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Developments in Insurance Agent/Broker Professional Liability 2015: The Year in Review, Part I

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Introduction

In the latter part of 2013, and in 2014, enormously significant decisions in Indiana, Florida and New York were issued which dramatically altered the landscape—now and going forward—with respect to how courts will consider claims asserting the existence of a "duty to advise" based on allegations of facts purporting to evidence a "special relationship." While the year 2015 was arguably not nearly so dynamic, there were still a number of rulings of interest. Of particular note were decisions regarding agent/broker liability to parties with whom they are not in privity, as well as decisions providing further explication as to when a duty to advise regarding coverage can arise. Other decisions of note addressed: when a fiduciary relationship has been created; whether there is a baseline duty to procure "adequate coverage"; applicability of the "duty to read" as a defense to coverage misrepresentation claims; and the continuing viability of the economic loss rule as a defense to agent/broker negligence claims.

Part one of this article, in this month's volume of the PLUS Journal, will focus on the cases touching upon the increasing efforts by third-parties to the agent/broker-client relationship to pursue claims against the agent/broker when it turns out that insufficient insurance was purchased or is available to cover their injuries/claims. The article will also examine several interesting decisions concerning the duty to advise, including a decision which set out to answer the question of "whether an insurance broker may be deemed negligent when an insured's policy excludes coverage that the insured never requested but later needed." Part two of this article, to be published in March's volume of the PLUS Journal, will discuss a variety of issues, including: case decisions touching on when a fiduciary relationship has been created; the question of whether a duty exists as a general matter to obtain "adequate coverage"; the continuing applicability of the "duty to read" as a defense to coverage misrepresentation claims; and the continuing viability of the economic loss rule as a defense to agent/broker professional negligence claims.

Liability to Third Parties With Whom There is No Privity

A growing issue of concern in the area of insurance agent and broker E&O is the threat of liability to parties with whom they are not in privity, based on the allegation that they were understood to be the beneficiaries of the agent's/broker's work in placing coverage. The vast majority of the cases that have considered the issue have held that agents/brokers should generally not be deemed to owe a duty of care to anyone beyond the client for whom they were asked to procure coverage. But cases testing the boundaries in this regard keep cropping up, especially where the underlying facts are bad, and the beneficiaries of the absent/insufficient coverage engender sympathy. And the analytical framework through which the courts are approaching the issue continues to evolve.

A significant decision on this issue was rendered in 2015 by the Sixth Circuit Court of Appeals. In *Johnson v. Doodson Ins. Brokerage, LLC*,[1] the Cleveland Indians hired National Pastime Sports to produce Kids Fun Day Events at Indians baseball games. The Kids Fun Day events had attractions designed to appeal to children, including an inflatable bouncy castle and inflatable slide. Pursuant to the terms of the contract between the Indians and National Pastime, National Pastime was required to purchase comprehensive general liability coverage with limits of $5 million. National Pastime submitted an application to its insurance broker, Doodson Insurance Brokerage,

stating that the Kids Fun Day Events would include inflatable attractions. Nonetheless, Doodson procured coverage excluding coverage for injuries caused by inflatables.

While attending an Indians game in June 2010, Douglas Johnson was crushed and killed by an inflatable slide that collapsed on him. Because coverage of injuries caused by inflatables was excluded, there was no coverage for the claim. In the ensuing litigation, Johnson's Estate won a default judgment for $3.5 million against National Pastime.[2] Thereafter, having failed to collect on the default judgment, Johnson's Estate brought suit against Doodson in Michigan federal district court, asserting claims for negligence and breach of contract.

Applying Texas law, because the insurance was procured in Texas, the district court found that the negligence claim could not proceed because there was no allegation that Johnson was in privity of contract with Doodson. Then, applying Michigan law, because it saw no meaningful distinction from Texas law as regards the breach of contract claim, the Court dismissed that claim as well, because in order to proceed under a third-party beneficiary theory Johnson's estate would have to have alleged that Doodson's promised performance was made directly for Johnson's benefit, which it had failed to do.

On appeal, the Sixth Circuit affirmed. In doing so, the Circuit Court noted that the Cleveland Indians had separately pursued a negligence claim against Doodson under a third-party beneficiary theory, and that claim had been held to be valid.[3] Nonetheless, the Court found that the claim before the Court in this case was distinguishable because there was deemed to be a "special relationship" as between the Indians and Doodson arising from the fact that the broker clearly knew that the insurance was being purchased for the purpose of covering the Kids Fun Day events being hosted by the Indians, and the broker sent a Certificate of Insurance directly to the Indians listing the dates of the Kids Fun Days, while also listing the Indians as an additional insured. In contrast, here, the Sixth Circuit (applying Michigan law) concluded that it was not foreseeable that the public would rely on and expect protection from voluntarily purchased liability insurance.[4]

A contrary determination was made in *Lat v. Soriano*,[5] with the court reversing a trial court dismissal of a professional negligence claim against an insurance agent by the intended beneficiaries of a life insurance policy that had been cancelled for non-payment of premiums. The policy provided that if the insured became totally disabled and advised her insurer, the monthly premium payments due under the policy could be waived. After the insured was diagnosed with cancer, she became totally disabled, and failed to make the requisite premium payments, but apparently never advised the insurer of her disability. In August 2013, she contacted the agent and asked if the policy could be reinstated, and he advised her that it could not. She died in September, and her beneficiaries received no insurance proceeds. Alleging the agent had provided her with negligent advice, the insured's adult children—who were named as the primary beneficiaries under the policy—brought suit against the agent.

The agent moved to dismiss the case at the pleading stage, arguing that the agent owed a duty of care solely to his customer, the insured, and not the beneficiaries named in the policy. The trial court granted the motion but on appeal the decision was reversed.

In reinstating the claim by the insured's beneficiaries, the appellate court noted that "[i]n connection with the procurement of insurance, California courts have found that under certain circumstances the limited duty of an intermediary may extend to third party beneficiaries of the policy."[6] In so doing, the court quoted from the *Nowlon v. Koram Ins. Center, Inc.* decision's conclusion that "[t]he broker's negligence here was just as detrimental to the third party as to the insured."[7]

In a decision rendered just before year end, the pendulum swung back in the other direction. In *Emerald Coast Finest Produce Co., Inc. v. Sunrise Fresh Produce, LLC*,[8] a Mississippi federal district court considered a claim by the owner of a building used as a warehouse against the insurance agent for the company it had leased the building to. The owner alleged the agent had failed to procure sufficient coverage for the building, which was destroyed by a fire. In pursuing its claim, the owner argued that it had a right to sue the agent on the grounds that it was an intended third-party beneficiary of the coverage. In doing so, the owner noted that while the lease agreement required the lessee to provide and keep in force fire and extended property damage insurance providing insurance equal to 100% of the replacement value of the building, the insurance put in place on the building provided only $5 million in coverage, and the cost to repair or replace it exceeded $15 million.

In pursuing its claim against the agent, the owner argued that the agent owed it a duty to determine the replacement cost of the building before placing coverage, to properly inspect the premises in order to do so, and to procure insurance coverage equal to the replacement cost of the building. The agent moved to dismiss on summary judgment, on the grounds that the owner had no legal right to sue it as a third party beneficiary, and the court granted the motion. In doing so, the court concluded that under Mississippi law, any right to pursue a claim as a third-party beneficiary "must spring from the terms of the contract."[9] And because any such rights the owner may have had must spring from the contract, it could therefore have no rights against the agent in regards to procurement of the policy, as any rights it had as a third-party beneficiary didn't exist until after the policy was procured.[10]

Duty to Advise

In the context of agent/broker E&O claims arising out of the absence of coverage for a claim, or insufficient limits, claims are often made that the agent/broker had a duty to advise the insured about the coverage even though under the law in the vast majority of states agents/brokers are not considered fiduciaries, and only owe a duty to advise about coverage in "special circumstances" or if the parties have a "special relationship."[11] Accordingly, the question of whether there is a "duty to advise" is a key litigation battleground. Through a combination of increasingly savvy lawyering by the plaintiffs' bar and a growing recognition by the Courts of agents and brokers as experts operating in a specialized field who are necessary to interpret, guide and advise insureds with respect to what can often be complex insurance policy language, the courts' acceptance of arguments for at least leaving it to the jury to decide if there is a duty to advise has expanded significantly. But litigation continues with regard to the parameters of what can be considered a viable basis for a "duty to advise" claim, and 2015 had its share of these cases. And with a growing number of broker service fee agreements being put in place to replace or supplement traditional commission based compensation arrangements, and brokers agreeing to serve as risk management advisors, insureds have been given additional ammunition to argue that the brokers have assumed additional duties and responsibilities either expressly or implicitly laid out in the terms of their service agreements.

An example of how this can play out can be seen in *O&G Indus. v. Litchfield Ins. Group, Inc.*[12] In this case, the Plaintiff had entered into an agreement to perform construction services in connection with the development of a power generation facility, and pursuant to the terms of the agreement had been required to maintain $102 million in liability insurance. Although it already had a tower of insurance in place (purchased by its insurance broker LIG) which complied with the contract requirements, it investigated using a Contractor Controlled Insurance Program ("CCIP") because of the cost savings it could provide. Further to this, Plaintiff ended up using Aon—which represented itself as an expert in CCIP Programs—to replace $51 million of the insurance via the CCIP.

The construction project was already under way and the existing corporate policies making up the tower had "wrap-up" exclusions which excluded coverage for any operations subject to a CCIP policy. Thus, it was going to be necessary for O&G to procure excess of wrap-up endorsements on the corporate policies so that the wrap-up exclusions would not apply and the corporate policies would become excess insurance above the CCIP. Although O&G had allegedly requested that LIG procure the excess of wrap-up endorsements, LIG failed to do so. As a result, the corporate policies did not provide coverage for O&G in the event the CCIP policies were exhausted, and instead of having $102 million of liability insurance in place, O&G had only $51 million in place. Subsequently, there was an explosion at the project site, causing multiple deaths and injuries, as well as millions of dollars in property damage and project delays.

In addition to suing LIG for failing to procure the wrap-up endorsements, O&G brought suit against Aon for professional negligence and breach of contract. O&G alleged that Aon was aware that the excess of wrap-up endorsements would have to be procured before the CCIP could be placed, but went ahead and placed the CCIP without first confirming that they had been obtained.

Aon moved to dismiss the claims against it on summary judgment. It argued that the court could find that, as a matter of law, it had no duty to confirm that the corporate insurance program LIG was responsible for contained the necessary excess of wrap-up endorsements before it purchased the CCIP coverage. Aon contended the court could reach this conclusion because it was not the broker of record of O&G's corporate program, and O&G never authorized it to touch that program in any respect. Further, Aon argued that the service agreement it had entered into with O&G limited Aon's responsibility to the CCIP. In response, O&G argued that it was not seeking to hold Aon responsible for LIG's negligence; instead, it was arguing that Aon had owed and breached a duty of care to confirm that the necessary excess of wrap-up endorsements that Aon had advised O&G were needed on the corporate program were in place before it purchased the CCIP insurance, in light of its knowledge of the contract O&G was a party to requiring it to have $102 million of insurance in place for the project.

The court denied Aon's motion for summary judgment, finding that there were genuine issues of material fact regarding the role played by Aon.[13] Critically, the Court noted, while Aon claimed it was only hired to place the CCIP, O&G contended that Aon was hired as an advisor, to render advice concerning the structure and sufficiency of insurance for the project, to eliminate any gaps in coverage, *and* to place the CCIP.[14]

Another example as to how this can come into play, but in a more favorable ruling for agents/brokers, can be seen in *TLM Realty Corp. v. Phil Glick.*[15] In *TLM Realty,* at around the time the insured realty company TLM Realty Corp. ("TLM") purchased a directors and officers insurance policy through the defendant Citizens Clair Insurance Agency, LLC ("Citizens Clair"), TLM entered into a written agreement whereby Citizen's Clair agreed to act "as an outsourced risk and claim management department for TLM Realty for an annual fee." Among the responsibilities Citizen's Clair agreed to assume pursuant to this Agreement were:

- "Reviewing the insurance related provisions of any contracts entered into by TLM"

- Conducting "[a]n in-depth review of the insurance provisions of construction, maintenance, supply and services contracts and leases"
- "Conducting review meetings to keep you apprised of the current status of claims"
- "Meeting with you on a frequent basis to discuss any new exposures which may exist and provide appropriate insurance coverage for those exposures as may be needed"

Subsequently, TLM, its owner and President, and related companies were sued by several limited partner investors in a real estate project, alleging they had been sold the assets of the project (a mall) for less than fair value. The TLM CFO failed to report the claim to Citizens Clair, believing it didn't fall within TLM's D&O coverage. Because the claim was consequently never reported to CLM's D&O insurer, the individual and entities named as defendants ended up having to pay $750,000 in legal defense costs and $1.45 million to settle. They then brought suit against Citizens Clair for breach of contract and negligence, alleging, among other things, that TLM should be liable to them for these exposures because the reason they had not timely reported the lawsuit was because Citizens Clair had failed to make adequate efforts to educate personnel at TLM regarding the full scope of the coverage afforded under the D&O policy.

In granting Citizens Clair summary judgment dismissing the claims against it, the Court noted that the simple fact was that TLM was denied coverage for the lawsuit due to its failure to provide timely notice of the lawsuit. And "[w]hile TLM Realty claims it did not understand the scope of coverage under the D&O Policy, it submits no evidence, beyond its own conjecture, to establish that TLM's lack of understanding was based upon an identified failure on the part of Citizens Clair."[16] Significantly, the court noted that TLM was sent a description of the claims covered by the D&O Policy, and Citizens Clair had met with TLM personnel frequently to discuss claims, all in compliance with Citizens Clair's contract obligations. And even to the extent the parties' agreement had created a special relationship, "[t]he existence of a special relationship between TLM Realty and Citizens Clair did not relieve TLM Realty of its own responsibility with respect to timely reporting of claims to Citizens Clair, nor is there anything in these papers to support a finding that TLM Realty abdicated all of its own responsibilities under the Agreement."[17]

The failure to advise customers to purchase uninsured or underinsured motorist coverage is also a frequent source of negligent failure to advise claims, and one case where this claim was made was *Watson v. Elswick*,[18] where, after their son was injured in a car accident, and the driver did not have sufficient coverage to address his severe injuries, a couple sued their longstanding insurance agent for failing to advise them to purchase underinsured motorist coverage. In pursuing their claim against the agent, they noted he had been their agent for 26 years, alleged that they had requested he purchase "full coverage" for them, and claimed to have been assured that they had "the best insurance money can buy." Based on this, they argued he should have advised them to purchase UIM coverage. The trial court nonetheless granted the agent summary judgment dismissing their negligence claim, a decision which was upheld on appeal. In affirming, the appellate court noted that the Plaintiffs had failed to establish a basis for finding a duty to advise under the circumstances. Significantly, the court noted that there was no evidence that the agent had been paid consideration over and above his commission on premiums, and that the relationship, though lengthy, was not one that would have put an objectively reasonable agent on notice that his advice was being sought and specially relied upon, and there had been no request for coverage advice.[19]

In *D'Agostino v. AllState Ins. Co.,*[20] after AllState denied a property claim arising from vandalism because the home was not the insureds' residence, the insureds brought suit against the insurer for, *inter alia*, breach of contract, and against their agent for failing to purchase the correct coverage (i.e., insurance for property intended to be rented to others, as opposed to homeowner's insurance). At the conclusion of the presentation of evidence at trial, the agent moved for a directed verdict dismissing the claims against him, arguing he had purchased the requested coverage, which had been renewed for 10 years. The plaintiffs argued in response that the agent should have checked and been aware that Plaintiffs had more than one homeowners policy. Had they done so, Plaintiffs contended, they would have been aware of a need to inquire as to which was the actual residence. In rejecting this argument, the court noted that people can own more than one residence, and this alone was not sufficient to create a duty to advise.

In *Schlossberg v. B.F. Saul Ins. Agency of Mo., Inc.,*[21] the court posed and considered a rather frightening question: "whether an insurance broker may be deemed negligent when an insured's policy excludes coverage that the insured never requested but later needed."[22] The case involved a company ("DTM") which provided security guards and related services to its clients. Its general liability policy excluded coverage for "liability arising out of, or caused or contributed to by the sale, leasing, rental, installation, maintenance or service of any alarm, alarm device, alarm component or alarm system," and its umbrella policy had a similar exclusion. However, after several years, the umbrella coverage was procured from a different insurer, and the alarm exclusion in that policy also excluded coverage for bodily injury or property damage arising out of, or caused or contributed to by the *monitoring* of any alarm, alarm device, alarm component or alarm system.

Each year the general liability policy application included a question that required DTM to itemize the services performed by its security guards, with a subcategory labeled "Burglar/Fire Alarms" including a notation stating "separate alarm application must be completed if this coverage is desired". Each year DTM filled in the notation "N/A". Additionally, when the GL and umbrella policies were renewed for the 2008–09 policy year, the broker sent DTM a letter advising they included exclusions for work with canines and alarm systems, and asked "[i] f this is a concern, please let us know immediately"—to which no response was supplied.

Subsequently, a client facility at which DTM's guards were responsible for monitoring the facility's heat sensor alarm system suffered a $3.6 million loss to specialized computer systems when the guards failed to follow proper procedures after a heat system was activated. Although the claim was covered under the GL policy, it was declined under the umbrella policy, and DTM argued that the broker was negligent in failing to warn DTM of the differences between the GL policy and the umbrella policy as it related to the alarm exclusion.

The broker moved to dismiss the professional negligence claim against it, and the court granted the motion. In doing so, the court concluded that "even assuming that an insurance broker has a . . . duty to provide notice of changes to a policy, that duty only arises upon a *significant* change in the policy."[23] In renewing a policy, a broker is not required to point out every formal change and linguistic revision. Because DTM consistently wrote "N/A" on the GL policy application as it related to alarms, and failed to respond to the broker's letter inquiring as to whether it had any concern about the alarm policy exclusion, the broker "had no way of knowing that the addition of the word 'monitoring' to the Umbrella Policy's alarm exclusion would be a significant change to DTM's policy."[24] In fact, the court noted, he had specific reasons to believe it was not. In summing up why it therefore had to find in favor of the broker, the court concluded, [i]mposing a duty of omniscience upon Defendants in a case such as this, only because in hindsight their failure to act caused a particular problem, would not further the policy goals of the tort system".[25]

Lastly, in a case to take particular note of, a Missouri federal district court found that a claim for negligent failure to advise had been stated based on the alleged duty to advise created by language contained in the insurance policy! The policy provided that Allstate "uses local agencies to assist customers with their insurance decision-making process by providing customers with information and high quality service."[26] Because the plaintiff alleged reliance on this, but receipt of no such assistance, the court concluded a viable negligent failure to advise claim had been stated.[27]

Endnotes

1 *Johnson v. Doodson Ins. Brokerage,* LLC, 793 F.3d 674 (6th Cir. Mich. 2015).

2 National Pastime also sued Doodson for negligence, resulting in a confidential settlement.

3 *Id.* at 677.

4 *Id.* at 678–79. Further, as to the breach of contract claim, the Circuit Court noted that under Michigan law a third-party beneficiary claim must be based on an allegation that the plaintiff was an intended beneficiary of the contract, and Michigan courts look to the contract itself, requiring that as a prerequisite of a third-party beneficiary breach of contract claim there must be evidence that the plaintiff was "directly referred to be in the Contract."

5 *Lat v. Soriano,* 2015 Cal. App. Unpub. LEXIS 8460 (Cal. App., 2nd Dist. Div. Nov. 23, 2015).

6 *Id.* at *13–14.

7 *Id.* at *14 (citing *Nowlon v. Koram Ins. Center, Inc.,* 1 Cal. App. 4th 1437, 1447 (Cal. App. 2d Dist. 1991)).

8 *Emerald Coast Finest Produce Co., Inc. v. Sunrise Fresh Produce, LLC,* 2015 U.S. Dist. LEXIS 171191 (S.D. Miss. Dec. 23, 2015).

9 *Id.* at *7 (quoting *Rein v. Benchmark Constr. Co.,* 865 So. 2d 1134, 1136 (Miss. 2004)).

10 *Id.* at *8–9.

11 Typically, courts hold that, absent "special circumstances," the duties of the agent/broker are limited to procuring the coverage specifically requested, or advising of the inability to do so within a reasonable period of time. *See, e.g., Voss v. Netherlands Ins. Co.,* 22 N.Y.3d 728, 734 (N.Y. 2014); *Wilks v. Manobianco,* 352 P.3d 912, 915–16 (Ariz. 2015); *Jones v. Chalmers Ins. Agency,* 2014 Me. Super. LEXIS 102, *12–13 (Me. Super. Ct. June 30, 2014); *O&G Indus. v. Litchfield Ins. Group, Inc.,* 2013 Conn. Super. LEXIS 1492, *41–42 (Conn. Super. Ct. Aug. 19, 2013). There is generally no ongoing duty to advise regarding policy limits, options, etc., absent these "special circumstances."

12 *O&G Indus. v. Litchfield Ins. Group, Inc., 2015 Conn. Super.* LEXIS 2162 (Conn. Super. Ct. July 1, 2013).

13 *Id.* at *10–11. 14 *Id.*

15 *TLM Realty Corp. v. Phil Glick,* 2015 N.Y. Misc. LEXIS 147 (N.Y. Sup. Ct. Jan. 16, 2015).

16 *Id.* at *15. 17 *Id.* at *21.

18 *Watson v. Elswick,* 2015 Ky. App. Unpub. LEXIS 707 (Ky. Ct. App. Oct. 9, 2015). 19 *Id.* at *6-7.

20 *D'Agostino v. Allstate Ins. Co.,* 2015 N.Y. Misc. LEXIS 3577 (N.Y. Sup. Ct. 2015).

21 *Schlossberg v. B.F. Saul Ins. Agency of Mo., Inc.,* 2015 U.S. Dist. LEXIS 166426 (D. Md. Dec. 8, 2015).

22 *Id.* at *1. 23 *Id.* at *24 (emphasis original). 24 *Id.* 25 *Id.* at *25

26 *Allstate Indem. Co. v. Dixon,* 2015 U.S. Dist. LEXIS 141631, *3 (W.D. Mo. Oct. 19, 2015).

27 *Id.*