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# Developments in Insurance Agent/Broker Professional Liability 2014: The Year in Review, Part II

by Peter J. Binging, Esq.

## Introduction

In last month's article, we discussed significant 2014 decisions with regard to the duty to advise, accrual of agent and broker E & O Claims for statute of limitations purposes, and the continuing erosion of the economic loss rule as a defense to agent/broker E & O Claims. This month's article will discuss significant 2014 decisions concerning the "duty to read" and its applicability as a defense to failure to procure claims, a decision discussing whether the duty to advise regarding or procure coverage can extend beyond the agent's/broker's clients to the general public, and decisions considering some interesting defense arguments raised to agent/broker E & O Claims. The article will conclude with some thoughts regarding lessons to be drawn from these decisions and apparent trends moving forward.

## Duty to Read

In years past, the argument that an insured had a duty to read his policy, and his failure to do so should preclude him from arguing that he failed to receive the coverage requested, would trump any argument the insured might make as to being misled regarding the promised coverage. In recent years, however, a number of courts have adopted the position that an insured's failure to read his policy, while evidence of possible comparative negligence on his part, will not necessarily act as a complete bar to his ability to sue his agent/broker for negligent procurement. However, some states have held firm, including Oklahoma, and this was illustrated in S*mith v. Allstate Vehicle and Property Ins. Co.*,[1] a federal district court case applying Oklahoma law.

In *Smith*, after Plaintiffs' home was damaged by a tornado and their insurer refused to pay the full cost of the repair, they sued both the insurer and the agent who sold them the policy. As against the agent, Plaintiffs asserted negligence, negligent misrepresentation / constructive fraud and breach of fiduciary duty claims, alleging the agent had: represented that the replacement cost policy they purchased would "serve to replace their home and personal property without any deduction for depreciation" knowing that was not true; and failed to advise them they had to partially pay to replace property before "they could actually recover the replacement cost of Plaintiffs' dwelling." They also asserted that he "had a duty to accurately inform Plaintiffs of all coverages, benefits, limitations, risks and exclusions," and a duty "to monitor and review the policy procured for Plaintiffs to ensure it provided appropriate and adequate coverage."

The agent moved to dismiss, and the Court granted the motion. In so doing, the Court noted that under Oklahoma law, while agents have a duty to procure the coverage promised, Plaintiffs never alleged the limits they asked for were not reflected in the policy purchased. Further, the policy, in fact, provided for payment of replacement cost without depreciation if the insured repaired, rebuilt or replaced damaged or destroyed property within 180 days of the actual cash value payment. In this regard, the court noted that "[a]lthough an agent may be held accountable for failing to answer an insured's coverage questions accurately, he or she generally is not obligated to explain the policy terms to the insured."[2] It was the insured's duty under Oklahoma law to read the policy, and he is estopped from denying knowledge of the terms unless he alleges and proves that he was induced not to read the policy by trick or fraud.[3]

Similarly, in *Alfa Life Ins. Corp. v. Colza*,[4] the Alabama Supreme Court held that "when documents available to the insured clearly indicate the

insurance in fact procured for the insured is not what the insured subsequently claims he or she requested the agent to procure," the agent is entitled to summary judgment dismissal of any negligent procurement claim based on the insured's contributory negligence.[5] In reaching this holding, the court took note of the fact that other contributory negligence jurisdictions disagreed, and believed that failure to read the policy or application might amount to contributory negligence barring a negligent procurement claim, but such failure does not constitute contributory negligence as a matter of law.[6] In so doing, the court explained the rationale behind this was that some policies are more complex than others, some insureds are more sophisticated than others, and sometimes there might be reason for the insured to rely on the insurance agent's representations about an insurance policy even though they are contradicted by language in the policy itself (where, for example, the agent's conduct permits the reasonable inference that the agent was highly skilled in the area), and it should thus be up to the jury to weigh the facts and circumstances to determine if contributory negligence should apply to bar the insured's claim. The Alabama Supreme Court stated it was not going to align itself with these courts due to "our caselaw emphasizing the strict duty of a party to read the documents he or she is provided in connection with a transaction."[7]

## Scope of Duty

How far out the duty owed by an agent or broker extends has been a subject of a number of decisions over the years, with arguments being made that for one reason or another the duty should be extended to members of the general public impacted by the absence of coverage. Generally, courts have been loathe to read the duty so broadly, and instead ruled that the duty is owed either to the customer of the agent/broker or a specifically intended beneficiary. The issue was revisited again, with the same result, in *Emahiser v. Complete Coverage Insurance, LLP*.[8]

In *Emahiser*, after a dump truck driver ran a stop sign, struck a car being operated by a woman and her son, killed the woman and injured her son, the woman's husband, in his capacity as administrator of her estate brought suit against the driver and the paving company he worked for. Under applicable federal and Ohio law, the paving company, as an interstate commercial operator, was required to maintain a minimum of $750,000 coverage. However, it only had insurance that capped coverage at $50,000 per person and $100,000 per accident.

In settlement of the estate's claims against the driver and the paving Company, the parties agreed to entry of a consent judgment that stipulated the amount of damages exceeded $750,000. The estate then brought an action against the paving company's insurance agency for negligent procurement by not ensuring the paving company had procured sufficient insurance. In pursuing this claim, the estate argued that in providing the paving company with insurance, the defendant agency "undertook to perform a duty owed by Rickey Paving to the driving public, including the [Plaintiffs]."[9]

The agency moved to dismiss on several grounds, including the argument that the estate, as a third party to the agency relationship between the agent and its customer, lacked standing to pursue the claim under Ohio law. Noting that this posed "a relatively novel question" as to whether a legal duty existed on the part of the insurance agency to the third party public, the court concluded that it did not, and dismissed the claim.

In reaching this holding, the court analyzed both Ohio case law, a recent Iowa Supreme Court decision, and the approaches taken by Courts in New Jersey, California, Maryland, and Arizona, and determined "[w]hile it is possible for a third party to bring a negligent procurement claim against an insurance agent or broker, the plaintiff must put forward allegations that he or she was a 'direct, intended, and specifically identifiable' beneficiary to the policy."[10] Although the plaintiff urged the court to find that the driving public at large is a sufficiently specific intended beneficiary, and the court agreed the statutes and regulations in issue had a public protection purpose, it concluded that imposing such a far-reaching duty on insurance agents would impose a duty on them that would stretch to "'a vast number of non-clients' - - literally all who reside in or travel in this state."[11]

## Defenses

Lastly, there were some interesting decisions with regard to defenses available to agent/broker negligence claims.

In *Rose v. Arthur J. Gallagher Risk Management Services, Inc.,*[12] Plaintiffs were a national real estate company, a related limited liability company which owned a large luxury apartment complex in Louisiana, and the sole managing member of the LLC ("AVR"). Defendants ("Gallagher") were the Plaintiffs' insurance brokers for over 10 years.

Pursuant to a contract entered into in 2007, Gallagher agreed, in exchange for an annual fee of $15,000, that Gallagher would act as AVR's broker for all property and casualty insurance requested by AVR, perform risk management services including marketing and selection of carriers, interpret coverage and offer professional advice as requested, advise AVR of changes in insurance industry trends, review AVR's contracts to determine if additional risk exposures were present, and generally assist AVR in the administration of its insurance program.

In early May 2008, AVR was considering the purchase of the luxury apartment complex, and had a blanket property insurance policy which covered the majority of its properties. The policy had a $250,000,000 limit with a sublimit of $30,000,000 for properties located in a Tier 1B location which had sustained damage caused by wind and hail. In connection with its efforts to calculate an appropriate purchase price for the property, AVR asked Gallagher to obtain a quote to add the property to its blanket coverage with full replacement coverage. When Gallagher quoted a premium of $204,430 to add the property to the blanket coverage, AVR went ahead and entered into a contract to purchase the luxury apartment complex for $97,500,000, and a loan commitment with its lender which required AVR to obtain full replacement coverage. However, after Gallagher emailed certificates of insurance to AVR for the $250,000,000 full replacement coverage without any sublimit, Gallagher learned that, in fact, because the property was located in New Orleans, it was subject to the $30,000,000 sublimit. Gallagher thereupon notified AVR of this, and undertook efforts to obtain additional coverage so as to provide full replacement cost insurance for the property. The quote obtained to give AVR full replacement coverage ended up exceeding $700,000.

AVR subsequently sued Gallagher for breach of contract and negligent misrepresentation, and claimed it had been damaged in the amount of

at least $5 million – because the amount it would have agreed to pay for the apartment complex would have been at least $5,000,000 less, had it known the true cost of the requisite property insurance. After obtaining evidence in discovery confirming the Gallagher account executive who handled the AVR account was aware AVR needed the price quote to set its budgets with regard to the purchase, AVR sought and obtained summary judgment as to liability on its breach of contract and negligent misrepresentation claims. Gallagher cross-moved for summary judgment, arguing that AVR's damage claim was speculative, in that AVR could not prove that but for the misrepresentation concerning the cost of the insurance it would have been able to purchase the property for $5 million less than it did. In denying Gallagher's motion on this ground, the court noted that while there may be situations where damages may be difficult to calculate, "where substantial damage has been suffered, the impossibility of proving its precise amount provides no basis for denying the recovery of substantial damages altogether."[13]

In *Scruggs v. Bost, et al.*,[14] Plaintiffs were a farmer and his various agricultural entities ("Scruggs") who had purchased genetically modified soybeans from Monsanto which were protected by patent, and which Monsanto sold to farmers under condition that they be used during only one growing season. While Scruggs was aware of the conditions under which Monsanto licensed its seed technology to farmers, he nonetheless replanted the seeds during other growing seasons and used seeds from his plantings for resale to other farmers. When Monsanto found out what he was doing it sued him, eventually obtaining a verdict for $8.9 million for Scruggs' willful infringement of its patents. Scruggs sought coverage under his general liability and umbrella coverage, which was denied based on the intentional act exclusion. He argued that he reasonably believed he could use the seeds as he did, and this argument was initially successful. However, on appeal the court reversed, holding that he was not entitled to coverage for what were clearly intentional and illegal actions.

Scruggs responded by suing his broker, claiming he had requested he be provided with coverage "in the event that anybody sued us over almost anything", and his broker had assured him that he would be protected from all potential liabilities, except for any that might arise out of the quality of the seed that he sold to third parties. However, he was not offered insurance against patent infringement. The claims against the broker were dismissed on summary judgment, and on appeal up to the Mississippi Supreme Court, the ruling was affirmed. In so holding, the court stated that the evidence of Scruggs' conduct being intentional was ample, and a federal jury had found his conduct to be willful following trial. As such, because there was no dispute he had acted intentionally and illegally, there was no insurance the broker could have purchased to protect him. Therefore, the broker could not be found liable for professional negligence as a matter of law.[15]

## Conclusion

As evidenced by the decisions discussed above, and in Part I of this article, there were some truly significant developments in the area of insurance agent and broker E & O case law this past year, and the relevant law continues to evolve. With regard to the duty to advise, the direction of the decisional law appears to indicate that courts will look long and hard to see if there may be an issue of fact concerning whether a duty to advise may have existed before summarily dismissing a claim based thereon. The economic loss doctrine continues to be in retreat as a defense to insurance agent/broker E & O Claims. The duty to read, while no longer an absolute defense to failure to procure claims in many states, continues to provide an important defense to agents and brokers accused of failing to procure the correct coverage or limits. And while cases with horrific fact patterns continue to give rise to arguments for broad extensions out of the agent's/broker's duties beyond their specific clients to the general public at large, thus far courts seem unwilling to cross that Rubicon.

*This article is derived in part from a forthcoming article to be published in the American Bar Association Tort & Insurance Practice Section Journal's Annual Survey of the Law on Professional Liability for 2014.*

## Endnotes

1 2014 U.S. Dist. LEXIS 48240 (W.D. Ok. Apr. 8, 2014).

2 *Id.* at *10.

3 *Id.*

4 2014 Ala. LEXIS 64 (Sup. Ct. Ala. May 9, 2014).

5 *Id.* at *35-36.

6 *Id.* at *33-35 (collecting cases).

7 *Id.* at *35. In another noteworthy decision, a Michigan appellate court noted that failure to read the policy may bar claims for fraud or negligent misrepresentation where the policy's language is clear and unambiguous because in such instance there could be no justifiable reliance. See Schumitsch v. Pioneer State Mut. Ins. Co., 2014 Mich. App. LEXIS 474 (Ct. App. MI, Mar. 20, 2014). However, the court held failure to read the policy would not bar a negligence claim where the broker assumed a special relationship by offering advice as to coverage. In such instance, failure to read the policy would only give rise to a comparative negligence defense. Id. at *5.

8 2014 U.S. Dist. LEXIS 143506 (W.D. OH Oct. 8, 2014).

9 *Id.* at *3.

10 *Id.* at *12.

11 *Id.* at *13 (quoting Napier v. Bertram, 191 Ariz. 238, 954 P.2d 1389, 1394-1395 (Sup. Ct. Ariz. 1998)).

12 2014 NY Slip Op 32831(U) (Sup. Ct. Nassau Cty. Sept. 26, 2014)

13 *Id.* at *11-12 (quoting Williston on Contracts §§ 64:8, 64:9 (4th ed.)).

14 2014 Miss. LEXIS 531 (Sup. Ct. Miss. Oct. 23, 2014).

15 *Id.* at *23-24.



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