FROM:	Secretary to Lloyd's Disciplinary Board
LOCATION:	58/NW1
EXTENSION:	5530
DATE:	6 June 2000
REFERENCE:	51/2000
SUBJECT:	**SEDGWICK ENERGY LIMITED AND SEDGWICK ENERGY AND MARINE LIMITED**
SUBJECT AREA(S):	Formal Disciplinary Proceedings – Case Nos. LDB/0005/03 and 04
ATTACHMENTS:	Notice of Censure
ACTION POINTS:	**For information**
DEADLINE:	**None**

Sedgwick Energy Limited has admitted three charges of misconduct and Sedgwick Energy and Marine Limited has admitted one charge of misconduct, in each case of conducting insurance business in a discreditable manner or with a lack of good faith.

At the relevant time, both companies were registered Lloyd's brokers and wholly owned by Sedgwick Limited (formerly SG Services Limited). The events in question occurred before Marsh & McLennan Companies, Inc. purchased the Sedgwick Group.

As a result of these proceedings, the following penalties have been imposed jointly on Sedgwick Energy Limited and Sedgwick Energy and Marine Limited:

i) a fine of £250,000; and
ii) censure in the terms of the attached Notice of Censure.

The companies have jointly agreed to pay Lloyd's costs in the amount of £50,000.

Details of the events giving rise to the charges are set out in the attached Notice of Censure.

This case was determined by Lloyd's Disciplinary Board and its decision gives effect to a settlement of these proceedings agreed between Sedgwick Energy Limited and Sedgwick Energy and Marine Limited and the Council pursuant to paragraph 3 of the Lloyd's Disciplinary Rules (Schedule 2 of the Disciplinary Committees Byelaw (No. 31 of 1996)).

This bulletin has been sent to all underwriting agents, Lloyd's brokers, corporate members, and market associations and to the ALM and recognised accountants.

AP Barber
Secretary
Lloyd's Disciplinary Board.

Lloyd's Disciplinary Board **Case nos.: LDB/0005/03**
LDB/0005/04

NOTICE OF CENSURE

SEDGWICK ENERGY LIMITED
and
SEDGWICK ENERGY AND MARINE LIMITED

Sedgwick Energy Limited and Sedgwick Energy and Marine Limited have admitted to misconduct in relation to the placing of a stop loss policy for its client, PDV Insurance Company Limited, in 1994 and in relation to the subsequent accounting for that policy.

Sedgwick Energy and Marine Limited took over the business of Sedgwick Energy Limited on 1 January 1996. These companies (together defined as "SEL") were at the relevant times registered Lloyd's brokers and agency brokers for their parent company Sedgwick Limited (formerly SG Services Limited). The events in question occurred before Marsh & McLennan Companies, Inc. purchased the Sedgwick Group.

PDV Insurance Company Limited was at the relevant time, and is, the Bermudan-based captive insurance company of Petroleos de Venezuela SA, an energy corporation owned by the State of Venezuela (these companies together defined as the "clients").

The disciplinary charges laid against SEL, and admitted, contain 4 separate counts of misconduct, in each case namely:

> ***Conducting insurance business in a discreditable manner or with a lack of good faith under paragraph 1(e) of the Misconduct, Penalties and Sanctions Byelaw (No. 9 of 1993).***

The following penalties have been imposed on SEL:

(i) a fine of £250,000; and

(ii) censure in the terms of this Notice of Censure.

SEL has agreed to pay Lloyd's costs in the amount of £50,000.

Summary of the facts and misconduct

1 In Autumn 1993 SEL were appointed as brokers and agents by the clients and their associated companies following a tender process. Under the letter of appointment, SEL were selected to place the 1994 insurance programme of the clients and their associated companies and to provide other services for an agreed fixed annual fee. SEL then placed the main insurance programme for 1994 and following this the stop loss policy, led by Lloyd's underwriters, under a line slip (the "line slip") arranged by SEL.

2 The standard brokerage and administration fee arrangements in relation to risks placed under the line slip were set out in the line slip. The line slip provided for brokerage of 15% of the gross premium (unless otherwise agreed) and an administration fee of 5% on the net premium (i.e. after deduction of brokerage).

SEL's total remuneration under the line slip was therefore 19.25% of gross premium, unless otherwise agreed.

3 In relation to the stop loss policy, SEL set out the remuneration arrangements in an endorsement, which was agreed with the leading underwriter only. The endorsement varied the standard arrangements of the line slip. The typescript in the endorsement provided for a reduction in the standard brokerage allowed by the line slip to reflect a reduction of 5% in the premium charged to the clients. SEL amended the endorsement in manuscript to convert the brokerage which remained to what was described as an "administration fee" and then placed this endorsement with the leading underwriter. The amended endorsement therefore provided for a 15% "administration fee", which amounted to approximately US$506,000.

4 The endorsement was prepared, amended and placed without the clients' knowledge, contrary to SEL's obligations of utmost good faith and integrity. By placing the stop loss policy and agreeing with underwriters to receive remuneration for this placement in this way, without raising the matter with the clients, SEL concealed from the clients the fact that they had earned remuneration in addition to the fixed annual fee.

5 SEL had quoted the stop loss premium gross of the standard brokerage and fees of 19.25% of gross premium, whereas they knew that PDVSA intended that all quotes should be net of brokerage and fees. The quotes were prepared in circumstances where the benefits of the stop loss policy (as SEL itself pointed out to the clients) were finely balanced. Consequently, the clients were unable to take an informed decision on whether or not to purchase the policy.

6 In quoting, SEL informed the clients that it had sought alternative markets, other than the line slip in question, but that none had proved competitive. In fact no alternative quote had been sought and this statement was untrue.

7 In April 1994, SEL sent to the clients the cover note and debit note for the stop loss premium. The debit note described the premium due as "Net amount due", which was misleading, because the premium was gross of the remuneration wrongfully retained by SEL. The clients paid the premium debited in April 1994.

8 In mid-1994, the clients reminded SEL that per the fixed annual fee agreement SEL should not charge commissions in any premiums quoted to the clients or their affiliates. In reply, SEL confirmed that no commissions had been taken, having affirmed their understanding of the fixed annual fee arrangement. What SEL told its clients was untrue.

9 In late 1994 to mid-1995, SEL identified a number of accounting errors relating to the stop loss. As a result, SEL made a payment of US$143,000 to underwriters out of monies initially retained as remuneration in excess of the amount agreed with the leading underwriter in the endorsement. This followed detailed review within SEL of the processing of the stop loss closings. SEL continued to retain remuneration of some US$506,000 contrary to the fixed annual fee agreement and without the knowledge or consent of the clients.

10 During the course of 1995, SEL was in negotiation with the clients to produce a service agreement (which negotiations had started in 1993) setting out the services which the Sedgwick Group would provide on an annual basis for an agreed annual

fee. A draft of the agreement produced by the clients provided for the disclosure of any commission, fee and/or payment received from third parties for the placement or renewal of risks. During the negotiations, one of the amendments suggested by SEL, to which the clients agreed, was that the service agreement should apply as from the 1995 programme and not to the 1994 programme (as the clients had intended). This suggestion was made in the knowledge that SEL had wrongfully retained remuneration on the stop loss policy in relation to 1994.

11 In March 1996, the clients sent to SEL a statement of account and a request for confirmation that all commissions, fees and/or payments received from the third parties (including reinsurers) in relation to the 1994 and 1995 programmes had been fully disclosed and paid to the clients.

12 As a result of this letter, SEL disclosed to its clients in August 1996 that it had wrongfully retained remuneration of US$355,000 on the 1994 stop loss. The explanation that SEL gave as to why they had retained this amount was materially misleading. SEL described this amount as brokerage and did not disclose that they had converted it to an "administration fee" by the endorsement agreed with the leading underwriter. SEL credited the amount of US$355,000 to its account with the clients.

13 SEL did not specifically disclose that, in addition to the amount of US$355,000, it retained an amount of some US$151,000 which it treated as a 5% administration fee on the net premium. SEL made a general disclosure in the following terms:

> *"…we are sometimes paid fees by the insurance market for the establishment and administration of general market facilities. These are payments made to us by underwriters in return for administering and managing those market facilities on their behalf and as such, are entirely separate from arrangements with our clients…"*

14 In circumstances where SEL, pursuant to the amended endorsement, converted brokerage to an "administration fee", there was no logical reason for SEL's decision to disclose only part of this sum retained, namely US$355,000 but not the balance of US$151,000.

15 The amount of remuneration retained by SEL in relation to the stop loss policy was material both in relation to the stop loss premium and in relation to the fixed annual fee agreed with PDVSA for 1994.

16 The available evidence in relation to the role of those involved in dealings with the clients was conflicting and inconsistent. However, regardless of individual responsibility, SEL in accepting the penalty in this case, has recognised its corporate failure which it knew or ought to have known would lead to the clients being misled.

17 SEL took disciplinary action against Stewart Johnston, Peter Hamlyn Gilbert, who were both directors of SEL throughout the relevant period, and James Bogue in respect of their failures to keep the clients properly informed and for not keeping proper records of discussions and decisions. Such action should not be seen, however, as an admission or an implication of any more serious misconduct.

LLOYD'S DISCIPLINARY BOARD