CONSEQUENCES OF A BROKER'S FAILURE TO ACCOUNT

Equitas Limited V Walsham Bros [2013] EWHC 3264

Equitas, the successor to Lloyd's syndicates writing non-life business for 1992 and all prior years of account, claimed that the defendant broker, Walsham, had received substantial sums which it ought to have remitted, either to the syndicates themselves before September 1996, or to Equitas thereafter. Equitas claimed that it had lost substantial investment income. Walsham acknowledged a duty to remit such sums, but contended that any claim was now time-barred.

Background

During the late 1980s and early 1990s there was turmoil in the Lloyd's market, arising out of syndicates' exposure to crushing long-tail liabilities, including in relation to asbestos and pollution claims from the USA, and also a series of catastrophes. Equitas argued that, during this period, Walsham had failed to remit to syndicates substantial funds which it had received. Such funds fell broadly into two categories, (1) claims received from outward protections placed with reinsurers or retrocessionaires and (2) reinstatement premium due on inwards business.

In cases where Walsham had paid over the funds received after substantial delay, Equitas claimed for loss of investment income. In cases where Walsham still had not paid over the funds received, Equitas claimed both the principal sum and lost investment income.

Nature of the proceedings

The court was requested to determine a number of issues of principle as a step along the way in resolving the dispute. The action proceeded on the basis that Equitas would, in due course, be able to make good its claim that at least some payments were not made reasonably promptly upon receipt and that other payments were not made at all. Equitas asserted that it was entitled to bring a claim as assignee of the syndicates and that duties were also owed directly to Equitas following a settlement agreement in 1996 entered into by market participants as part of a package of agreements giving effect to reconstruction and renewal at Lloyd's.

In summary, Equitas argued that it was entitled to recover damages for Walsham's breach of duties to remit funds reasonably promptly upon receipt, such duties arising as a matter of contract, tort and restitution. Walsham's failure had first occurred more than six years before the commencement of the proceedings. Equitas framed its case in tort as well as contract in order to take advantage of the later expiring limitation period that often characterises a claim in tort, particularly if ss.14 A and B Limitation Act 1980 apply. Equitas also sought to avoid any defence of time-bar by arguing that the duties owed by Walsham were continuing duties, such that a fresh cause of action arose every day that Walsham failed to make a remittance. Alternatively, Equitas argued that there had been deliberate concealment by Walsham, such that the running of the limitation period had been postponed.

Walsham accepted that it was obliged to remit funds received reasonably promptly. It did not accept that it had failed to do so. However, Walsham contended, no doubt in view of the limitation issue, that its duty arose exclusively as an absolute obligation in contract and restitution, but not in tort. Males J made findings as follows:

- **Market understanding of the duties of Lloyd's brokers** – The expert evidence was that the duties owed by Lloyd's brokers were (i) to collect reasonably promptly from the reinsured and pay reasonably promptly to the reinsurers all premiums, net of applicable brokerage and claim refunds, (ii) to 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, (iii) to collect reasonably promptly from the reinsurers all valid claims (and returns of premium) and pay these reasonably promptly to the reinsured and (iv) to administer the reinsurance contract in a professional and business-like manner, including the maintenance and preservation of proper and adequate records, and providing the relevant records, or copies thereof, to the reinsured and to the reinsurers, if requested.

- **Absolute duty** – The judge held that the broker's contractual and restitutionary duty to remit funds reasonably promptly was to be regarded as an absolute duty, not merely a duty to exercise reasonable diligence. It was a general principle of the law of agency that an agent who held or received money for his principal was bound to pay it over or account for it.

  The broker was at the same time performing a contract for the supply of a service, being the collection and remittance of funds on behalf of its client syndicates, with the result that a term was to be implied into the contract between the broker and its client that the broker would carry out that service with reasonable care and skill, pursuant to s.13 Supply of Goods and Services Act 1982. Further, it had been held in Equitas v Horace Holman (2007) hat a broker owes a duty to take reasonable care to maintain proper and adequate records which would allow the syndicates, at any stage, to ascertain the true state of the account with them and what sums were owed to the syndicates by their reinsurers, as well as to preserve and produce such records on request. However, the fact that the broker was additionally under these duties did not derogate from the absolute nature of the obligation referred to above.

- **Duty in tort** – Males J held that the syndicates relied on brokers to administer their reinsurance policies, and that responsibility was assumed and undertaken by brokers. Accordingly, brokers assumed a duty of care towards such syndicates, unless this was inconsistent with, or excluded by, the terms of any contract between the parties.

- **Whether time bar was overcome by the broker owing a continuing obligation** – Walsham was held to be under a continuing obligation to maintain accounts and administer the syndicates' reinsurance policies. In the circumstances, this was not a case where the broker was merely under a once-and-for-all obligation to provide payment on a due date. The broker owed continuing duties to Equitas (no distinction was to be made as to whether the duty arose in contract, tort or restitution). The Judge's decision meant that, in respect of funds held by Walsham, there was in principle a fresh cause of action accruing each day when those funds were not paid over. Therefore, Equitas was entitled to recover damages in respect of Walsham's breaches of its continuing duties in the six years preceding the commencement of the action. Any funds held by Walsham which had not been paid over would be recoverable.

- **Entitlement to compound interest** – Males J approved an earlier authority to the effect that the law proceeds on the basis that the measure of the successful claimant's loss is the cost of borrowing to replace the money of which he has been deprived, regardless of whether the claimant actually did borrow. A conventional rate is used representing the cost to commercial entities similar to the claimant. Males J held that such interest should be compounded on a basis reflecting the commercial terms that would have been available, unless this would produce an unfair result in any specific case.

- **From when does interest run?** – Lloyd's 1988 Code of Practice for Lloyd's Brokers provided that brokers were entitled to interest or investment income earned on funds held in their Insurance Broking Accounts ("IBAs"). However, Males J held that the broker was merely entitled to retain interest earned during the relatively short period until the broker was obliged to remit funds to its client. The action proceeded in accordance with Equitas's understanding that, pursuant to the usual procedures of the market, payment ought to have been remitted by at least the first day of the month, two months after the month in which funds were actually received by the broker.

- **Investment income** – It had been foreseen and widely publicised at the time of reconstruction and renewal that Equitas, with its economy of scale and ability to invest on a longer term basis than syndicates with their 36 month period of account, should be able to obtain investment returns significantly better than those previously achieved by individual syndicates. Therefore Equitas, rather than claiming interest on funds not remitted after September 1996, claimed damages for lost investment income by reference to the actual investment returns it had achieved. Males J held that Equitas was entitled to recover on this basis.

  However, the judge was at pains to emphasize that the issue had only been the subject of limited argument before him. The only reason advanced as to why Equitas should not, in principle, recover its lost investment income had been that the damages were too remote. Walsham had not, for example, argued that Equitas had failed to mitigate by borrowing in the market to make good the payments which Walsham had failed to remit, which would then have enabled Equitas to use the borrowed funds to achieve its investment return. Because that case had not been advanced, it had not been necessary to consider whether Equitas would have had a good answer, to the effect that failure to borrow funds to replace what it did not know was missing could hardly be regarded as a failure to mitigate. Walsham had also accepted that the improved investment return which Equitas was expected to achieve was within the parties' reasonable contemplation.

  In terms of how far back Equitas could go in claiming interest and damages for loss of investment income, the judge pointed out that this would not necessarily extend back to losses arising from breaches committed more than six years prior to commencement of the proceedings. This would depend on whether Equitas succeeded on any of its additional limitation arguments, such as deliberate concealment.

Implications

Subject to any appeal, this case should assist clients to obtain compensation from insurance and reinsurance brokers. The case clarifies that the broker's duty to remit funds reasonably promptly is absolute and not merely a duty to exercise reasonable diligence. Further, brokers are liable to pay compound interest on funds retained beyond the point at which such funds would normally be remitted. The decision also illustrates that funds can be recovered from brokers even when the broker first breached its duty to pass on funds more than six years prior to the commencement of proceedings. Finally, damages for lost investment income may be available in respect of funds remitted late.