knowingly permitting a contamination.

4. For the future – How to best assess or manage environmental risk.

BROKERS DUTIES AND DILEMMAS
by Julian Flaux Q.C.

1. The received wisdom as a matter of English law is that an insurance broker is the agent only of the assured or of the reinsured who employs him to place or administer a contract of insurance or reinsurance and owes duties exclusively to that principal and not to the insurer or reinsurer with whom he is placing the relevant contract. As a matter of general principle, this is undoubtedly correct, save in special cases.

   (a) Where by his words or conduct the broker assumes a duty to the insurer. Examples of these may be found where (a) the broker undertakes to do something which imposes a personal responsibility owed to insurers such as in *The Zephyr* [1984] 1 Lloyd's Reps. 58, [1985] 2 Lloyd's Reps. 529 where the broker who gave a signing indication was held to owe a duty of care to the reinsurers or *Pryke v. Gibbs Hartley Cooper* [1991] 1 Lloyd's Reps. 602 where a broker who was an intermediary undertook a specific responsibility to the insurer where the broker would not otherwise have owed a duty. The decision in *Pryke* reaches a contrary conclusion to that reached by Mr. Justice Hirst in *IGI v. Kirkland Timms* (1985) unreported that where a broker is an "intermediary" he owes a duty to both insured and insurer. The conclusion in *Pryke* is to be preferred.

   (b) Where the broker is also a coverholder pursuant to a binding authority or brokers' cover granted by insurers to the broker. In such cases the broker acts as an underwriting agent for the insurers in accepting business to be bound under the cover, and owes the insurers, both in contract and in tort to take reasonable skill and care in and about the selection and acceptance of business and the communication of relevant information to the insurers – see for example *Woolcott v. Excess Insurance Co.* [1979] 1 Lloyd's Reps. 231 [1979] 2 Lloyd's Reps. 210.

2. In considering the position of brokers, I propose to leave to one side those special cases where a broker has been held to owe duties in contract or in tort to the insurer and to focus on the classic situation where the broker's duties are owed to his client, the insured or reinsured and not to the insurer. This may be described as the normal situation and yet the legal result reached by the Courts that a broker does not owe a parallel duty of care to the insurer (see e.g.: *Pryke*) lies somewhat uneasily with the practical and commercial reality. This reality is that quite apart from his legal duty to his client, the broker may be acutely aware of his commercial relationship and reputation with the insurers. Historically, this has been particularly true in Lloyd's where until relatively recently large broking houses owned or had substantial interests in particular managing agencies of syndicates and would place a preponderance of their business with those syndicates.

3. Despite divestment, these historical connections have been slow to loosen. To a lawyer, they give rise to acute actual or potential conflicts of interest which brokers seem to fail or recognise or to resolve. A close connection of this kind is sometimes perceived by the client assured as leading the broker to "take sides with" with underwriters in relation to claims. Many brokers would no doubt dispute this and would argue that the close historical or commercial connections with certain underwriters enables them to place business which might not otherwise be place or to secure payment of claims which might otherwise be queried or delayed. Such apologists would no doubt be correct but this in turn raises vexed questions as to other potential conflicts of interest elsewhere in the market. These matters may lie outside the scope of this conference which is essentially concerned with claims, but from a lawyer's perspective, the potential conflicts of interest which the historical and commercial connections between Lloyd's brokers and Lloyd's underwriters give rise to may be seen as contributing to the problems which Lloyd's now faces. At a critical time, when the future of the market is in the balance, these potential conflicts have to be resolved – quite how is another matter!

4. Quite apart from the close historical and commercial relationships within the market which may lead to a tension between the brokers' legal duties to his client and his commercial activities. Thus, in many, if not most cases, insurers "employ" brokers to administer and settle claims. Brokers may instruct loss adjusters on behalf of insurers and liaise with adjusters or even with insurers' solicitors in relation to particular claims.

5. The situations which I have described are all ones which give rise to potential conflicts of interest between the broker's duty to his client, the assured or reinsured and his own commercial interests. I propose to consider three particular areas of potential conflict or dilemma:

    (1) How should the broker conduct himself in what might be described as the "normal" situation where he is asked to present a claim to insurers and, at the same time, is "retained" by insurers to administer the claim in the manner described in the previous paragraph.

    (2) What is the status of documents in the brokers' files concerning the claim and, in particular, should the brokers disclose or provide access to such documents to insurers.

    (3) What should the broker do when he becomes suspicious as to the bona fides of his client's claim.

The normal situation

6. At the risk of being unpopular with brokers or thought to be uncommercial, it seems to me that in the usual case where a broker has placed insurance for an assured and administered the contract of insurance on his behalf and is then asked to present and process a claim on behalf of that assured, the broker's overriding duty is to his client, the assured. The broker should not place himself in a situation where there could, even arguably, be a conflict of interest, by acting also for underwriters, at least without obtaining the informed and express agreement of his client, the assured, beforehand. That this is the law both in relation to insurance brokers and in relation to agents generally is clearly established: see *Anglo-African Merchants v. Bayley* [1970] 1 Q.B. 311 and *North & South v. Berkeley* [1971] 1 WLR 470, cases in which Mr. Justice Megaw and Mr. Justice Donaldson deprecated the practice whereby brokers acted for insurers, as well as for assureds, in relation to claims and held that the practice was an unreasonable one which should cease.

7. It must follow that if the broker wishes to administer the claim on behalf of the insurers, he has to tell the assured beforehand that he has been instructed to do so by the insurers and must explain to the assured that this may give rise to a conflict of interest: see *Clark Boyce v. Mouat* [1994] 1 A.C. 428 a case

involving a solicitor who acted for both parties, although there can be no doubt that the principle recognised there applies with equal vigour to all agents including insurance brokers.

How many brokers have ever conducted themselves in accordance with this well-established legal principle? Notwithstanding the trenchant criticisms of Commercial Court Judges 25 years ago, the practice of brokers acting for insurers as well as assured in the administration of claims has continued. I suspect that this occurs not because brokers wish deliberately to face conflicts of interest but for obvious reasons of practicality and commercial expediency. To the broker in the real world, the law may be seen as taking an unrealistic and uncommercial approach; indeed brokers may sometimes see themselves as intermediaries" in a more general sense, "honest brokers" who seek to negotiate a fair deal between assured and insurer. However, there can be no doubt that this is not their status as a matter of law. Their overriding duty is their client, the assured and brokers would be well advised to acquaint themselves with the applicable legal principles and ensure that, however onerous those principles may seem, they comply with them. Failure to do so may expose brokers to claims for damages for loss suffered as a consequence of the brokers having acted in conflict of duty and, hence, failed fully to comply with their duty to their client, the assured or reinsured. In a climate in which disgruntled Plaintiffs, including Lloyd's Names, may be casting around for other "deep pockets" against which to bring claims, brokers should be careful to avoid any suggestion that they have acted in conflict of interest or have failed to inform their principals that they are in a situation of potential conflict.

Documents

8. Two separate categories of documents which may be generated by or come into the possession of a broker are capable of giving rise to a dilemma or conflict:

    (1) Documents which the broker generates whilst acting as the assured's agent or which come into his possession in that capacity.

    (2) Documents which the broker obtains whilst administering a claim for insurers or liasing on their behalf with third parties such as loss adjusters.

9. As regards the first category, it is well-established that documents brought into existence by an agent whilst engaged on the principal's business are the principal's documents and not the agent's and, subject to the agent's entitlement to keep the documents during the course of the agency in order to run the agency effectively, the principal is entitled to demand that the documents be handed over: *Re Burnand* [1904] 2 KB 68; *Leicestershire County Council v. Michael Faraday & Partners* [1941] 2 KB 205. Since the documents and the information contained in them are the principal's property, the agent is obliged to provide the principal with access to the documents and information and the opportunity to take copies at any time. This is merely one aspect of the agent's general duty to account to his principal. This well-established legal principle was recently applied in an insurance context in *Yasuda Fire & Marine v. Orion Marine Insurance* [1995] 2 W.L.R. 49 a case where after termination of an underwriting agency, the principal was held to be entitled to inspect and copy documents and computer records in the possession of the underwriting agent.

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10. Applying that principle to the case of the insurance broker, it follows that in large measure, the contents of placing files, created by the broker whilst engaged on the principal's business, are the principal's documents. The only exceptions will be internal file notes and memoranda and rough notes created by the broker in order to prepare for the placing, unless these were shown to underwriters. Such documents fall into the same category as the internal private memoranda and notes of surveyors in *London School Board v. Northcroft* (1889) a decision the relevant part of which is quoted in the *Faraday* case. Similarly, it has been held that accountants' working papers used in preparing an audit of a client company were the accountants' documents and not the clients' whereas correspondence between the accountants and the Inland Revenue concerning the clients' affairs was conducted by the accountants as agents for clients and, hence, was the clients' property: *Chantry Martin v. Martin* [2 Q.B. 286.

11. In the claims context, where a broker is employed by the assured to pursue and process a claim, it must follow that any correspondence generated by the broker whilst performing that function is the assured's documentation and thus his property. Examples would be correspondence between the broker and the assured or correspondence between the broker and loss adjusters or surveyors instructed by him on behalf of the assured.

    What is the consequence of this conclusion, so far as the broker is concerned, particularly in his dealings with underwriters?

    The principle that documents generated whilst acting for the assureds are the assured's documents is itself a wider legal principle that information gained by an agent is confidential to the principal and may not be disclosed to a third party without the principal's consent – see Bowstead page 177. It follows that where the broker's claims file comprises documents generated whilst performing his duty as agent for the assured, the broker should not provide the insurers with a copy of the file or documents in it without the assured's consent.

12. Obviously, this principle is difficult to apply in practice. Thus, in one sense, the broker may need to disclose documents or information to the insurers in order properly to discharge his duty to the assured to secure early and satisfactory

settlement of the claim. It cannot be sensible that the broker should have to ask permission to disclose such documents and information. Whilst I know of no case which addresses this problem, it seems to me that the solution must be that when the assured invites the broker to handle a claim on his behalf, by necessary implication, he agrees to the broker doing whatever is necessary properly to discharge that function, including disclosure of information and documents to the insurers. The IBRC Code of Conduct 1978 seems to endorse this approach when it provides:

> *"information acquired by an insurance broker from his client shall not be used or disclosed except in the normal course of negotiating ... or unless the consent of the client has been obtained."*

However, whilst that sensible commercial approach is no doubt correct where the information and documents which the broker possesses and intends to show to the insurers support the assured's claim, different considerations may well apply where the broker comes into possession of information or documents which damage or cast doubt upon the assured's claim. Herein lies what seems to be one of the central dilemmas which faces a broker who acts as the means of communication and negotiation between the assured and the insurers, a dilemma to which I will return later.

13. The second category of documents which may be in the brokers' possession consists of documents obtained by them at the insurers' request. In the claims context, the classic example would be where the brokers have been instructed by insurers to obtain an assessor's or loss adjuster's report. Are the brokers under a duty to disclose the document to their main principal, the assured? This question arose 25 years ago in *North & South Trust v. Berkeley* [1971] W.L.R. 470. Notwithstanding that, as I have said, the Judge held that the practice of brokers acting for insurers was an unreasonable one which gave rise to a conflict of interest, he held that the brokers were not liable to disclose to the assured information or documents which they had gained whilst acting for the insurers. Thus the brokers were not obliged to hand over to the assured the assessor's reports obtained at the insurer's behest. Nonetheless, the Judge held that in acting for insurers at all, the brokers were in breach of their duty to their client, the assured, and that to the extent that the assured could show that breach had caused him loss or damage, he would have a claim in damages. This may be a threat which is more apparent than real since the concept of damages as a consequence of the assured not obtaining access to the insurers' documents is

a somewhat nebulous one, but it is an example of a possible consequence of the dilemma in which a broker may find himself if he plays a dual role.

Fraudulent claims

14. Perhaps the most serious dilemma which a broker faces is when in presenting and administering a claim, he comes to suspect its bona fides. In such circumstances, a broker faces a conflict different in quality from that which is self-inflicted when he assumes a dual role, namely a conflict between his duty to his client, the assured, to act in the latter's best interests and his own independent duty of utmost good faith. Just as at the pre-contact stage, the broker has a duty to disclose to insurers material facts within his knowledge under section 19 of the Marine Insurance Act, which is one aspect of the overriding duty of utmost good faith under section 17 of the Act, so at the post-contract stage, not only the assured, but also the broker will owe a continuing duty of utmost good faith. See *The Litsion Pride* [1985] 1 Lloyd's Reps. 437 at 513-4 where Mr. Justice Hirst concluded that the broker was within the ambit of the good faith obligation at the post-contract stage as well as the pre-contract stage.

15. In deciding how the broker may resolve his dilemma, an important starting point is to consider what the assured's duty of utmost good faith entails in relation to the presentation of claims, because the broker cannot be under any greater duty than his principal. The law in this area is still far from satisfactory and is confused, although a series of recent cases have gone some way to clarifying the extent of the duty of utmost good faith in relation to the making of claims: two decisions of the Court of Appeal in *Orakpo v. Barclays Insurance Services* [1994] CLC 373 and *Diggens v. Sun Alliance* [1994] CLC 1146 and two unreported decisions of Commercial Court judges: *Prudential Assurance v. Bucks. Printing Press* (1993 Saville J.) and *The Star Sea* (1994 Tuckey J.). The effect of the decisions may be summarised as follows:

    (1) One aspect of the duty of utmost good faith is the duty not to make a fraudulent claim i.e.: not to make a claim knowingly or recklessly which involves substantial falsehood. The mere exaggeration of a claim or presentation of a doubtful claim even knowingly, for the purposes of negotiation will probably not amount to making a fraudulent claim for these purposes (see Staughton L.J. in *Orakpo v. Barclays Insurance Services* [1994] CLC 373 @ 382 and Evans L.J. in

Diggens v. Sun Alliance [1994] CLC 1146 @ 1165.

(2) In *The Star Sea*, Tuckey J. considered that, at the stage when the claim is being presented to underwriters, the duty may go wider than a duty not to act fraudulently and may "at least ... require the insured to be honest and open by disclosing the facts relevant to his claim which are unknown to underwriters. In practice, this is what happens because underwriters will not decide whether to pay or to decline a claim until they believe they have been given all the relevant facts". To the extent that this wider aspect may require the assured to disclose to insurers information or documents which cast doubt upon his claim whilst not rendering it a fraudulent claim, the conclusion of Tuckey J. may be said to lie somewhat uneasily with the Court of Appeal dicta on exaggerated and doubtful claims to which I have referred.

(3) Once the insurers have declined the claim and litigation or arbitration ensues, any duty of good faith in relation to that claim comes to an end. (See *The Star Sea*).

16. It seems to me that if there is a wider aspect of the duty of good faith beyond a duty not to make fraudulent claims, as Tuckey J. suggests in *The Star Sea*, the broker who comes into possession of information or a document which casts doubt or suspicions on his client's claim (without necessarily making it fraudulent) is placed in a dilemma. Whilst he should not do anything inimical to the assured's interests, to fail to disclose the information or document to insurers may be a breach of the duty of good faith by both insured and broker. It seems to me that so long as the law may be said to recognise this wider duty (and I understand that *The Star Sea* is to be appealed, with the consequence that the Court of Appeal may endorse a narrower duty merely not to act fraudulently) the broker facing this dilemma can only resolve it by informing the assured that he has obtained such information or document which casts doubt or suspicions upon the claim and advising the assured that the material should be disclosed to insurers. If the assured agrees, all well and good and, of course in practical terms he may often have to do so if he is to have any hope of having his claim settled, for the reason given by Tuckey J. However, if the assured refuses to allow the material to be disclosed, it seems to me that the broker will have to cease to act for the assured in the further presentation of the claim.

17. Where the broker comes to realise that the claim is a fraudulent one, the

dilemma is similar, although its resolution is probably simpler. Whilst the broker's duty is to act in the best interests of his client, this cannot possibly extend to pursuing with insurers a claim which he knows to be fraudulent. In such circumstances, the broker must inform the assured that he has learnt that the claim is a fraudulent one or that he has strong suspicions to that effect and that he has to case to act for the assured. A difficult question which may arise is whether having ceased to act, or indeed before he ceases to act, the broker should disclose what he has learnt to insurers. In this context, the position of Lloyd's brokers is regulated by the Byelaw No. 11 of 1989 which requires them to report any actual or proposed misconduct of which they know or which they believe is likely to occur, including misconduct by the assured, to the head of Lloyd's Regulatory Services Group. Thus, a Lloyd's broker who learns that a claim by his client is fraudulent or believes that it is (presumably on reasonable grounds) should report it to the Head of Regulatory Services but is not obliged to disclose it to insurers.

18. The position of non-Lloyd's brokers or Lloyd's brokers handling claims in the non-Lloyd's market is governed by the common law. It is clear that the broker does not owe any duty to the insurers to report to them that the assured intends to defraud them: *Bank of Nova Scotia v. Hellenic Mutual* [1990] 1 Q.B. 818 @ 896, but does the broker continue to owe a duty to the assured not to disclose to insurers details about the claim which will demonstrate to them that the claim is fraudulent? This question has not been considered by any of the authorities. The Fisher Report in 1980 concluded that the broker had neither the duty nor *the right* to disclose his doubts and suspicions to insurers which suggests that the brokers' duty to his clients may continue. However, the authorities on the duty of confidentiality generally do recognise that it has limits and that confidential information may be disclosed where it is in the public interest to do so. Since the broker owes no duty to the insurers to make disclosure to them of fraud by his client I consider that there may well be some doubt as to whether the broker's duty of confidentiality to his client comes to an end when he learns of a fraudulent claim and, thus, whether the broker can, with impunity, disclose the matter to insurers. Given that doubt and the possible uncertainty as to whether disclosure would be a breach of the duty of confidentiality owed to assured, it seems to me that the only safe approach for brokers to adopt in such circumstances is to cease to act for the assured, withdrawing completely from the claim without any statement to insurers as to why this has occurred.