Legal Aspects of Delegated Authorities

1 Legal Aspects in Creating the Delegated Authority Contract

The Duty of Disclosure

In entering into a contract that delegates authority to another party one of the issues that arises is whether or not the delegated authority contract is itself subject to insurance law in the same way as a conventional insurance contract. The answer to this is that as the delegated authority contract is a contract to enable insurance contracts to be underwritten rather than an insurance contract. It is not, therefore, subject to insurance law. Thus, it is not subject to the provisions of the Insurance Act 2015 regarding "fair presentation of risk" and prior to that to the principle of "upmost good faith."

In *Pryke v Gibbs Hartley Cooper Ltd* [1991] 1 Lloyd's Rep 602 it was held: "*In creating a delegated authority contract "I do not accept that the…..line slip facility is a contract of the utmost good faith. The contracts "upon speculation" are made when the individual declarations are made under the line slip and the underwriters become bound".*

This was confirmed in *HIH Casualty v Chase Manhattan* [2001] 1 Lloyd's Rep 30: "*certain types of contract albeit not strictly uberrimae fidei, can give rise to something close to an obligation of disclosure"*

Assumption of Responsibility by the Broker

***Pryke v Gibbs Hartley Cooper Ltd* [1991] 1 Lloyd's Rep 602**

Gibbs Hartley Cooper acted as brokers for an MGA in Florida called Atlas. They obtained capacity from the London market led in Lloyd's by the Pryke Syndicate and supported by other Lloyd's syndicates and Excess Insurance Company. The binding authority agreement excluded "financial guarantee" risks, which Lloyd's Syndicates were not authorized to underwrite. The MGA accepted a risk which was a financial guarantee. Mr Pryke was advised of this by a broker from another firm. He instructed Gibbs Hartley Cooper to advise their client to cancel the risk from inception. GHC had a meeting with the client but did not achieve this. The MGA gave 30 days notice of cancellation. When claims arose Mr Pryke brought an action against them. GHC asserted that they were brokers for the MGA and did not owe Mr Pryke a duty of care. The court held that:

When placing a binding authority the broker was acting for the Coverholder. There was no contract between the broker and the insurers to carry out administration of the contract. Brokerage was paid for the introduction of the business, not for servicing the contract. However, the brokers had agreed to carry out additional duties and assumed and owed a duty of care to the insurers.

2 Fiduciary Duties of Coverholders and Brokers

Fiduciary duties are an important aspect of the legal relationship between a coverholder and the insurer for whom they are underwriting business. A fiduciary duty was defined in *Bristol & West Building Society V Mothew* [1996] EWCA Civ 533:

"*A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary… This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal…*"

There is certainly "a relationship of trust and confidence" created by the insurer investing so much in the abilities of the coverholder.

In *Henderson v Merritt* [1994] UKHL 5 it was held that an action could be brought for breach of contractual duties concurrently with an action for breach of fiduciary duty: *"The existence of a contact does not exclude co-existence of concurrent fiduciary duties (indeed the contract may well be their source); but the contract can and does modify the extent and nature of the general duty that would otherwise arise."*

In *Markel International v Higgins and QBE and Amalfi Underwriting v Higgins* [2008] EWHC 1135 (Comm), Mr Higgins had, in 2004, formed Surety Guarantee Consultants (SGC), an underwriting agency that underwrote surety bonds on behalf of Templeton Insurance, an Isle of Man Company. Templeton was not acceptable security for many insureds and SGC brought in Markel, through Mr. Peter Smith, who agreed to underwrite as a co-insurer. Smith imposed certain terms on the underwriting authority: the maximum period for any one bond was 3 years, cover was for UK domiciled risks only, the limit was £1m any one bond, £2.5m any one contractor. Smith subsequently moved to Amalfi, another coverholder, who underwrote for QBE, and he took the SGC account with him. The underwriting authority was in similar terms.

QBE found out that one of SGC's employees, Mr Felstead, who fulfilled a management and administrative role, had been convicted of fraud and had served a three-year prison sentence. The Financial Services Authority had previously told SGC's compliance manager that it would not grant approval for Mr Felstead to carry out 'controlled functions'. QBE were told that in the light of his fraud he would be leaving the company. However, he did carry on with SGC.

SGC abused both binding authorities granted by Markel and Amalfi/QBE and exceeded the agreed limits on its authority. Premiums were siphoned off into a British Virgin Islands registered company owned by three of the four promoters of SGC. Bordereaux sent to Markel and Amalfi were falsified to make it look as if the business was in fact within agreed limits and when an audit was undertaken, some of the bonds that had been written were replaced on the files with dummies. SGC went into insolvent liquidation and claims were made against the individuals concerned, including Mr Felstead. Their defence was to challenge their personal liability; they argued that it was not they who owed fiduciary duties to Markel and Amalfi/QBE, but SGC.

The court rejected this. The three individuals named on the binder plainly owed fiduciary duties personally to Markel and Amalfi/QBE and had breached those duties by perpetrating a fraud. The court also held that those individuals and another, a director of Templeton had committed the torts of knowingly procuring breaches of contract by SGC, dishonestly assisting SGC to commit breaches of fiduciary duty and conspiring to injure their principals using unlawful means.

Another example of where a breach of fiduciary duty arose was in *Sphere Drake v Euro International and others* [2003] 1 Lloyd's IRLR. 52. From 1992 Stirling Cooke Brown (SCB), had been placing reinsurance in the London market for Workmen's Compensation insurance underwritten by US Insurers. This was known as "WC carveout". This had been classified by Lloyd's as short tail business but was really long-tail liability business. In 1997 SCB established Euro International as an MGA to underwrite the business. This gave them more control over the business as well as providing another source of income from the same business through the high rate of commission paid to Euro. Sphere Drake were the reinsurers for whom Euro International were writing the business, almost all of which came from SCB. Sphere Drake thought the business to be underwritten by Euro was traditional Personal Accident business. SCB were, therefore, generating brokerage income from the placing of the reinsurance, and income from the commission paid by Sphere Drake to Euro for underwriting the business. SCB were also able to bring pressure to bear on Euro to underwrite the business at a very marginal profit at a gross level by arranging retrocession cover at very favourable rates so as to produce a net underwriting profit. Retrocession was then placed on that retrocession at a very favourable rate. SCB were, of course, taking brokerage as each retrocession contract was placed, leaving less premium available to meet the losses. This was described by the Judge as "*arbitrage*" or "*net underwriting*", "*deliberately accepting business known to produce losses in excess of the premium charged, on the backs of Reinsurers who would be expected to pay the losses for even less premium*". It was also described as "*pass the parcel*" or "*Russian roulette by proxy*". It also created a "spiral" within the retrocession market.

Euro had underwritten 119 reinsurance contracts on behalf of Sphere Drake, 112 of which were placed by SCB. The gross premiums totalled $25m, and the losses in excess of $250m.

The reinsurers involved in the retrocessions were able to void the contracts as a result of misrepresentation of the business:
"There was obviously a duty to disclose to any reinsurer, the fact that the business to be reinsured with him was being written deliberately on the basis that the business would make a gross loss, with a loss ratio in some cases of many hundreds of per cent (or more than 1,000 per cent); the reinsurer would be expected to pay for those losses but receive a premium that was far less than the premium that had been received by the reinsured …"
(Thomas J)

It was also held that the business had been fraudulently misrepresented to Sphere Drake whose underwriter was not aware that the business would be loss making at a gross level. Euro had also fraudulently understated the premium to Sphere Drake. It was held that the individuals at Sterling Cook Brown and Euro owed a fiduciary duty to Sphere Drake.

There was also comment on the approach of Sphere Drake towards acceptance of the binding authority: *However, although [Sphere Drake underwriter] was deceived and the trust he reposed in [EI underwriter] as a former Lloyd's underwriter was betrayed, the way in which he approached the granting of the binder and his supervision of it was characteristic of the standards prevalent at the time of the Sasse affair at Lloyd's in the 1970s*.

3 Coverholder's Authority and Obligations

The actual authority given to the coverholder is laid down in the agency agreement. However, even if they are not expressly detailed in the contract, there are implied terms. These may include:

- To act with reasonable skill and care
- Always act in the best interest of the principal
- Not to make secret profits
- To act in good faith
- To avoid conflicts of interest
- To act within the terms of authority given
- Personal as well as corporate
- Apparent or Ostensible Authority - no actual authority but the third party would understand that the agent had that authority through the position they had been placed by the principal
- The principal is, therefore, bound by the agent's acts even if these are outside of the actual agreement

Ostensible Authority

One of the difficult areas for insurers is where a coverholder underwrites a risk that is outside the authority that the insurer has given them. If the risk has a claim the insurer cannot deny liability under the policy by reason of the principle of ostensible or apparent authority. This was defined in *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480:

An "apparent" or "ostensible" authority, on the other hand, is a legal relationship between the principal and the contractor created by a representation, made by the principal to the contractor, intended to be and in fact acted upon by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the "apparent" authority, so as to render the principal liable to perform any obligations imposed upon him by such contract. To the relationship so created the agent is a stranger. He need not be (although he generally is) aware of the existence of the representation but he must not purport to make the agreement as principal himself. The representation, when acted upon by the contractor by entering into a *contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract.*

Therefore, even though no actual authority has been given, a third party would understand that the agent had that authority through the position they had been placed by the principal. The principal is, therefore, bound by the agent's acts even if these are outside of the actual agreement. Therefore, where a coverholder has underwritten business outside the terms of the coverholder agreement the insurer will be bound by the coverholder's action. The insurer may then have a right of action against the coverholder, and under most Coverholder Agreements there is a requirement for the Coverholder to have Errors and Omissions Insurance in place.

However, in *Baines and Others v Ewing* [1866] LRR1 Ex 320 Ewing gave authority to a firm of insurance brokers in Liverpool called North, Ewing and Co to underwrite policies on his behalf for a sum insured any one vessel of £1007. North Ewing underwrote a line of £1507 on a policy covering the *City of Brisbane* a ship belonging to the plaintiffs. The plaintiffs were not aware of the limit imposed on the brokers, but it was well known in Liverpool that in nearly all cases there would be a limit of some sort which remained undisclosed to third parties imposed on brokers by their principals. The defendants, on learning what had been done did not ratify the policy. The premium had remained throughout in the hands of the brokers. On several other occasions the brokers had subscribed for amounts beyond the limit, but never, either in this case or any other, to the knowledge of the defendant. It was held that "in fact he only held him out as having the ordinary authority of a Liverpool broker, and when we ask what that authority is, the answer is unfavourable to the plaintiff's claim. It is not necessary to consider what the result would be if there were no limitations notoriously fixed between the principal and the agent."

It was held that the defendant was not liable for the whole amount underwritten, the broker having exceeded his authority, and that the contract where on the action was founded was not capable of division and therefore the defendant was not liable to the extent of £1007.

In *Willis Faber v Joyce* [1911] 27 Times Law Report Rep 338 it was held that Insurers may be liable under a delegated authority where the authority has terminated but they have not advised parties who placed business with the coverholder.

Ratification

However, the insurer may choose to ratify the coverholder's action. Ratification occurs where a principal's agent breaches the authority given by the principal but the principal agrees to be bound by the agent's action. An insurer may agree that, although a risk accepted by a coverholder was outside the terms of the authority given they are nevertheless prepared to ratify the contract. Such ratification may be to the Insured, the Coverholder or both. Where ratification is made to an insured, but not to the coverholder, the insured would still have a right of action against the coverholder. An insurer may only ratify for business that they are authorised to underwrite.

In Great Atlantic Insurance Co v Home Insurance Co [1981] 2 Lloyd's Rep 219, Home gave Heath a reinsurance binding authority. Heath reinsured marine and aviation business underwritten by Great Atlantic. Home contended that there was no actual authority. It was held that they did, but that in any event Home had ratified by delaying in trying to terminate the contract 21 December – 11 June 1980

Ratification may be expressed or implied. In *Suncorp Insurance and Finance v Milano Assicurazioni SpA* [1993] 2 Lloyd's Rep 225, Suncorp was an underwriting agent for a pool of reinsurers led by Milano. Suncorp committed Milano, without their knowledge, to act as a front for others in the Pool, increasing their line from 20% to 32.5%. They had no actual authority to do this under the terms of the agreement, and such a practice is not generally accepted in the London market. Brokers placing business would not have assumed that that an underwriting agents had such authority. The underwriters had not made representations that may give rise to apparent or ostensible authority.

Milano became aware of the breach of contract but took no steps to notify placing brokers acting for reinsureds.

"Milano did adopt and intended to adopt the Suncorp contracts, at least to some extent. It thus seems to me on the basis that it is not possible to ratify in part, they have thus ratified the Suncorp contracts". "A principal may wish to ratify a transaction for commercial reasons so as to preserve his commercial reputation. It is in such circumstances that it seems to me that it should be possible for the principal to ratify as against the third party but not waive any breach of duty as against the agent. There seems no reason to me why the principal should not be able to make his position clear in this regard, in that there are two distinct but connected contractual relations. There is the contract which the agent has purported to make for the principal, and the contract between the agent and the principal." (Waller J)

3. Conflict of Interest

The broker is the agent of the party seeking insurance and they must not allow any other duty to conflict with their obligations to their primary principal. In some circumstances, a broker may act in a dual capacity as agent for both the insurer and the insured, e.g. where the policy provides for notice of the claim to be given to the broker, who would owe a duty of care to the insurer to inform them of the claim, or where the broker is entitled to issue cover notes for temporary insurance on the insurer's behalf. If a conflict is perceived to exist, the broker must obtain the principal's fully informed consent to the broker acting in a dual capacity. In *Anglo-African Merchants Ltd v Bayley* [1970] the court stated that:
"an agent who has accepted employment from one principal cannot in law accept any engagement inconsistent with his duty to the first principal, unless he first makes the fullest disclosure of all material facts to both principals and obtains their informed consent to his so acting"

4. Ownership of Business

A problem that often arises is what happens to the business bound under a coverholder agreement when the coverholder and insurer part ways. There is rarely any term in the coverholder agreement stating who has the right to invite renewal of the individual risks. The answer will very much depend on the circumstances.

***Praet v H G Poland* (1962) 1 Lloyd's Rep 566**

In *Praet v H G Poland* the issue of ownership of the business was raised. The brokers had a binding authority in Lloyd's, but during its currency were able to effect a binding authority with other insurers providing a higher rate of commission. It was held that the business was owned by the insurers.

***Hiscox Underwriting v Dickson Manchester* [2004] EWHC 479 (Comm)**

Dickson Manchester had a Professional Indemnity Binding Authority underwriting on behalf of Hiscox producing £6.5m. DM were acquired by the insurer HCC and wished to place the business underwritten on behalf of Hiscox with HCC at renewal. The binder was cancelled and Hiscox sought access to records in accordance with the terms of the agreement. However, DM were concerned that this would enable Hiscox to obtain contact details of the insureds and of the placing brokers. DM disputed the right of Hiscox to carry out such an inspection as they did not wish Hiscox to be in a position to approach brokers. Arbitration was to take place within weeks, but with income at £500,000 a month an immediate decision was required. The court decided that in accordance with the terms of the agreement Hiscox had a right of access to the records.

***Europ Assistance Insurance Ltd v Temple* [2007] EWHC 1785 (Comm)**

Europ gave authority to Temple to sub-delegate to a large number of coverholders – solicitors effecting legal expenses cover. A dispute led to both parties repudiating the contract. Europ then asked the sub-delagatees (coverholders) to account directly to them rather than Temple. Temple told the Coverholders to continue to deal with them under the Coverholder agreement. Europ sought an injunction to stop Temple from conducting the run-off.

The injunction was refused. The business was Temple's (in particular the relationships with its sub-delegatees) and granting the injunction would damage Temple's legitimate business interests in running off the covers as well as causing confusion amongst the coverholders. Europ's interests could be protected by an award of damages for any loss it suffered because Temple breached its duties to Europ in handling the run-off.

***Temple Legal Protection Ltd v QBE Insurance (Europe) Ltd* [2009] EWCA Civ 453**

Following Europ an underwriting authority to underwrite legal expenses cover was given by QBE to Temple from 1st Jan 2006. Temple were authorised to delegate authority to solicitor coverholders. Solicitors handling claims reported to Temple. The relationship between Temple and QBE quickly deteriorated, particularly when one of Temple's underwriting directors, Mr. Rocco Pirozzolo, resigned in order to take up the position of legal expenses underwriter with QBE.

Temple thought that QBE was trying to steal its business. QBE gave 240 days' notice of cancellation. In August 2006 Temple served notice to terminate the binder and shortly afterwards entered into a binder with a new insurer, IGI, which took effect from 1st October 2006. At that point it stopped writing new business for QBE. On 4th January 2007 QBE wrote to Temple stating that it would assume all claims handling functions relating to policies underwritten by QBE, including the run-off. It also wrote to a number of coverholders asking them to deal directly with it in future. Temple wished to protect its commercial relationship with its Coverholders and asserted that under the contract it had a right to handle the run-off Contracts of insurance were between QBE and individual litigants.'

The relevant clause in the Coverholder Agreement read:

10.2.2 unless otherwise agreed in writing by QBE, Temple shall remain liable to perform its obligations in accordance with the terms and conditions of this Agreement in respect of all insurances bound prior to Termination until every such insurance has expired or has otherwise been terminated…..

Temple again argued that its own commercial interest in maintaining and developing its business was of paramount importance and its authority to act on QBE's behalf was irrevocable. However, It was held that this did not give Temple a right to perform the run-off although they had an obligation to do so if QBE so wished.

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