It's Cocoa, Jim, but not as we know it:

Court's modern interpretation of underwriters' and brokers' duties

#2. The underwriters' defence

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An overview of the case

In this series of articles we take a look at the decision in *ABN Amro Bank N.V. v Royal & Sun Alliance insurance plc and 13 Underwriters and Edge Brokers (London) Limited*. In this article we look at the underwriters' defence strategy. The remaining articles will focus on particular areas of the case, these will be:

- Brokers' duties
- Witness evidence

A modern show of the historic defence strategy at its worst, or should that be best? We'll let you decide.

In our previous article we set out the main details and background to the decision in *ABN Amro Bank N.V. v Royal & Sun Alliance plc and 13 Underwriters and Edge Brokers (London) Limited*, in which RPC acted for Edge. Here we explore the defence strategy deployed by the Underwriters and the pitfalls in its execution.

You may recall that the initial defence of the Underwriters, before proceedings were issued, was the argument that the policy did not respond as the Transaction Premium Clause (TPC) did not extend cover to credit risks and was only concerned with the basis on which insured goods which had been subject to physical loss or damage (PLOD) were to be valued.

However, as the litigation progressed, Underwriters added more and more defences. They introduced a factual dispute regarding what happened at meetings between the broker and the lead underwriter; issues of rectification, collateral contract, lack of authority to bind and the effects of the General Underwriters Agreement (GUA) and estoppel were included; and about six months before trial, Underwriters purported to avoid the policy altogether based on non-disclosure of policy terms that were contained within the policy document shown to each underwriter. Underwriters also included defences based upon alleged breaches of the Sue and Labour clause by the Bank, and an argument that the lack of quality checks on the cocoa products was the true cause of the Bank's loss. In other words, Underwriters deployed a "kitchen sink" defence.

Non-disclosure of the TPC

Underwriters' defences were centred on the TPC itself. As well as disputing the construction of the clause (on which the judge rejected Underwriters' argument outlined above), Underwriters argued that the TPC was an unusual risk which would not be familiar to a marine cargo underwriter. They argued that a cargo underwriter could not be expected to appreciate that the purpose of the clause was to introduce cover for credit risks. Accordingly, the broker should have disclosed to Underwriters not only the existence of the TPC but also its intended meaning.

Both the Bank and Edge submitted there was no such obligation to disclose to underwriters the broker's or insured's subjective intention or understanding as to the meaning of a clause, as "an insurer is presumed to know its own business and to be able to form its own judgment on the risk as it is presented".

The Judge agreed with the Bank and Edge on this issue. He found that an obligation on the insured to offer its views as to the effect and meaning of the terms proposed "would require the insured to estimate the risk for the underwriter" and that "the contractual effect of the clause is a matter on which the underwriter should form his own view".

Even though the TPC was agreed to be an "unusual" clause in a marine cargo policy, the Court found that underwriters had received all of the necessary information for them to make their decision. The wording containing the TPC was in front of the underwriters, who were able to make any enquiries they thought were necessary.

Along similar lines, some Underwriters argued that it was against their internal policies to underwrite credit risks, and therefore they could not underwrite credit risks and had not in fact done so. This defence also failed – it is for the underwriter to check the risks they are signing up to cover.

Non-disclosure of the NAC

Non-disclosure arguments were also raised in respect of a Non-Avoidance Clause (NAC), which stated that Underwriters could not avoid the policy for non-disclosure or misrepresentation unless it was fraudulent. As fraud was one of the arguments that Underwriters did not throw in the "defence hat", it was argued instead that the NAC was such a material clause that its mere presence in the policy required express "disclosure", even though the NAC appeared in the policy slip shown to all of them at renewal.

The court rejected this defence. It reiterated that it is the underwriter's role to read the policy and interpret the terms within. Any questions about the terms of the policy can be raised before the underwriter puts down his or her stamp.

Affirmation

Even if the underwriters had been successful in each and every argument they raised in respect of avoidance, they still would have been unable to avoid the policy. This was because the Court found Underwriters had affirmed the validity of the policy by filing their original Defence and Counterclaim without raising an avoidance case or reserving their rights to do so.

It is true that Underwriters sought to reserve their rights in pre-action correspondence. However, no such reservation was included in their original Defence, which was based on arguments that asserted and relied upon the validity and continued existence of the policy (such as the construction arguments discussed previously).

The legal principles of affirmation were not in dispute. If a party elects to affirm, it must be communicated in clear and unequivocal terms and the underwriter must have full knowledge of the facts entitling them to avoid the policy. If underwriters wish to keep the right to avoid a contract of insurance alive, they must reserve their rights and keep doing so on any occasion which might otherwise be regarded as affirmation of the policy.

The unreported case of *Barber v Imperio Reinsurance Company UK Ltd* (15 July 1993) finally gets the recognition it deserves in this judgment. The Court found that the underwriters were in possession of all the relevant facts at the time the original Defence was served in February 2019. Underwriters were therefore held to have affirmed the policy in serving the Defence and therefore were unable to avoid the policy.

This conclusion was supported by the fact that Underwriters had not offered to return the premium until the amended Defence (raising the avoidance case) was served in 2020.

Commentary

The moral of the story is to ensure that, if you need to reserve your rights, continue to do so at every occasion to avoid unintentionally affirming the policy by failing to do so!

Underwriters must ensure they always read the policy and do not rely on others, such as brokers, to highlight certain clauses. If there are any concerns over the interpretation or meaning of any clause, make sure questions are raised prior to inception. "Kitchen sink" defences are often used but care must be taken so as not to include bad points which taint arguable ones.

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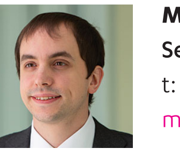

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