal principle". The majority had little difficulty upholding the Court of Appeal's decision. The law lords considered the scope of J&H's duty to Aneco by reference to the facts and in the light of the established law concerning "scope of duty". The established "scope of duty" principles considered included:

1. The principle that brokers (and others) cannot be held liable for losses that fall outside of their duty of care *(Overseas Tankships (UK) Ltd v Morts Dock and Engineering Co Ltd (The Wagon Mound (No 1)) [1961] AC 388)*. This principle was never disputed in Aneco.

2. The general principle that brokers (and others) will be liable in contract for the foreseeable consequences of their negligence, including any adverse consequences of entering into a transaction with a third party, provided such consequences can be fairly held to fall within the scope of the broker's duty of care. This principle was established in the case of *Youell v Bland Welch & Co Ltd (No 2) (The "Superhulls Cover" case) [1990] 2 Lloyd's Rep 431* where the brokers were instructed to obtain reinsurance in the London market in respect of construction risks for three new building vessels. In this case the brokers had wrongly informed the insurers that they had obtained reinsurance as "original". However, the reinsurance was subject to a cut-off clause whereby the cover terminated 48 months after the construction of the vessels commenced. The brokers failed to inform the insurers of this fact. If the insurers had been given such information, they would not have accepted the reinsurance and would have written greatly reduced lines on the original insurance. In the circumstances, the trial judge held that the brokers were in breach of their duty of care, both in contract and tort, and that the measure of damages applicable was the difference between the amount for which the insurers became liable on the original insurance and the amount for which they would have been liable if they had written reduced lines.

3. The sub-rule established in the case of *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd [1997] AC 191 known as South Australia Asset Management Corporation v York Montague Ltd ("SAAMCO")*. This sub-rule is applicable in special circumstances where those who undertake to provide specific information are not generally liable for all the foreseeable consequences of their negligence. They are only liable for the consequences of the specific information they provide being wrong, thereby distinguishing between a duty to provide information for the purposes of enabling someone else to decide upon a course of action, and a duty to advise someone as to what action should be taken.

In Aneco, J&H sought to rely upon the decision in SAAMCO arguing that SAAMCO established the limits of the duty of care owed by a professional adviser when providing information to his client. On this basis, J&H alleged that their only

duty was to arrange reinsurance for Aneco and to confirm to Aneco when they had done so. Further, that they did not have a general duty to advise on the availability of reinsurance cover in the market or the market assessment of the risks inherent in the Bullen Treaty. The House of Lords rejected this argument. It is clear from Lord Lloyd's judgment that the application of the decision in SAAMCO should be confined to cases where valuers or other professionals had undertaken only a limited duty to provide specific information for a particular purpose. Further, that the general principle established in the Superhulls Cover case had not been undermined by SAAMCO. Lord Lloyd stated:

> *"...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 the scope of the defendant's duty is confined to the giving of specific information..."*

Based upon an analysis of the general principle in the Superhulls Cover case, the House of Lords held that J&H had undertaken a duty to advise Aneco on the availability of retrocession cover in the market without which Aneco would not have entered into the Bullen Treaty. Further, J&H's failure to advise that appropriate retrocession cover was not available resulted in Aneco's loss of $35 million. J&H's duty was not limited to merely effecting the placement of the retrocession contract and confirming that they had done so to Aneco. J&H's duty was extended to include an obligation to report on the market assessment of the risks involved, which J&H failed to do. It was Lord Lloyd's view that:

> *"...At the very least they [the brokers] owed a duty to inform Aneco whether or not reinsurance was available. If they had performed that duty carefully, they would have told the insurers that reinsurance was not available, in which case "the whole thing would have collapsed", as the brokers well knew. For it would have been obvious to Aneco that the unavailability of reinsurance was due to the current market assessment of the risks. It is really fanciful to suppose that there might have been some other reason for reinsurance being unavailable. Why then should the brokers not be liable for the full extent of the losses attributable to their breach*

of duty? Why should it be assumed in favour of the brokers that reinsurance was available on the market, thus limiting their liability to $11m, when if they had done their job properly they would have known that it was not?"

Implications for reinsurance brokers

It is now clear that reinsurance brokers may be subject to wider duties of care concerning advice they have given during the placement of reinsurance contracts than they previously considered applied. Further, that the measure of damages payable by them if negligent in providing such advice may include all of a reinsured's uninsured losses and the value of any reinsurance cover that is not effective. It should, however, be remembered that the House of Lords' decision is not groundbreaking news. The reinsurance industry has been aware of the position since July 1999 when the Court of Appeal handed down its judgment in Aneco.

In the light of the House of Lords' decision in Aneco, it is clear that:

- the greatest impact of the Aneco decision should be in relation to outstanding claims against reinsurance brokers rather than claims arising from post-Aneco conduct.
- both reinsurance brokers and their professional indemnity insurers should ensure that they have made adequate reserves in respect of claims involving advice given in similar circumstances to that in Aneco (if they have not already done so following the Court of Appeal's earlier decision).
- the price of brokers' professional indemnity coverage may be increased in the future.
- clients will review how they plead their claims against their brokers in the future. In order to maximise their potential recoveries from their brokers, Aneco type claims will increase.

Whilst the House of Lords decided Aneco on its facts, the decision has the potential to expose brokers to greater liabilities than they may have considered possible. There are several questions that reinsurance brokers should now ask themselves in order to manage and limit their potential liabilities:

Who is my client?

Reinsurance brokers should ensure that they can identify who their client is when acting for a number of parties in a chain of reinsurance/retrocession placements. Different duties will be owed to each client.

How do I know what duties I have accepted?

In a perfect world (quite possibly an accountants' world where long letters of engagement are commonplace) the duties of a reinsurance broker should be clearly recorded so that both the reinsurance broker and his client are aware from the outset of the full extent of the broker's duties. The reality is that we do not live in a perfect world. It is often the case that brokers' duties are accepted during the course of a retainer either in ongoing correspondence or conversations. For example, a reinsurance broker may be asked to comment on or confirm a point during the course of a placement. It is unlikely at that time that either party will consider the full legal effects of such conduct.

In order to avoid doubt concerning the scope of a reinsurance broker's duties to his client, detailed records of instructions should be kept, preferably agreed by both parties. Reinsurance brokers should also be wary in the future of "loose" discussions with, or letters to clients that may give rise to an increased duty of care.

How can I limit my duty of care?

The reinsurance broker can seek to limit the duty of care in a number of ways. One way is to enter into a letter of engagement with a client setting out the terms of the reinsurance broker's retainer. If the reinsurance broker's duties are to be limited to the placing of a reinsurance/retrocession insurance contract, this should be clearly stated. Alternatively, if a reinsurance broker is concerned during the course of placing business that the advice he is giving may give rise to a wider duty of care, akin to the one in Aneco, he should send a letter to his client stating what his duties are limited to. Reinsurance brokers should ensure that they take considerable care to understand the nature of the tasks they undertake and whether they are being called upon to provide advice rather than just information.

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