INSURANCE BROKERS' E&O DUTIES REGARDING UNUSUAL POLICY TERMS: IS THERE A "DUTY TO NANNY?"

The law is quite clear that an insurance broker owes a duty to draw its client/insured's attention to any unusual or onerous policy terms and to explain their nature and effect. This allows the insured the chance to comply with such terms and/or to obtain alternative cover if it chooses: *Ground Gilbey v Jardine Lloyd Thompson [2012].*[1]

1 https://uk.practicallaw.thomsonreuters.com/D-104-3826?originationContext=document&transitionType=PLDocumentLink&contextData=(sc.Default)

Mr. Justice Jacobs' recent decision in *ABN AMRO Bank –v-- [Underwriters] and Edge Brokers (London) [2021] EWHC 442 (Comm)*, discusses two different, distinct and novel questions which may arise when an unusual term is included in an insurance policy, namely: (1) does the broker owe Underwriters a duty to explain (to Underwriters) the unusual term and/or (2) does the broker owe the insured a duty to explain (to Underwriters) an unusual term?

In *ABN AMRO*, theinsured bank's negligence claim against its insurance broker ("Edge"), was based on another well-established principle that an insurance broker owes its client a duty to obtain, so far as possible, insurance cover which clearly meets its client's requirements, leaving no room for significant debate (ignoring "spurious" issues) and which does not expose the client to unnecessary risk of coverage litigation (as applied in *Standard Life v Oak Dedicated [2008]*)

The judgment discusses some unusual issues and it provides an informative read for anyone who wishes to understand how the London insurance market works.

Fourteen Underwriters had raised various coverage defences to the bank's claim for indemnity under a cargo policy, based on policy construction, non-disclosure, misrepresentation, rectification, and estoppel arguments. With the exception of two Underwriters who succeeded with their estoppel argument, these defences failed for a variety of reasons (and this will be the subject of a separate article). The claim in negligence against the broker proceeded in respect of the share of the two successful Underwriters and the bank's (otherwise unrecoverable) legal costs of pursuing the defeated Underwriters.

By way of background, in early 2016, Underwriters subscribed to a policy which was based on conventional marine "all risks" terms, including the Institute Cargo Clauses 'A'. The policy was broked by Edge and it incepted on 1 February 2016 (thus too early to be caught by the Insurance Act 2015 - which would not have made much, if any, difference to the decision): it was placed in the London marine market with cargo underwriters who were specialists in storage and transit risks, and in particular the risk of physical loss and damage.

However, the policy contained an unusual clause (the "Transaction Premium Clause" or " TPC") which (the Judge ruled), covered risks which were not dependent on physical loss and damage, including (it was decided) the risk to the bank of the default of its customers, even in the absence of physical loss or damage. The important words of the TPC were:

" the Insured 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…

'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 bank provided structured commodities' finance to clients who were in the business of buying and selling cocoa products. These so-called "repo" transactions involved the banks providing working capital by purchasing the client's cocoa products for a defined period of time, after which the client was contractually obliged to buy them back. Late in 2016 two clients suffered major and ultimately terminal financial collapse and, although it was of no direct relevance in the case, senior executives of both client companies were convicted and imprisoned in the US for frauds committed against several banks, including the claimant bank.

The clients (Transmar and Euromar) defaulted under the repo deals by failing to repurchase the cocoa products: the bank mitigated its losses by disposing of the products at the best achievable prices, but some of it proved to be of poor quality, and there was a significant shortfall between what could be recovered under sales to third parties and the amounts owed by Transmar and Euromar. This shortfall (approximately £33.5m) was the amount claimed under the TPC in the policy.

Underwriters relied upon the fact that cover for this "Default" risk would ordinarily be placed with specialist trade credit underwriters (and not cargo underwriters) and (unsuccessfully) contended that the TPC in their policy should be construed so as to apply only as a form of "Basis of Valuation" clause where physical loss and damage were caused to the cargo. Underwriters lost this "construction" argument.

Does the broker owe Underwriters a duty to explain (to Underwriters) any unusual terms?

Regarding Underwriters' argument that Edge owed them a duty, on placing, to disclose to them that the purpose of the TPC was to provide insurance for default in the absence of physical loss or damage, it was of course an obstacle that the slip policy which was place/renewed with them contained the TPC.

Underwriters' argument, based on section 18 of the Marine Insurance Act 1906, can be summarised as follows: the purpose of the TPC, or the risk that the underwriter was asked to run, should have been disclosed to them on placing; the TPC was an unusual risk - not simply the wording but the risk itself. Underwriters said they would not, particularly upon renewal, be looking out for it and that an underwriter could not, or could not necessarily be expected to ask a question about it; because he may have assumed that it was a basis of valuation clause (which did involve loss and damage), or may not have focused on it in the context of a very large policy. Underwriters said it should be borne in mind that the practice in the marine market was for there to be relatively short 'brokes', and that the market was basically doing the same things over and over again. That was why the market, which was built upon mutual trust, relied on the brokers to draw it to their attention. The market would slow down and grind to a halt if underwriters were expected to read lengthy documents in the detail required to understand each clause - the market did not work on the basis that people would sit and read the policies that they were writing. That might happen in an ideal world, but it was not what happened in

practice. Underwriters made clear that the duty to disclose the purpose of a clause in the policy did not apply to every clause - it only applied to something unusual and out-with the contemplation of underwriters.

The Judge decided that the TPC would increase a prudent underwriter's assessment of his probable maximum loss and that there was no dispute that, in a broad sense, the TPC was a "material" clause. He also accepted that, in the context of its case against Edge, the evidence at trial showed that if Underwriters had been told that the Bank wanted credit risk cover, the cargo underwriters would have said "no" (save perhaps the leading Underwriter)

Notwithstanding this, Underwriters' case on non-disclosure failed because there was no non-disclosure of the TPC - the underwriters either knew or were presumed to know the terms which they signed and to which they agreed. The Judge held that Underwriters could not complain that the TPC was not disclosed to them - it was, after all, there in the policy to which they subscribed. He said *"It is a remarkable feature of the case that, despite a large number of underwriters writing this risk, and despite a large number of peer reviews, no-one involved on the defendants' side raised any questions about the …TPC"* and held that, whether Underwriters' case was advanced as a failure to disclose the purpose of the TPC, or a failure to disclose the subjective intention of the broker or the bank in including the TPC, there was no non-disclosure of a material fact. He found that the TPC, although bespoke and unprecedented in the cargo market, was "carefully drafted" (by the bank's competent external lawyers) and "clear": the Judge did not find that the leading Underwriter had formed any clear view as to what the TPC actually meant and did not take sufficient time to consider it.

The Judge also rejected Underwriter's non-disclosure argument because of Section 18 (3)(b) of the Marine Insurance Act 1906, which provides that there is no duty to disclose circumstances which are known or presumed to be known to the insurer. He said *"the terms of the policy that the underwriter subscribes, by scratching the slip containing the policy terms there set out, are clearly either known or presumed to be known to the insurer. The question of what a particular clause means is indeed, as Edge submitted, a paradigm matter on which the underwriter can and should form his own view. The insured is not in my view required to offer his views as to the effect or meaning of the contractual terms proposed. To do so would require the insured to estimate the risk for the underwriter. To use the colloquial language used in some of the cases, the broker does not have an obligation to tell the underwriter how to do his job, or to conduct the underwriter's business for him. Nor, as Lord Esher said in The Bedouin, is the assured bound to tell the underwriter what the law is. This necessarily extends to telling the underwriter what a particular clause means."* He said that the contractual effect of the TPC is a matter on which the underwriter should form his own view and that Underwriters were presented with what was, on the evidence, a lengthy and unusual clause, which did not involve a minor tweak to standard wording, which might perhaps go unnoticed. The clause used concepts, in particular "Default" on a number of occasions, which are unfamiliar in the context of ordinary cargo insurance. The language of the clause as a whole, and in particular the references to Default, were sufficient to disclose its purpose. Nevertheless, even if that were wrong, a reasonably careful underwriter presented with a lengthy and unfamiliar clause of this kind, would be prompted to make further enquiries if interested in the insured's purpose or intention or understanding in relation to the clause.

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He said that that a policy wording, at least when it is subscribed for the first time, must be read by Underwriters. Indeed, the 2012 Code of Practice concerning Contract Certainty requires, as its first principle

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The Judge could not see how an insurer could fulfil this aspect of the Code if it has not taken steps to read the policy wording in order to ensure that all terms are clear and unambiguous.

In short, the Judge decided that the insured has no duty to tell the insurer of unusual policy terms, or to explain their purpose or effect, because (whether in the marine market or otherwise) an insurer can reasonably be expected to read the terms of the policy that he is subscribing. He said, *"indeed, the proposition that underwriters should not read the slips which they sign would in my view come as a surprise to generations of insurance lawyers."*

He added that there was no "moral fault" on the part of the brokers . The TPC was a prominent clause originally presented to the leading Underwriter as part of a three page document - it was not a subtle change that was in any way disguised. Furthermore, the nature of the market was that cargo underwriters could not assume that all policies placed in the market went no further than covering physical loss or damage since various non-damage add-ons (e.g. as here, for delay, for fraudulent document cover and for CEND cover) were common in the cargo market.

Does the broker owe the insured a duty to explain (to Underwriters) any unusual terms?

Turning now to the insured bank's contention that Edge owed it (the bank) a duty to explain the TPC to Underwriters, there was actually no dispute, subject to issues of quantum, that Edge would be liable in the event that the Underwriters' defences based upon rectification/ estoppel/ collateral contract were to succeed (based on the principle applied in *Standard Life v Oak Dedicated*, mentioned above). In relation to two companies, the estoppel defence succeeded and accordingly Edge was liable for the bank's losses arising from their inability to make a successful recovery against them. However, that was not enough to decide the remainder of the case (principally for the bank's unrecoverable costs) against Edge.

Edge's defence included an argument that the TPC had been prepared by the bank's reputable external lawyers, upon whom the bank had exclusively relied in order to secure the desired Default cover. The Judge dismissed this in these terms: *"Edge were well paid. I do not see how alleged lack of reliance by the Bank could provide Edge with a defence to an allegation that it acted in breach of its contractual duties... the Bank was looking principally to [its lawyers, NRF] for advice in connection with the drafting of the wording of the proposed amendments. I also accept that it looked to NRF for advice when questions arose concerning whether and how the 2015 amendments had been incorporated into the policy renewed in January 2016. However, I do not accept that the Bank was looking exclusively to NRF. It is clear that the Bank was looking to Edge for its professional expertise and advice as well... Thus, in my judgment, Edge owed duties to the Bank and these did not reduce, still less disappear, because NRF had drafted the TPC."*

Moreover, the admitted duties did require Edge to tell the bank, at the outset, that the credit risk market was the appropriate market in which to place the cover which the bank was seeking, and (since the individual broker concerned did not have the relevant expertise in that area) specialist brokers within Edge should have been involved. Such advice would have enabled the bank to take an informed decision as to how to proceed.

The Judge went on to hold that, on the facts of the present case, the fulfilment of the relevant duty owed by Edge to its client (i.e. to arrange cover which clearly and indisputably met the client's requirements, and did not expose the client to an unnecessary risk of litigation) did require Edge to discuss with the Underwriters the nature of the cover which was being sought in the TPC (i.e. that it was credit risk cover). This was necessary in order to avoid the potential for future dispute in circumstances where the new cover sought was of considerable importance to the client; the cover had no precedent in the marine cargo market; there did exist an established and different market in which such risks would usually be placed; the underwriters were being asked to write a risk which would materially increase the potential for losses; and where the relevant clause, the TPC, was long and tightly drafted and its full import would not necessarily be grasped by an underwriter on a first reading. The Judge considered that there was a clear rationale for doing so, namely to avoid the scope for dispute later, and to ensure beyond all reasonable doubt that the cover was in place. The rhetorical question was pertinent: "why take the chance, why not just do it?"

The Judge did not reach this conclusion on the basis that the TPC was unclear or ambiguous. The TPC did not lack clarity when carefully read and understood. However, the careful drafting of a clause, in circumstances where that clause was unusual and indeed unprecedented in the market in which the cover was being placed, could not reasonably be relied upon by the broker as providing protection against the unnecessary risk of litigation. This is because the door could and did in a case such as ABN AMRO, remain open for the very arguments that Underwriters in fact advanced.

Those arguments were essentially focused not upon the language of the clause, but other matters which were potentially relevant to the construction of the contract: in particular, the factual matrix relating to the nature of the market in which the cover was placed and the existence of a specialist market for credit risks, and the commercial consequences of the rival constructions for which the parties argued. There was also a risk that credit risk insurance would fall outside the authority of the cargo underwriters who were being approached: in this regard, it was not argued by underwriters that lack of authority provided a defence to the claim, although the limits of authority were referred to in the context of arguments as to the factual matrix and related matters. The significant point, however, was that if there was a risk that the writing of credit risk insurance lay outside the authority of the subscribing underwriters, there was potential scope for a future dispute on the cover if the nature of the TPC was not discussed with subscribing underwriters. The placement of cover, without any discussion with subscribing Underwriters, therefore exposed the bank to the risk of unnecessary litigation.

For these reasons, the Judge decided that Edge failed in its duty to the bank. He rejected Edge's argument that there was no relevant breach of duty because (Edge said) Underwriters' construction arguments were "spurious". He said Underwriters' arguments paid little or no regard to the actual wording of the TPC. However, to the extent that they were based upon the factual matrix and context and the commercial consequences of the bank's construction, they did in his view have sufficient strength as not to warrant being described as "spurious".

The Judge did not consider that his conclusions resulted from the imposition of an unprincipled "duty to nanny" (as Edge's leading counsel described it). He said *"there was nothing in my reasoning or conclusions which was intended to suggest that brokers generally owe duties to their clients to explain particular clauses, including unusual clauses, to underwriters. Ultimately, the question is what was required on the facts of the present case in order to fulfil the duties which Edge admitted i.e. obtaining the cover that was sought, and procuring cover that clearly and indisputably met the Bank's requirements, and so did not expose it to an unnecessary risk of litigation. That question may, and does on the facts of the present case, require brokers – in order to protect the position of their clients – to give information to underwriters, or to discuss the implications of that information, even though the underwriters could not succeed on an avoidance case."*

That was in his view a different question to that which arose in the context of the non-disclosure argument: that non-disclosure question, clearly, was significantly impacted by the Marine Insurance Act 1906 (and would now be similarly impacted by the Insurance Act 2015) whereas the broker's duty to its client was not.

Whether there is going to be an appeal will be made public shortly.

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