

# LIABILITY OF INSURANCE INTERMEDIARIES

## Issues and Perspectives

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## PREFACE

The landscape surrounding agent and broker liability issues seems to be perpetually shifting. What remains clear is that the number of claims against insurance professionals and insurance companies appears to be rising. This can be attributed to a number of factors, some acting in concert, some independently, but not the least of which are: the increasing complexity of the insurance products and business environment in which they are offered; the increasing sophistication of business transactions (and the knowledge base of the people involved in them); statutory and regulatory changes; and divergent interpretations by courts of review across the country. Unfortunately, this makes it very difficult to find a single coherent theme when analyzing agent and broker liability issues across the United States. Nevertheless, it is our hope that, by looking at the disparate treatment of agent and broker liability in different jurisdictions (via statute, case law or a combination of both), we can further a general understanding of key issues and, perhaps more important, help insurance intermediaries minimize the likelihood that they will find themselves facing an errors and omissions claim or lawsuit.

### AGENTS / BROKERS / PRODUCERS - DEFINING THE ROLES OF INSURANCE INTERMEDIARIES

The general principles of the law of agency will typically apply to insurance companies and their agents. In this context, the term "agent" is not merely a description of a person's job title, but a legal term of art with specific legal implications. The law will tend to use the term "agent" much more broadly than one might expect and will look to the actual relationship between the parties to define a particular person's role in a transaction, usually without any regard to what titles or labels parties ascribe to themselves.

In an E&O claim against an agent or broker, it is vital to first determine what role the individual played in the transaction in question

Many state statutes alter or even eliminate (as is the case in Illinois) traditional classifications of insurance intermediaries as general agents, soliciting agents and brokers. Many states do have separate licenses for "agents" and "brokers" while some reject those labels and use the term



“producer.” Illinois, for instance, does away with any distinction between agents and brokers, and uses the term “producer” to describe the activities traditionally undertaken by both agents and brokers.

Typically, in the insurance business, a broker is a licensed independent contractor who represents buyers (applicants) for insurance (primarily property and liability insurance) and who deals with either insurance companies or insurance agents in obtaining the insurance coverage which the insurance buyer wants. Customarily, a broker gives the insurance buyer “customer service” regarding insurance coverage requirements, modifications of coverage, renewals, and the like.

Although the broker arranges insurance coverage for his or her customer, the broker usually receives a commission from the insurer. Acting as independent advisers, some brokers receive consulting fees from customers who seek the broker’s advice and services.

As a general legal rule, an insurance broker is the agent of the buyer/insured, and an insurance broker is not the insurer’s agent (except the broker is sometimes the insurer’s agent for the purpose of receiving the first premium). Consequently, insurers are usually not contractually liable for a broker’s representations, promises, or other acts in contracting. The absence of contractual liability does not, however, end the analysis. A “broker” may nevertheless be found to bind an insurance company under certain circumstances based on the particular conduct in question and the nature of the relationship.

Whether a broker represents the insurer or insured turns on the discrete facts of each case and the particular function being performed (or error committed).

### Who (or What) Is an “Agent?”

The terms “agent” and “broker” are not mutually exclusive. For example, the Restatement of Agency declares that: A person may even be both an agent and a broker, and at different times act in different capacities, sometimes representing the applicant for insurance and at other times acting for the insurance company. Thus, there can be situations in which the agent owes fiduciary duties to the insurer while the broker owes similar duties to the client so as to render the broker liable for its negligent failure to obtain coverage.



Establishing the distinction between an insurance agent and a broker is often crucial as it determines who is owed a duty (whether it is narrowly or broadly defined) by the insurance representative. If the representative is considered to be only the insurer's "agent," then he or she may not owe any duty to a policyholder.

An "agency" relationship is defined by the law as the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act. The one for whom action is to be taken is the principal. The one who is to act is the agent.

The existence of a fiduciary or "special" relationship encompasses heightened duties of care by which the agent must abide.

To help define the relationship in question:

- Look to the terms of a written or oral agency agreement
- Determine for whose benefit the intermediary was acting with respect to the specific matter at issue (e.g., placing insurance, setting terms, collecting premium)

Agency law acknowledges that, if the agent breaches a duty owed to the principal, that breach creates a claim for the principal against the agent.

However, that principal's claim against its agent does not eliminate its duties to third parties. Therefore, an agency relationship has legal consequences as between the principal and the agent, between the principal and third parties and between the agent and third parties.

The following rules summarize an insurance intermediary's potential agency duties and responsibilities:

- 1) An insurance producer owes its principal fiduciary duties of the highest good faith, loyalty, candor, and honesty;
- 2) An insurance producer may not proceed without or beyond its authority; and,
- 3) If the insurance producer's actions exceed its authority and cause loss to its principal, the producer is fully accountable to the principal for resulting damages.



## PROFESSIONAL DUTIES OWED BY INTERMEDIARIES

The general rule is that an insurance agent (and remember that “agent” in this context is as defined by the law of agency, not the traditional industry notion of an insurance agent), simply by undertaking to function as an insurance agent, assumes a professional duty of care in the services he or she provides to a client.

An individual who holds himself out as having professional expertise in a given field is expected to conduct his or her affairs in the manner expected of similar professionals. An insurance agent has an affirmative duty to exercise that skill and care which a reasonable and prudent person engaged in the insurance business would use under similar circumstances.

Beware of emails – they are usually discoverable and contain information that can easily be taken out of context

For example, a person who represents himself or herself as having expertise in insurance is expected to be able to do more than simply fill out an application form, and an insurance professional who represents that he or she possesses the skill needed to arrange a complex package of insurance coverages for a business will be expected to perform this task in a manner commensurate with the skills represented.

An agent has a duty faithfully to carry out the client’s instructions. An agent or broker must therefore diligently procure and, if requested, maintain, the specific type of coverage sought by the policyholder.

An agent who specifically assumes extra duties for increased compensation must perform these duties in the manner agreed upon with the policyholder, and the agent is required to fulfill an express or implied contract to take on additional responsibilities beyond just procuring or maintaining coverage. These additional duties may give rise to claims alleging both breach of contract and negligence.

Agents and brokers may also be held to a heightened standard of care if they hold themselves out to the insurance- buying public as possessing special expertise, knowledge or skill in the field of



insurance. For example, an Arizona appellate court held that an agent, who expressly held himself out as an insurance professional, was liable for failing to advise a policyholder of the need for employee dishonesty coverage. Although the policyholder did not request this form of coverage, the court found that the agent must be held to a standard of care beyond the “exercise of reasonable care, skill and diligence in procuring insurance coverage” because an insurance agent holds himself or herself out to

the public as a specialist. Insurance producers (like doctors, lawyers or other professionals) may be held to the degree of skill and expertise which he or she affirmatively claims to possess. Remember, too, that, once an agency relationship is found, the law will likely impose fiduciary duties on the agent.

### Duties to Insured – General Considerations

A producer employed to procure insurance for his principal is under a duty to exercise good faith, reasonable skill, and ordinary diligence to secure the insurance on the best terms obtainable. An agent (or a broker) who accepts a customer’s order to insure must not exceed his or her authority or depart from his or her instructions. In doing so, the agent is obligated to exercise the strictest veracity, candor, and good faith both toward the agent’s employer/insurer and the insured.

It is also wise for broker or agent to keep the principal/insurer fully and promptly informed of all material knowledge and facts possessed by him relating to the risk, or to the business entrusted to his care or done by him, which it is important that the principal should know. Such information should be thorough and accurate. Further, an insurance agent or broker may be liable to an insured person because of the manner in which the agent or broker executes an insurance contract or undertakes an obligation.

Additionally, although an insurance broker owes duty of care to its customer, that duty is not unaffected by conduct of the customer. Insurance brokers are under a duty to exercise care that reasonably prudent businessmen in brokerage field would exercise under similar circumstances and if broker fails to exercise such care and if such failure is direct cause of loss to customer, he is liable for such loss. This liability can, under certain circumstances, be vitiated or mitigated if the



customer is also guilty of failure to exercise the care of a reasonably prudent businessperson for the protection of his own property and business which contributes to happening of the loss.

### Duty to Explain/Advise

Overall, an insurance agent or broker who accepts a customer's application to insure must exercise reasonable skill and ordinary diligence. Depending on all the objective surrounding circumstances, an agent's or broker's general duty of care, diligence and reasonable skill may obligate the agent or broker to advise an applicant or an insured about the particular insurance coverages available.

Based on the reasonable expectations of its customers, a professionally licensed agent or broker is usually considered more than a mere "order taker." A licensed insurance agent or broker will be held to the duty of functioning with the skill and competence of a reasonable insurance agent. A producer who breaches that duty can be held liable for the resulting damages notwithstanding the amount of advice and counseling provided or the scope of the services it provided. Some jurisdictions hold that a broker who customarily represents only the applicant or insured should have affirmative duties to explain, advise, and counsel the broker's customers, while other states reject the imposition of such a duty to explain a policy's specific terms and conditions.

A Nebraska decision highlights the tension between the duty to advise and its opponents, noting that several other jurisdictions had staked out two opposing positions: some jurisdictions flatly reject the idea of an intermediary's duty to explain policy terms to an insured, while others recognize a duty to explain in certain circumstances. The court in that case ultimately found the middle ground, and held:

On the one hand, insurance agents should not carry the overwhelming responsibility of explaining to insureds every provision of every policy. On the other hand, insurance agents should not be able to avoid exercising a reasonable amount of care for their clients. . . . It is undeniable that many insurance contract provisions are not written in plain English and cannot be understood without some level of expertise. We therefore find most persuasive those cases which recognize that an agent has a legal duty to explain policy terms, but also require certain circumstances to trigger that duty. The triggering circumstances cannot be stated as an arbitrary list, but must, of necessity, be developed on a case-by-case basis (emphasis supplied).



*Dahlke v. John F. Zimmer Insurance Agency*, 515 N.W.2d 767 (Neb. 1994).

Many courts apply a similar analysis, and, accordingly, there can be a number of decisions in any given jurisdiction concerning an insurance professional's duty to advise (or lack thereof). These court opinions sometimes apply to advice about which insurance policies should have been purchased, as well as the advice about what insurance coverage is contained in the insured's existing policy.

### **Representative Decisions Holding That an Agent Has Some Duty to Advise**

Conn. - *Dimeo v. Burns, Brooks & McNeil, Inc.*, 6 Conn. App. 241, 504 A.2d 557 (1986), cert. denied.

Ga. - *European Bakers, Ltd. v. Holman*, 177 Ga. App. 172, 338 S.E.2d 702 (1985).

Ill. - *National Boulevard Bank v. Brokerage Resources, Inc.*, 42 Ill App. 3d 940, 356 N.E.2d 988 (1976)

Ind. - *United Farm Bureau Mut. Ins. Co. v. Cook*, 463 N.E.2d 522 (1984).

Minn. - *Campbell v. Valley State Agency*, 407 N.W.2d 109 (1987)

La.- *Durham v. McFarland, Gay & Clay, Inc.*, 527 So. 2d 403 (1988).

Tex. - *Northern Assur. Co. v. Stan-Ann Oil Co.*, 603 S.W.2d 218 (1979).

### **Representative Decisions Concerning the Lack of a Duty to Advise**

Ark. - *Scott-Huff Ins. Agency v. Sandusky*, 318 Ark. 613, 615 (1994).

Cal. - *Fitzpatrick v. Hayes*, 57 Cal. App. 4th 916, 67 Cal. Rptr. 2d 445 (1997).

Colo. - *Apodaca v. Allstate Ins. Co.*, 232 P.3d 253, 259 (2009).

Ill. - *Bernier v. Transamerica Ins. Co.*, 215 Ill. App. 3d 118, 124 (1991).

Kan. - *Marshall v. Donnelly*, 14 Kan. App. 2d 150, 783 P.2d 1321 (1989).

Mass. - *Robinson v. Charles A. Flynn Ins. Agency*, 39 Mass. App. 902, 653 N.E.2d 207 (1995).

Mich. - *Pressey Enters. v. Barnett-France Ins. Agency*, 271 Mich. App. 685, 687 (2006).

Minn. - *Klimstra v. State Farm Auto. Ins. Co.*, 891 F. Supp. 1329 (1995).

Mo. - *Farmers Ins. Co. v. McCarthy*, 871 S.W.2d 82 (1994).

N.H. - *Dewyngaerdt v. Bean Ins. Agency*, 151 N.H. 406 (2004).

N.Y. - *Wied v. New York Cent. Mut. Fire Ins. Co.*, 208 App. Div. 2d 1132, 618 N.Y.S.2d 467 (1994).



N.D. - *National Farmers Union Standard Ins. Co. v. Souris River Tel. Mut. Aid Co-op.*, 75 F.3d 1268 (8th Cir. 1996)

Tex. - *Environmental Procedures, Inc. v. Guidry*, 282 S.W.3d 602, 627 (2009).

Was. - *Gates v. Logan*, 71 Wn. App. 673, 678 (1993)

Wis. - *Tackes v. Milwaukee Carpenters H Fund*, 164 Wis. 2d 707, 476 N.W.2d 311, 313 (1991).

Wyo. - *Small v. King*, 915 P.2d 1192 (1996).

Vt. - *Booska v. Hubbard Ins. Agency, Inc.*, 627 A.2d 333 (1993).

### Duty to Procure Insurance

The general insurance rule is that an insurance agent or broker who undertakes to procure insurance for another and fails to do so may be held liable for damages resulting from the failure to procure insurance.

The following are opinions from representative jurisdictions that discuss the general issues concerning the duty to procure insurance.

Fla. - *First Nat'l Ins. Agency v. Leesburg Transfer & Storage, Inc.*, 139 So. 2d 476, 480 (1962).

Ga. - *Beavers Ins. Agency, Inc. v. Roland*, 135 Ga. App. 263, 217 S.E.2d 484 (1975).

Iowa - *Wolfswinkel v. Gesink*, 180 N.W.2d 452, 456 (1970).

Ind. - *Bulla v. Donahue*, 366 N.E.2d 233 (1977).

Me. - *Bramson v. Chester L. Jordan & Co.*, 379 A.2d 730 (1977).

Mo. - *Kap-Pel Fabrics, Inc. v. R. B. Jones & Sons, Inc.*, 402 S.W.2d 49 (1966).

N.C. - *Alford v. Tudor Hall & Assocs.*, 75 N.C. App. 279, 330 S.E.2d 830 (1985).

N.J. - N.J.S.A. 2A:15-2 ; R. 4:27-2. *Eschle v. Eastern Freight Ways, Inc.*, 128 N.J. Super. 299, 319 A.2d 786 (1974).

Pa. - *Aresto v. National-Ben Franklin Fire Ins. Co.*, 184 Pa. Super. 114, 133 A.2d 304 (1957).

Or. - *Martini v. Beaverton Ins. Agency*, 314 Ore. 200 (1992)

D.C. - *Adkins & Ainley, Inc. v. Busada*, 270 A.2d 135 (1970).

In situations where a plaintiff establishes that he or she would have been insured under a requested policy contracted for by someone else, he or she can maintain action against an insurance agent for its alleged negligence in failing to obtain insurance as a third-party beneficiary



to the contract. A complaint setting out such agreement, failure to secure insurance, and resulting damages is legally sufficient in most jurisdictions. See discussion below regarding potential liability to third parties.

The following are opinions from representative jurisdictions that discuss the legal sufficiency of complaints alleging the different theories one may pursue against a producer for failure to properly secure coverage.

Ala. - *Highlands Underwriters Ins. Co. v. Elegante Inns, Inc.*, 361 So. 2d 1060 (1970).

Idaho - *Keller Lorenz Co., Inc. v. Insurance Associates Corp.*, 98 Idaho 678, 570 P.2d 1366 (1977).

Ill. - *Wheaton Nat'l Bank v. Dudek*, 59 Ill. App. 3d 970, 376 N.E.2d 633, 17 Ill. Dec. 487 (1978).

Me. - *Bramson v. Chester L. Jordan & Co.*, 379 A.2d 730 (1977).

N.C. - *Johnson v. George Tenuta & Co.*, 13 N.C.App. 375, 185 S.E.2d 732 (1972).

Ohio - *Thomas v. Connally*, 43 Ohio Misc. 5, 332 N.E.2d 87 (1974).

Or. - *Arley v. Chaney*, 262 Or. 69, 496 P.2d 202 (1972).

Wash. - *Anderson Feed & Produce Co. v. Moore*, 66 Wash. 2d 237, 401 P.2d 964 (1965).

### **Representative Decisions Concerning the Negligent Failure to Effect Insurance or Issue a Policy**

Ala. - *Highlands Underwriters Ins. Co. v. Elegante Inns, Inc.*, 361 So. 2d 1060 (1978).

Cal. - *Lippert v. Bailey*, 241 Cal. App. 2d 376, 50 Cal. Rptr. 478 (1966); *G.T.S. Co., Inc. v. Russell, Gleason & Van Rooy, Inc.*, 84 Cal. App. 3d 626, 148 Cal. Rptr. 786 (1978).

Ga. - *Wright Body Works, Inc. v. Columbus Interstate Ins. Agency*, 233 Ga. 268, 210 S.E.2d 801 (1974), on remand, 133 Ga. App. 727, 213 S.E.2d 25 (1975).

Ill. - *Roberson v. Knupp Ins. Agency*, 125 Ill. App. 2d 373, 260 N.E.2d 849 (1970).

Iowa - *Smith v. State Farm Mut. Auto. Ins. Co.*, 248 N.W.2d 903 (1976).

La. - *Arceneaux v. Bellard*, 149 So. 2d 444 (App. 1963), writ refused, 244 La. 154, 150 So. 2d 771.

Md. - *Hampton Road Carriers, Inc. v. Boston Ins. Co.*, 150 F. Supp. 338, 343 (1957).

N.C. - *FliBack Co., Inc. v. Philadelphia Mfrs. Mut. Ins. Co.*, 502 F.2d 214 (4th Cir. 1974).

Wash. - *Hellbaum v. Burwell and Morford*, 1 Wash. App. 694, 463 P.2d 225 (1969).



### **Duty to Notify Insured Regarding Coverage**

The general insurance rule is that an agent or broker has an affirmative duty to make reasonable efforts to notify an applicant or insured about insurance coverage.

An insurance agent has affirmative duty to notify its client if agent is unable to continue previous coverage and thus agent may be held liable for failing to inform the insured that a replacement policy does not provide the same coverage as the previous policy, even though insurance for specific loss that insured suffered was not, in fact, obtainable at time policy was replaced due to market conditions.

### **Duty to Insurer**

Insofar as the insurance company is concerned, an insurance agent must act in good faith, confine all acts and conduct within the scope of the agent's actual authority, obey the principal's instructions, and use due care and reasonable diligence in the transaction of the business entrusted to the agent. As a general rule, an insurance agent is liable to the insurance company for the losses resulting proximately from a failure or departure in such duties.

## **Fiduciary Duty**

### **Special Circumstances or Special Relationship**

An agent or broker may be held to a heightened standard of care when involved in a longstanding, special relationship with a policyholder/insured. This "special relationship" concept can be somewhat nebulous. For example, the length of the relationship is not the deciding factor, although the time period of the relationship may weigh heavily in a court's determination that a heightened standard exists. Courts will tend to look past the time element and usually attempt to determine whether (in the context of a longstanding relationship), the policyholder/insured sought and relied upon information supplied by the agent or broker.

The existence of a special relationship between an agent or broker and an insured may be treated either as a question of fact or as a question of law, depending on the jurisdiction.



## Fiduciary Duty/Special Relationship – Elements

In some jurisdictions, to share a special relationship with an insured, an intermediary must (1) exercise broad discretion in serving the insured's needs; (2) counsel the insured about specialized insurance coverage; (3) hold himself out as a highly skilled insurance expert coupled with the insured's reliance on his expertise; and (4) receive compensation beyond any ordinary commission for the advice or guidance provided. In others, a special relationship may be created where an intermediary knows that the insured (1) is unsophisticated in insurance matters, (2) is relying on him to procure appropriate coverage, and (3) needs the coverage at issue. Regardless of the specific factors considered or test applied, an insured or applicant arguing for a special relationship must demonstrate something more than a standard intermediary-consumer relationship.

*See, Court View Centre, L.L.C. v. Witt*, 753 N.E.2d 75, 87 (2001); *Szelenyi v. Morse, Payson & Noyes Ins.*, 594 A.2d 1092, 1094 (1991); *Sadler v. Loomis Co.*, 776 A.2d 25, 46 (2001); *Harts v. Farmers Ins. Exch.*, 597 N.W.2d 47, 51-52 (1999); *Beauty Craft Supply & Equip. Co. v. State Farm Fire & Cas. Ins. Co.*, 479 N.W.2d 99, 101-02 (1992); *Lewis-Williamson v. Grange Mut. Ins. Co.*, 39 P.3d 947, 949-50 (2002); *AAS-DMP Mgmt., L.P. Liquidating Trust v. Acordia N.W., Inc.*, 63 P.3d 860, 863-64 (2003); *Murphy v. Kuhn*, 682 N.E.2d 972, 975 (N.Y. 1997); *Sintros v. Hamon*, 810 A.2d 553, 557 (2002); *Gordon v. Spectrum, Inc.*, 981 P.2d 488, 492 (1999).

### **Illinois enjoys the rare distinction of relieving insurance producers from most fiduciary duty claims**

#### **The Insurance Placement Liability statute states:**

**735 ILCS 5/2-2201** Ordinary care; civil liability.

- (a) An insurance producer, registered firm, and limited insurance representative shall exercise ordinary care and skill in renewing, procuring, binding, or placing the coverage requested by the insured or proposed insured.
- (b) No cause of action brought by any person or entity against any insurance producer, registered firm, or limited insurance representative concerning the sale, placement, procurement, renewal, binding, cancellation of, or failure to procure any policy of insurance shall subject the insurance producer, registered firm, or limited insurance representative to civil liability under standards governing the conduct of a fiduciary or a fiduciary relationship except when the conduct upon which the cause of action is based involves the wrongful retention or misappropriation by the insurance producer, registered firm, or limited insurance representative of any money that was received as premiums, as a premium deposit, or as payment of a claim.
- (c) The provisions of this Section are not meant to impair or invalidate any of the terms or conditions of a contractual agreement between an insurance producer, registered firm, or limited insurance representative and a company that has authority to transact the kinds of insurance defined in Class 1 or clause (a), (b), (c), (d), (e), (f), (h), (i), or (k) of Class 2 of Section 4 of the Illinois Insurance Code.
- (d) While limiting the scope of liability of an insurance producer, registered firm, or limited insurance representative under standards governing the conduct of a fiduciary or a fiduciary relationship, the provisions of this Section do not limit or release an insurance producer, registered firm, or limited insurance representative from liability for negligence concerning the sale, placement, procurement, renewal, binding, cancellation of, or failure to procure any policy of insurance.



The New Jersey Supreme Court has held that “because of the increasing complexity of the insurance industry and the specialized knowledge required to understand all of its intricacies, the relationship between an insurance agent and a client is often a fiduciary one.” *Sobotor v.*

Savvy lawyers for E&O claimants will often look at the following to help establish a “special relationship”

- The mechanism for charging fees (is there a small percentage charged for “servicing” the account?)
- The business proposal
- Other marketing materials, especially web pages or brochures

*Prudential Property and Casualty Co.*, 491 A.2d 737, 741 (N.J. 1984).

Likewise, an insurance professional who represents that he or she possesses the skill needed to arrange a complex package of insurance coverages for a business usually will be expected to perform this task in a manner commensurate with the skills represented.

Once a heightened standard of care is found to exist, an agent or broker is required to perform duties in addition to just diligently and faithfully carrying out a policyholder’s instructions. Depending upon the facts of a given case, these duties may include: (1) renewing insurance without a specific request by the policyholder; (2) advising an insured about coverage issues; (3) procuring the best available coverage; (4) analyzing an insured’s insurance needs; and (5) investigating the financial condition of an insurer.

Courts often blur, or disregard, the distinctions between “insurance agents” and “insurance brokers” depending on the circumstances of a particular case. For example, the Minnesota Supreme Court, when confronted with the agent-broker dichotomy, held that “a person who procures insurance for others can be an insurance agent, an insurance broker, or both.” *Eddy v. Republic National Insurance Co.*, 290 N.W.2d 174, 176 (1980)

Additionally, courts sometimes hold that an insurance representative serves in a “dual capacity” as both an agent and broker. These holdings are often based on statutes found in various jurisdictions which provide that both an agent and broker are an insurer’s agent for the purpose of receiving premium payments.



## Liability to Third Parties

In some jurisdictions, insurance producers may be liable to third parties who are injured by the conduct of a party who would have been insured but for the producer's alleged negligence or breach of contract to procure the insurance. Other courts, however, have found that, absent an express contractual provision evidencing the parties' intent, no direct benefit is conferred by contract to a third party sufficient to support a third-party beneficiary action against a producer.

Courts in a number of jurisdictions have imposed this liability on brokers. In *Eschle v. Eastern Freight Ways, Inc.*, 128 N.J.Super. 299, 319 A.2d 786 (1974), the broker neglected to procure coverage for a truck that was involved in an accident. Due to the negligence of the truck driver, a passenger in the car with which the truck had collided was injured. The passenger was held by the court to be within a circle of foreseeable harm that would result from the broker's negligence and was allowed to bring an action directly against the broker.

At least two different theories have been advanced to support a direct action by an injured party against an insurance broker. First is a public policy favoring insurance to compensate accident victims. *Id.* A second basis focuses on the objective of the contract to procure insurance such that the injured party may be found to be a third-party beneficiary. *Gothberg*, supra, 208 N.E.2d at 20 ("general public . . . possessed more than a mere 'incidental' benefit from the contract to procure public liability insurance"); *Impex Agricultural Commodities, Division Impex Overseas Corp. v. Parness Trucking Corp.*, 576 F.Supp. 587 (D.N.J. 1983). Other courts have allowed a claim either as direct action or based on an assignment. *Jackson v. Aetna Life & Casualty Co.*, 93 Cal.App.3d 838, 155 Cal.Rptr. 905 (1979); *Crawford v. Holt*, 172 Ga.App. 326, 323 S.E.2d 245 (1984); *Rae v. Air-Speed, Inc.*, 386 Mass. 187, 435 N.E.2d 628 (1982); *Contra, Freeman v. Schmidt Real Estate & Insurance, Inc.*, 755 F.2d 135 (8th Cir. 1985).

Courts generally recognize that liability insurance coverage is procured for the protection of the public as well as of the individual insured. In a decision that did not involve a direct action by an injured party against a producer but that could make that issue moot in most cases, the court in *Daugherty v. Blaase*, 191 Ill.App.3d 496, 548 N.E.2d 130, 138, Ill.Dec. 900 (4th Dist. 1989), held that insurance producer malpractice claims could be assigned by the insured because the relationship



between a producer and an insured was business, not personal, and was not based on confidentiality. The court further allowed a claim against a producer to be assigned before the entry of a judgment against the insured. Thus, injured parties may end up with what are essentially direct actions against producers merely by coming to an agreement with the insured to have the insured's claim assigned them.

Careful consideration should be given to those who may be in the "circle of foreseeable harm" or who are arguably intended beneficiaries of a contract of or to procure insurance. It is no longer safe (if it ever was) to assume that a producer's potential liability runs only to its client or to the insurer.

#### ILLUSTRATIVE FACT PATTERNS FROM DIFFERENT JURISDICTIONS

Insured stated cause of action for negligence in complaint against insurance company and its agents, where he alleged: insurer had issued homeowner's policy to him which it renewed every year for ten years; every year he contacted agents to inquire whether coverage limits of his policy were adequate to rebuild his home and on each occasion he was informed they were; after his residence was completely destroyed by fire agents informed him in response to his inquiry that coverage was adequate to reconstruct house; policy limits were insufficient to replace house because property values had substantially increased in ten years; insurer and agents were under duty to provide him with accurate information and breached duty by advising him coverage was satisfactory when they lacked sufficient basis to make such representation; and he reasonably relied on statements and was damaged as result. Although insurer and agents were not required under general duty of care to advise insured regarding sufficiency of coverage limits or replacement value of his home, once they elected to respond to his inquiries, special duty arose requiring them to use reasonable care. *Free v. Republic Ins. Co.*, 8 Cal. App. 4th 1726, 11 Cal. Rptr. 2d 296 (1992).

Under Michigan law, insurance agent does not have affirmative duty to advise client regarding adequacy of policy's coverage; however, duty to advise may arise when special relationship exists between insurer and policyholder. Although long-standing relationship may offer some evidence of such special relationship there must, in addition, be some evidence that there was some type of



interaction on question of coverage with insured, in fact, relying on expertise of agent. Thus, although insurer had handled a number of policies for corporation and shareholders over long period of time, there was no special relationship giving rise to duty to advise shareholders on adequacy of underinsured motorist coverage in fleet policy where there was no evidence that shareholders had ever questioned adequacy of their insurance. *Bruner v. League General Ins. Co.*, Mich. App., 164 Mich. App. 28, 416 N.W.2d 318, 320 (1987).

When an insured contacted her Minnesota automobile insurer, prior to move to Wisconsin, preparatory to shifting to Wisconsin policy with another insurer, agent was not under duty to inform insured of differences in uninsured motorist coverage between Minnesota and Wisconsin law, specifically of difference that Wisconsin required physical contact in hit and run case while Minnesota did not. *Klimstra v. State Farm Auto. Ins. Co.*, 891 F. Supp. 1329 (D. Minn. 1995).

Insurance agent had no duty to inform insured of the difference between replacement coverage and coverage based on actual cash value where there was no special relationship established between insured and the agent and where insured never asked for replacement coverage. *Stokes v. Harrell*, 289 Ark. 179, 711 S.W.2d 755 (1986)

When purchasing insurance, an applicant has duty to read the insurance policy and if the policy is unacceptable, the applicant may either reject it or renegotiate. The applicant may not maintain a claim for misrepresentation against the agent after becoming aware that the policy does not provide coverage requested. Thus, insured (who requested "full coverage" for a concert she was promoting) read the policy which was obtained and was dissatisfied. However, the insured did not reject or renegotiate policy. Under these facts, the insured is not entitled to bring action against the agent for allegedly misrepresenting that he had obtained "full coverage" when, in fact, the agent had provided only a general liability policy. *Small v. King*, 915 P.2d 1192 (Wyo. 1996)

Where homeowners sought policy to cover house that was undergoing renovations, insurance agent recommended that they insure house for 80 percent of replacement value to avoid coinsurance penalty in event of partial loss, and house burned down before renovations were completed, no special relationship between insurance agent and homeowners existed so as to create, in effect, fiduciary duty between parties, despite fact that agent had served homeowners'



insurance needs for 12 years; agent's duty was to be generally fair and truthful in explaining nature of policy, which agent did, while relying on homeowners' representations that renovations were to be mostly cosmetic. Since agent could not reasonably have foreseen that homeowners would instead embark on renovations so substantial that they rendered actual cash value of house just before fire less than half the amount for which it was insured and since agent was not required to warn homeowners about impact of necessarily complex contract language on every eventuality, agent did not breach duty to advise homeowners appropriately. *Booska v. Hubbard Ins. Agency, Inc.*, 627 A.2d 333 (Vt. 1993)

Under New York law the duty owed by insurance agent to insured is ordinarily defined by nature of the request the customer makes to the agent. The agent has a duty to the customer to obtain coverage within a reasonable time after request or to inform customer of agent's inability to do so but agent owes no continuing duty to advise, guide or direct customer to obtain additional coverage. Thus, agent had no affirmative duty to advise customer of availability of supplementary uninsured motorist coverage where customer never requested such coverage. *Wied v. New York Cent. Mut. Fire Ins. Co.*, 208 App. Div. 2d 1132, 618 N.Y.S.2d 467 (1994).

Where insureds asked broker to obtain "best" available coverage, broker had no duty to advise them of availability of underinsured motorist (UIM) coverage or to obtain such coverage on their behalf; under New York law duty owed by insurance agent to customer is ordinarily defined by nature of request customer makes to agent and customer never requested UIM coverage. *Empire Indus. Corp. v. Insurance Cos. of N. America*, 641 N.Y.S.2d 345 (1996).

#### TREND?

#### TORTS OF OTHERS DO NOT RELIEVE INTERMEDIARY OF LIABILITY

Two courts in different jurisdictions recently held that when an insurance intermediary is sued for alleged wrongful breach of a duty of care owed to an insured, it is not a complete defense that the coverage provided by the policy the intermediary placed was wrongfully denied.

In California, a summary judgment for an insurance broker was reversed, even though the policy the broker procured for the insured actually provided coverage. In that case, the broker was sued



by a musical group when the group's insurer denied coverage for certain events under a "field of entertainment liability exclusion," claiming that the broker negligently failed to procure proper coverage. After the Court determined that the policy did indeed provide coverage, the broker moved for summary adjudication. The California Appellate Court reversed a judgment in favor of the broker, and held that even though there was coverage, the fact that the insured had to litigate to obtain the coverage provided a sufficient basis to hold the broker liable for the costs of having to litigate. *Third Eye Blind Inc. v. Near North Entertainment Ins. Svcs., Inc.*, 127 Cal.App.4th 1311, 26 Cal.Rptr.3d 452 (March 29, 2005).

In Michigan, the Appellate Court held that in an unpublished opinion that an insurance broker could be held liable for the costs of litigation when an insurer wrongfully denied automobile coverage. As in the case above, the Court ruled that the policy the broker procured did indeed provide coverage, but the fact that the insured had to litigate to obtain the coverage exposed the broker to liability—in this case for failing to obtain relevant information that provided the basis for denial by the insurance company. Perhaps even more disturbing is that the case was decided on the insured's summary judgment motion. *Stover v. Secura Ins. Co.*, No. 252613, 252615, 2005 WL 1367103 (Mich.App.June 9, 2005).

### DEFENSE STRATEGIES AND OPTIONS

Virtually all E & O claims arise because the underlying insured has made a first party claim under a policy, or tendered the defense of a third party claim, and the underlying carrier takes a position of either no coverage, or less coverage than the underlying insured thought was or should have been in place. While our focus today is on the implications of agency and its potential impact on an Agents' E & O case, let's take a look at the various defense options that can present themselves, and which should be considered in the evaluation and defense of any claim you may have.

- Coverage exists by virtue of the acts of the intermediary as the carrier's agent (agency). The carrier is bound by the actions of its agent acting within the scope of its actual or apparent authority. In the true agency context, liability for an agent's acts is imputed to the principal. This is true whether or not the carrier would have written the coverage in question had it been asked. The insurer is still liable to the underlying insured. Whether or not it would have written the coverage impacts the damages it sustains because of the agent's acts, and the



amount it can consequently collect from the agent if it pursues such an action. Sometimes, the only damage the insurer can show is the amount of the premium that would have been charged had the missing coverage been written, which is technically an offset to the underlying insured's loss. The typical "defenses" raised by carriers are: no agency (is there possibly sub-agency?); outside the scope of agency authority (this is typically a fact question); not acting in an agency role in the transaction in question; would not have written the coverage in question.

#### Other Defenses:

- The carrier is wrong. There IS coverage. Demonstrate to the underlying carrier that there is coverage, and that it needs to reverse its coverage position. Often, the agent will side with the underlying insured on questions of ambiguous policy language so coverage can be found. Utilize internal subject matter experts to assist. Involve coverage counsel when warranted.
- The loss is covered elsewhere. Actively search for any other coverage you can find.
- Coverage exists by virtue of waiver or estoppel because of the actions of the underlying carrier, even if the carrier's coverage position is essentially correct (e.g. failure to issue reservation of rights; failure to pay demand within limits, etc.).
- No coverage anyway. Prove that, even if the policy in question had been procured, there would have been no coverage for the loss in question.
- Impossibility. The coverage in question was not available anywhere so, even if the underlying insured had been aware of the lack of coverage, it would not have been able to procure it elsewhere. (Therefore, the agent's representation did not cause the lack of insurance).
- The underlying insured did not sustain a loss. E.g.: There is a gap between primary and excess, but the underlying loss is settled within primary limits.
- No duty on the part of the agent. (Lack of any special relationship creating the duty being claimed).
- Not the agent's fault. Someone else committed the error in question (e.g. carrier fails to send cancellation notice to the correct insured; the intermediary broker fails to pass on a critical endorsement limiting coverage to the insured and tells the insured the coverage is in place, etc.).
- Insured agent acted within the applicable standard of care.
- The underlying case may be defensible. Consider taking over the underlying insured's defense if no one is defending them and this is appropriate to do. (Don't forget secure an appropriate drop-down agreement, assignment, etc. if you do this).



## COUNSELING THE INSURANCE PRODUCER - PREVENTING ERRORS AND OMISSIONS

Professionals in all fields are subject to lawsuits being brought against them for alleged breach of their duties. Insurance producers are certainly no exception to that norm. The errors and omissions of insurance intermediaries have not, however, received the widespread attention of those committed in the practice of law and medicine.

The following sections are intended to review some of the steps that can be taken by a producer to minimize the likelihood of breaching its duties to its clients and thereby to reduce the number of claims brought against it. Needless to say, this counseling also inures to the benefit of customers of insurance producers, who, it is hoped, will be the recipients of more expert and diligent service.

Underlying and implicit in all of the steps outlined below is a particular manner in which business should be conducted. What has sometimes been a rather informal and casual service-oriented business should be viewed by the producer as an obstacle course filled with traps and stumbling blocks for the unwary. The producer must understand that even the oldest of friends is a potential claimant and that smiles, handshakes, and games of golf are often quickly replaced by frowns, shaking fists, and allegations seeking millions in punitive damages. For this reason above all others, no exceptions to careful business practices should be made. It is the difficult client to whom most "favors" are given from whom claims most often seem to emanate.

### **Obtain Errors and Omissions Coverage**

The first lesson to be learned is that even when all services are performed properly and the producer has been a model agent or broker, claims may nevertheless be brought. In those situations and in those in which an error has been committed, insurance coverage is essential to the continued financial well-being of many producers. The pitch for high limits and maximum protection can be made better by an insurance salesperson, but escalating verdicts and the increased cost of being found "not guilty" attest to the validity of that outlook. Producers should not underestimate the chances of facing an errors and omissions claim and should protect themselves accordingly.



### Avoid Advertising Yourself into a Higher Standard of Care

Producers who sell themselves by informing customers through advertising that they can expertly answer all of the client's insurance needs are effectively asking for dissatisfied clients as well as the imposition by the courts of a higher standard of care. The greater the degree of reliance on the producer that the insured can justify, the greater the likelihood that the producer will be found to have breached its duties. The statement by the producer that it can "take care of everything" creates false expectations and is taken as an absolute guarantee of satisfaction by the insured. There is still some difference between a customer's dissatisfaction and a producer's legal liability; overstated advertising and false assurances tend to make one the same as the other.

### Know the Insurers

The more that the producer knows about the insurers with whom it places business or writes coverages, the more accurate the information is that can be communicated to the other parties in the transaction. A good deal of useful information can be gleaned from Best's publications and ratings and from weekly or monthly insurance industry publications. Read them. Additionally, the producer should be familiar with the management, claims practices, and policies of the insurers with whom it regularly does business.

### Know the Marketplace

Given the generally accepted standard that a producer may be liable for failure to advise the insured of lower-priced comparable insurance, it is all the more essential today that the insurance producer be aware of what the marketplace will offer to meet the needs and desires of various insureds. The producer should familiarize itself with new and alternative coverages, prices, and companies in order to be certain that its clientele is being properly served. Given the rapidly changing insurance market, producers simply cannot afford to assume that the best policy of a decade or even a year ago is still the ideal today. A continuous review of available insurance is very helpful for avoiding unhappy customers and their subsequent lawsuits.



## **Know the Policy**

The insurance producer must take great pains to know the terms, coverages, conditions, and exclusions of the policies that it obtains or writes. As noted above, producers may eventually be held liable for improper explanations of coverage that bind the insurer. Similarly, the producer who obtains an improper policy for an insured because it does not totally understand what the policy really covers does a disservice to the insured and to itself as well. The policy should be completely understood before being obtained and should be rechecked before being delivered to the insured. When in doubt, the producer should force the insurer to explain its policy, preferably in writing. The educated producer who does not have to guess or assume anything about the insurance policy is better insulated from lawsuits than its less learned counterpart. This education should also be passed on to all of the producer's employees, even to those who "merely" answer the phone or prepare correspondence. Moreover, clerical employees who are not insurance experts should be given the authority only to take messages for the producer and not to deal substantively with an insured's questions or problems. Even the employee who is least important to the running of the business can push the entire agency over the abyss and into the courtroom as a party defendant.

## **"Document" Your Files**

One of the most glaring weaknesses in the business is the dearth of meaningful correspondence in the electronic or paper file of the typical producer. An extraordinary number of lawsuits boil down to swearing contests of "his word against mine" only because no one had ever reduced the parties' agreement or understanding to writing. This error is easily corrected, and while not rendering the producer immune from these lawsuits, it does make him more easily defended and will often lead to a favorable summary disposition of the case.

The producer should confirm all oral communication in writing and should send that confirmation to its customer. In this manner, all agreed undertakings and all understandings of the parties as to any matter of substance are capable of easy review and proof. If a producer has agreed to try to procure a certain type or priced policy, that agreement and the type or price of the policy to be obtained should be reduced to writing and communicated to the customer. The burden will then fall on the customer to explain why he failed to disagree with the memorandum at the time of receipt and spoke up only after the loss in question occurred.



Similarly, all recommendations and advice given to the customer should be reduced to writing and sent to him as should any instructions and wishes communicated to the producer by the customer. Reliance on memory is to be avoided even for a short period of time and is, regardless of its accuracy, wholly unimpressive as proof in a court of law.

Producers should also make logs of all incoming and outgoing telephone calls regardless of to whom or by whom they are made. The parties to and the date of any conversation should be recorded, and any substantive matter discussed should be noted. The call should then be confirmed in writing, if material, even if only confirming that the customer decided not to purchase coverage or make a considered change. The producer who truthfully testifies that it is his practice to prepare a written summary of any request made by the insured and to confirm that request in writing with the insured can speak more effectively to the absence of any notes of conversations and to the lack of a letter or e-mail to the insured than can the producer who corresponds only rarely or only when he believes it is important. The impression conveyed by a diligent producer is often very persuasive to a jury, which is likely to believe that if the matter complained of is not in writing, it did not happen as alleged by the complainant.

It is extremely important that the insurance producer maintain a written record of what the customer chooses not to do. Just as requests for coverage or changes in coverage should be confirmed by the producer in writing, so too should a client's decision not to obtain certain coverage or change. Even a client's refusal or hesitancy to decide whether coverage should be obtained or changed should be memorialized and, preferably, sent to the client. When known, the producer should note the reasons, if any, stated by the customer for not purchasing or changing coverage, such as the client's concern about the increased premium or inability to pay.

Additionally, when taking applications for insurance, the producer must be careful to avoid telling the client that coverage is in effect or accepted. Never tell the applicant that he is bound when he is not. Confirm the accuracy and truth of the application by sending a copy to the client after completion with a cover letter asking the applicant to verify information contained in the application and advising that, unless notified of changes, the application will be considered by the insurer as is. The letter should further advise the applicant that the application may become a part



of the policy and that, even if coverage issues, the policy may be voided and no claims paid if the application turns out to be false or misleading. This, again, places the burden on the insured to advise the producer of any changes that should be made. Those changes should also be reduced to writing and then sent to the insurer and insured.

Producers should avoid using catchall phrases in speech and writing, e.g., "You're covered" or "You have full coverage." Given that all policies are limited in what is covered and have exclusions, producers should carefully and specifically explain coverages that are provided under the policies.

Significant events should be documented even when they arise or are first communicated in "social" settings. Given the indication of some courts that coverage should be kept in place unless the insured instructs otherwise, the producer would be wise to make certain policies are renewed until the insured's instructions not to do so are accurately documented. The producer obviously should not delay in placing coverage, notifying an insured of changes in coverage, limits, or premium, submitting claims, or notifying an insured of cancellation — all of which should be done in writing.

Finally, documentation of files is extremely important in those areas governed by precise statutes or regulations. For instance, Illinois surplus line regulations require a producer to retain affidavits and other documents evidencing the transaction and all efforts undertaken. In almost every situation, a carefully documented file is a producer's best defense, and its importance cannot be overstated.

### Use a Diary System

It is essential that the producer have some kind of system that will automatically remind him of what, if anything, needs to be done on a pending file. Errors are often committed when the producer sends out an application to the insured and awaits its return while holding the applicant's premium deposit. After a few months have passed and the applicant suffers a loss, it is suddenly alarming to find that the application was never forwarded to the insurance company and that the premium funds are still on deposit in the producer's special account. Diary systems are likewise essential for preventing errors pertaining to binders, policy issuance, renewal, and claims. Follow-up dates should be used every time a client's file is worked on or examined.



Long delays in processing applications and other requests can best be avoided by use of an effective diary or tickler system that will enable the producer to serve his customers in a diligent and up-to-date manner.



## NOTES

