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

by Peter J. Binging, Esq.

Introduction

This past year agents and brokers E&O began with a bang, with several enormously significant decisions regarding the duty to advise. Additionally, there were significant decisions with regard to when negligent procurement of coverage claims accrue for statute of limitations purposes, when the economic loss rule can be raised as a defense to a broker negligence claim, whether an insured's failure to read his policy can be raised as an absolute defense, and whether a duty to procure coverage can be extended to the general public in certain circumstances. This article, presented in two parts, will discuss some of the more interesting and important decisions of the past year, and in Part II, consider what lessons can be learned by agents, brokers, underwriters of agents and broker E&O coverage, claims personnel and E&O defense counsel going forward.

The Duty to Advise

With regard to the agent's and broker's duty with respect to procurement of coverage, the basic rule is that agents and brokers owe a duty to purchase the coverage requested or advise of their inability to do so within a reasonable period of time. The reason for this is that insureds are in a better position than anyone else to know their insurance needs, calculate the value of their assets and business operations, measure their ability to pay for insurance, and determine their ability to absorb uninsured risk. Further, if you were to act on the presumption that agents and brokers should be deemed responsible for insureds purchasing the coverage necessary for all possible circumstances, you would place an impossible burden on them. You would also run the risk that insureds would have no incentive to purchase the appropriate coverage, and would instead rely on their agent's or broker's errors and omissions coverage as excess insurance to protect them in the event that their coverage proved insufficient for a particular loss or claim.

For these reasons, the "special circumstances" necessary to give rise to a duty to advise can vary, but typically have been found to include (among others): clients paying broker fees for services beyond standard commissions; agents/brokers representing themselves as experts with knowledge the insured is relying on their expertise; agents/brokers providing advice on a specific coverage issue; and agents/brokers having a long-standing relationship with their clients such that the agent/broker should be aware the insured is placing special trust and reliance on him for advice and guidance with respect to the purchase of insurance. Absent these special circumstances, courts have not hesitated to find that an agent/broker has no legal duty to advise, and thus cannot be found liable for having failed to suggest or offer different coverage than what was purchased.

This history notwithstanding, there are indications the "special circumstances" line of defense that has previously provided such a substantial barrier to claims against agents and brokers for failing to properly advise their clients with regard to coverage issues is beginning to show some vulnerabilities, and it is more and more likely that a claim based on a failure to advise will survive where others typically failed. Three recent decisions in the past 12 months considering the issue offer evidence the duty to advise may be entertained as a viable claim far more frequently than once might have been imagined.

The first case of significant note in this area in the past year was actually issued in December 2013, where an Indiana appellate court considered an

argument made by a prosthodontist group that it had relied on its agent to provide advice regarding the sufficiency of its business contents property coverage, after it suffered a loss more than $500,000 in excess of its limits. In *Indiana Restorative Dentistry, P.C. v. Laven Insurance Agency Inc.,*[1] the trial court granted the agent summary judgment and dismissed the claim against it, after noting that the facts showed: (1) the agent's discretion to act on the insured's behalf in obtaining insurance renewals was limited to the coverages and amounts reflected on forms completed by the insured; (2) the agent did not provide insurance counseling; (3) the agent did not hold itself out as having skills over and above other agents; and (4) the agent's compensation was limited to commissions on the premiums. The agent argued it had purchased the insurance requested, and that should be the end of it, and the court agreed.

However, the appellate court reversed, relying in significant part on the fact that each year the agent would send the insured a questionnaire tailored to its business, the responses to which would provide the basis for the coverage limits purchased. The court found that even though the agent had purchased what was requested, by sending the questionnaire *the agent was inherently counseling the insured about its policy renewal.* Thus, "[e]ven though [the insured] made the final decision on its actual procurement of the recommended policies, [its] decision was in no small degree guided by its response to [the agent's] tailored questionnaire."[2]

In January, a Florida federal district court considered whether a duty to advise had existed and been breached in connection with the purchase of property insurance by a condominium association in *Tiara Condominium Association, Inc. v. Marsh USA, Inc.*[3] Here, the insured had an insurance committee composed of highly educated and sophisticated members (including an insurance company executive), and had asked its broker to purchase property insurance based on a two-year-old appraisal it was well aware would substantially understate the condominium's present value in order to reduce its premiums. Nonetheless, it argued its broker should be responsible for the fact that the coverage limits turned out to be insufficient to cover damages caused by two hurricanes hitting Florida in rapid succession. Marsh moved for summary judgment, contending the condominium association knew exactly what it had purchased and the risks presented. In denying the broker summary judgment, the court noted that in its contract with the insured Marsh had agreed it would act as the insured's "risk management" and "financial risk" advisor. So even though there was little doubt the Condominium's Board had engineered the purchase of less insurance to reduce its premiums, the court was going to leave it up to the jury to determine if Marsh had been negligent in failing to fully advise of the potential consequences of using the older appraisal, including the potential for the insurer to apply a coinsurance penalty as was allegedly threatened in this case, in connection with the negotiation of a reduced settlement of the insurance claim).[4]

Finally, in February the New York Court of Appeals considered whether a broker owed a duty to advise with respect to a company's business interruption coverage in *Voss v. The Netherlands Ins. Co*.[5] In Voss, the insured had argued that the broker had led it to believe it would regularly assess and offer advice with regard to the amount of the business interruption coverage limits. However, there had not been any dialogue with the broker about the business interruption coverage limits over several years, and then the insured suffered a significant business interruption loss for which it had insufficient limits. Because no advice on this had been given, the dissent argued that this meant no duty to advise should be found. Nonetheless, the majority concluded the allegations were sufficient to raise an issue of fact concerning whether the broker had accepted and breached a duty to advise concerning a coverage issue. Even though this really seemed to be a dispute about the broker's failure to provide *any* advice as opposed to negligent provision of advice that was relied upon and thus created a "special relationship," the court found there was an issue of fact for trial regarding whether a special relationship existed.[6]

Looking at these decisions, one can argue that they are just three recent rulings, the rulings are specific to their facts, and they are not necessarily representative of how courts will decide these issues in other cases going forward. However, they suggest a pattern is emerging that, where there is any possible argument that "special circumstances" exist giving rise to a duty to advise, the Courts are going to look very long and hard before summarily dismissing the insured's "failure to advise" claim.[7]

Statute of Limitations

In *Stephens v. Warden Ins. Agency,* LLC,[8] a Michigan state appellate court considered an issue of first impression with regard to when a negligent procurement or negligent advice claim accrues for statute of limitations purposes, and determined it accrues when the insurer denies the insured's claim. In reaching this determination, the court noted the determination as to when such claims accrue has received diverse treatment nationwide, with some courts holding the claim accrues when the insurance agent/broker commits negligence by procuring deficient coverage, others delaying the accrual of the claims to the date when the insured experiences the event for which no coverage is available, others holding such claims accrue when coverage is denied, and still others holding accrual does not commence until the underlying coverage dispute has been resolved by litigation.[9] The Michigan Appellate Court found such claims accrue when coverage is denied because "[o]n that date any speculative injury becomes certain, and the elements of the negligence action complete."[10]

In *Christianson v. Conrad-Houston Insurance,*[11] the Alaska Supreme Court affirmed dismissal of a complaint alleging negligent procurement by a broker on statute of limitations grounds where, following commencement of a personal injury lawsuit against the insured, tender of the defense to the insurer, denial of tender, and incurring of costs to pay for his own defense, the insured waited nearly four years to sue the broker (and the statute of limitations for professional negligence was three years). In so doing, the court noted that while a statute of limitations usually begins to run upon the occurrence of the last element essential to the cause of action, Alaska has adopted the "discovery rule", under which a cause of action accrues when the plaintiff has information sufficient to

alert a reasonable person to the fact he has a potential cause of action. In applying this rule, the courts in Alaska must look to the date when a "reasonable person in like circumstances would have enough information to alert that person he or she has a potential cause of action or should begin an inquiry to protect his or her rights."[12] Looking at the facts presented in this case, the Alaska Supreme Court found it was appropriate to conclude as a matter of law that the insured had a duty to make reasonable inquiry to protect his interests.[13]

Economic Loss Rule

While agents and brokers have regularly raised the "economic loss rule" as a defense to claims against them for negligence involving purely economic loss, the recent trend has seen courts moving towards rejecting this argument in the context of insurance agent and broker E&O claims. In *Sherman v. John Brown Ins. Agency, Inc.*,[14] yet another court joined the growing number of courts concluding the doctrine should not apply to bar such claims.

In *Sherman, the* Plaintiff, a building contractor, brought claims for both breach of contract and professional negligence against his insurance brokers based on the failure to purchase liability insurance which would have provided coverage for roofing operations. In the absence of this coverage, Plaintiff was left without insurance for a claim brought by the estate of an independent contractor who had died after falling from scaffolding erected by the Plaintiff.

Attempting to get the negligence claims against the broker defendants dismissed, the defendants argued, among other things, that the negligence claim was barred under Pennsylvania law by the economic doctrine. As interpreted by the Pennsylvania courts, the economic loss doctrine provides that no cause of action exists for negligence that results solely in economic damages unaccompanied by physical or property damages. While there is an exception to the economic loss doctrine for professional negligence claims, the defendants argued the exception could not apply in this case because pursuant to Pennsylvania Rule of Civil Procedure 1042.1 insurance brokers and agents are not among the list of enumerated professionals against whom a professional liability action can be initiated.

In finding the exception applied nonetheless, the court in *Sherman* noted Pennsylvania courts have characterized claims for failing to procure proper coverage as "professional negligence claims", and Pennsylvania courts considering the standard of care owed by agents and brokers have noted they are required to exercise the skill and knowledge normally possessed by members of that profession. Holding that the statute's list of professionals against whom a commencement of a professional liability lawsuit or claim must be preceded by the plaintiff obtaining a certification of merit from a qualified expert in the field does not necessarily encompass every professional against whom professional negligence claims can be commenced, the court found negligence claims against agents and brokers qualified as an exception to the economic loss doctrine in Pennsylvania.[15]

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Endnotes

1 *Glascoff v. One Beacon Ins. Co.*, 2014 WL 1876984 (S.D.KY. May 8, 2014).

2 999 N.E.2d 922 (Ct. App. Ind. Dec. 17, 2013).

3 *Id*. at 933.

4 *Id*. at 1283-1284. Interestingly, the court ended up bifurcating the trial, and first having the jury consider whether the requisite "special relationship" existed necessary to create a duty to advise. That trial resulted in a verdict that there was no special relationship, and thus no duty to advise.

5 2014 NY Slip Op 01259 (N.Y. Feb. 25, 2014).

6 *Id*. at *6.

7 Another interesting decision in this regard is *Seven Bridges Foundation, Inc. v. Wilson Agency, Inc.*, 2014 Conn. Super LEXIS 651 (Superior Ct., CT Jud. Dist. Of Stamford – Norwalk, Mar. 21, 2014). In *Seven Bridges*, after a construction company had purchased builder's risk insurance in the amount of $6.5 million for a building they were constructing, they asked if, in light of completion of some of the work, their insurance broker could reduce the coverage from $6.5 million to $3 million. After this was done, there was a fire requiring $5.2 million in repairs. When factoring in both the reduction in coverage and a coinsurance penalty, the construction company ended up with only $2.1 million in coverage for the loss. In response, the company sued its broker, claiming the broker intentionally failed to explain the risks faced by reducing the coverage, in an effort to curry favor with the company (and develop it as a client) by making it appear as if the company was 100% protected, but with a substantial premium savings. Even though the allegations specifically stated that the broker had complied with the company's request, the court allowed the action to proceed with claims of breach of fiduciary duty and fraudulent misrepresentation based on these allegations.

8 2014 Mich. App. LEXIS 1934 (Ct. App. MI Oct. 16, 2014).

9 *Id*. at *18-19 (collecting cases).

10 *Id*. at 19.

11 318 P.3d 390 (Sup. Ct. Alaska 2014).

12 *Id*. at 397 (quoting *Lee Houston & Assocs., Ltd. v. Racine*, 806 P.2d 848, 851 (Alaska 1991)).

13 *Id*. at 398.

14 2014 U.S. Dist. LEXIS 106825 (W.D. Pa. Aug. 5, 2014).

15 *Id*. at *17. In reaching this decision, the Court followed similar recent decisions in *Sharon Academy v. Wieczorek, Inc.*, 2013 Vt. Super. LEXIS 34, *10 (Vt. Super. Ct. Nov. 13, 2013), *Cleveland Indians Baseball Co., L.P. v. New Hampshire Ins. Co.*, 7272 F.3d 633, 640 (6th Cir. 2013), and *Tiara Condominium Ass'n Inc. v. Marsh & McLennan Companies, Inc.*, 110 So. 3d 399, 407 (Fla. 2013).

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