Insurance Broker E&O – Emerging Trends in Civil Litigation and Practice Tips for 2016

By Timothy G. Ventura

Riding the E&O Line
The Newsletter of the Professional Liability Committee of the DRI
Volume 16, Issue 3, September 14, 2015

This article identifies emerging trends in civil litigation errors and omissions (E&O) claims against insurance agents and brokers, with a quick look at some recent national cases which address the expanding "duty to advise," and a focus on the current state of Pennsylvania E&O law. While recognizing areas ripe for claims, I conclude with practice thoughts for E&O defense counsel, and "best practices" for insurance professionals to mitigate their E&O exposure in 2016.[1]

I. DUTIES OWED

With respect to a retail broker's tort duties owed, the general rule is that "An insurance broker is under a duty to exercise [reasonable] care that a … businessman in the brokerage field would . . . and if the broker fails to exercise such care and if such care is the direct cause of loss to his customer, then he is liable for such loss. Industrial Valley Bank and Trust Co. v. The Dilks Agency, et. al., 751 F.2d 637 (3d Cir. 1985); see also Al's Cafe v. Sanders Ins. Agency, 820 A.2d 745, 751 (Pa. Super. Ct. 2003). In other words, the agent has a duty to use that degree of care as would be expected of a reasonably competent agent under the same or similar circumstances. Keep in mind the distinction between claims for breach of tort duties owed (negligence) v. contract or statutory causes of action.

Duty to Procure v. Duty to Advise/"Special Relationship"

A key inquiry courts continue to tackle is the issue of a broker's "duty to procure" v. "duty to advise." Duty to procure means the broker is simply an "Order Taker," i.e., a duty to obtain coverage *requested* by the customer which they are willing to pay for, or to notify them of inability to do so. This duty is largely limited after binding of a policy absent affirmative misrepresentation.

On the other hand, a "special relationship" between a broker and customer may trigger a heightened "duty to advise," and this is an emerging trend which suggests expanding the duty of brokers under certain circumstances. Courts have identified the following factors which may give rise to a "special relationship" and duty to advise:

- Client pays "broker fee" for services beyond standard commission (10-15% of total premium);
- Advertisements of brokers as experts in a certain field/reliance by client;
    - (e.g., restaurants/bars, aviation risks, condo buildings, etc.)
- Broker provides advice on specific coverage issue;
- Long-standing or exclusive relationship between broker and client;
- Who makes final decision on coverage selections?
- Engagement Letter/Contract Language.

I recently handled a case where a mid-sized insurance brokerage always required their customers to sign a "Management Fee Agreement" which read in part:

> We often charge fees to cover various expenses such as inspections, credit reports, customer service, risk management . . . appraisals or valuations. Additionally we charge a management fee as part of our overall compensation, in addition to receiving commission. This is not intended to increase your overall cost of placing insurance through our company. The fee is separate and apart from all premiums and installment fees charged by insurance companies.
>
> *In accordance with State Insurance Laws, we must ask that you sign this memorandum prior to coverage going into effect, acknowledging your acceptance of the above as part of procuring the … insurance coverage through our facilities.*

Needless to say, plaintiff's counsel viewed this document as a "smoking gun" which triggered a "special relationship" and heightened duty of our broker to advise, appraise and valuate their customer's insurance needs, as well as recommend and instruct the client as to the type and *amount* of commercial coverage needed to adequately insure their commercial building, business personal property and business income interruption. Brokers should be wary of using documents like this, including additional fees charged for services which go beyond mere "procurement" functions.

Unfortunately for defendants, courts are tending to deem the "special relationship" issue a question of fact for a jury, rather than a question of law to be adjudicated at the summary judgment level before trial. Here are some recent decisions:

- Florida recognizes "special relationship" exception to the general rule of no duty to advise and considers it a question of fact. Tiara Condo. Ass'n v. Marsh, USA, Inc., 2014 U.S. Dist. LEXIS 3677 (S.D. Fla. Jan 13, 2014). The broker's MSJ was denied. USDC for Southern District of Florida noted the contract with the client stated broker would act as "risk manager" for client, and therefore a factual question existed whether there was a "special relationship" and if broker had a "duty to advise." The jury found no "special relationship" existed. Plaintiff condo association was a sophisticated insurance purchaser.

- In a 2015 opinion, the Supreme Court of Indiana, on summary judgment review, held that judgment was proper on implied contract theory (good for defense because no comparative negligence on contract theory), but that it was a question of fact as to whether the parties enjoyed a special relationship that created a duty to advise. Ind. Restorative Dentistry, P.C. v. Laven Ins. Agency, Inc., 27 N.E.3d 260 (Ind. 2015). After a fire, a dentist's office discovered that the contents coverage of its insurance policy—a policy it had maintained for over thirty years—was inadequate to cover the loss. The insurance agent and the insured disputed whether their long-term relationship was a special relationship that obligated the agent to advise the insured about its coverage. The parties also disputed whether their past dealings show a "meeting of the minds" on an implied contract, requiring the agent to procure a policy

that would cover all losses to office contents. The Court reasoned:

> All special relationships are long-term, but not all long-term relationships are special. "[I]t is the nature of the relationship, not [merely] its length, that invokes the duty to advise." Over the past four decades, our Court of Appeals has consistently relied on four factors beyond mere duration to identify a special relationship: whether the agent(1) exercise[es] broad discretion to service the insured's needs; (2) counsel[s] the insured concerning specialized insurance coverage; (3) hold[s] oneself out as a highly-skilled insurance expert, coupled with the insured's reliance upon the expertise; and (4) receiv[es] compensation, above the customary premium paid, for the expert advice provided.. (citing Parker, 630 N.E.2d 567 (Ind. Ct. App. 1994).

However, these factors are not exhaustive, nor is any particular factor dispositive. The Court went on to identify these special relationship factors:

- Annual questionnaires sent to customer
- Marketing material touting industry expertise in dentistry
- Underscores industry trade association ties
- Long term relationship 10+ years with current agency
- No extra fees above commission
- In Voss v. Netherlands, the NY Court of Appeals (Feb. 2014) found an issue of fact for trial existed regarding whether a special relationship existed and if broker owed a duty to advise on business interruption coverage.
- A special duty or relationship may be created when an agent assumes additional duties by holding herself out as having specific expertise. Williams v. Hilb, Rogal & Hobbs Ins. Servs. of Cal., Inc., 98 Cal. Rptr. 3d 910, 919 (Ct. App. 2009).
- "Insurance agents or brokers are not personal financial counselors and risk managers, approaching guarantor status. Insureds are in a better position to know their personal assets and abilities to protect themselves . . . unless the [agents or brokers] are informed and asked to advise and act." W. Joseph McPhillips, Inc. v. Ellis, 778 N.Y.S.2d 541, 543 (App. Div. 2004).

Note that some states recognize a duty to advise even *without* special relationship test as this is engulfed by breach of fiduciary duty or even negligence standards.

Breach of Fiduciary Duty/Restatement 552

Claims for breach of fiduciary duty and Restatement (Second) of Torts § 552 are

creating another mechanism for imposing liability. Some courts hold that insurance agents and clients have a fiduciary relationship akin to a lawyer, accountant or other professional. As such a fiduciary will be required to exercise *utmost good faith* and mere silence could be actionable. *See* Randolph v Mitchell, 677 So.2d 976 (Fla. 5th DCA 1996); Triarsi v BSC Group Services, LLC, 422 N.J. Super 104 (2011). "It is unclear whether a fiduciary relationship exists between an insurance broker and an insured. An insurance broker does act in a fiduciary capacity when he receives and holds premiums or premium funds." *Mark Tanner Constr. v. Hub Int'l Ins. Servs.*, 169 Cal. Rptr. 3d 39, 48 (Ct. App. 2014).

Some states including Pennsylvania have adopted 552, which provides for liability of one who supplies information for the guidance of others in the course of his profession, who rely upon it. This applies where a broker negligently conveys information to an insured about the coverage available under a policy. *See* Rempel v Nationwide Ins. 370 A.2d 366 (Pa. 1977). Most states already use 552 to create liability for other professions (accountants, appraisers, bank officers).

II. DECLARATORY JUDGMENT ACTIONS

Turning away from the special relationship analysis, other litigation trends include insurance carriers as plaintiff pursuing the broker on E&O claims. I am actively defending one such suit where Carrier Plaintiff sues co-defendant Policyholder seeking policy rescission (equitable relief on dec. action claim) for the alleged material misrepresentations in the policy application. Carrier claims it would never have issued the policy or charged higher premium had application questions been answered accurately. The carrier also sued my client broker for money damages in same suit under separate counts for fraud/negligent misrepresentations in the application (failure to investigate truthfulness of app. answers and negligent oversight). Carrier claims that, if coverage is owed on the policy for underlying catastrophic loss, then defendants owe underlying defense costs and indemnity payments incurred by carrier (policy limits) to defend and indemnify the underlying claims.

We raised a series of broker defenses, including: 1) Plaintiff's declaratory action against policyholder is an *equitable* claim seeking policy rescission and should be adjudicated separately as a threshold issue; if Carrier prevails on rescission and Court rules Carrier owes no coverage under the policy, then Plaintiff's tort claims against Broker are extinguished and moot because plaintiff arguably has no damages (No cross claims from policyholder against broker); 2) Carrier's tort claims against Broker should fail because Broker owed no tort duties to Carrier, and there is no contract between Carrier and Broker; 3) Carrier and its Managing General Agent (MGA w/binding authority) were comparatively/contributorily negligent for failing to perform their due diligence in writing and binding the policy by adequately inspecting the property and reviewing information/documents provided by Broker in the application process (loss runs from prior carrier); 4) Retail broker had no duty to conduct an independent investigation into the truthfulness and accuracy of information supplied by policyholder in application, and Broker had no knowledge of the alleged misrepresentations; 5) Even if Application Questions were answered differently, Carrier/MGA would still have issued the policy and simply charged a higher premium to do so, and Carrier's damages recoverable against Broker should be limited to the difference in charged premium. (Issue: consequential damages include defense costs of underlying claims which could exceed policy limits?)

III. COMMON LEGAL CAUSES OF ACTION ALLEGED AGAINST RETAIL BROKERS

- Breach of Contract (4 year statute of limitations in PA; oral included)
- Negligence/Negligent Misrepresentation

- Fraud/Intentional Misrepresentation (requires clear and convincing burden of proof, higher than preponderance; gives rise to punitive damages in PA)
- Breach of Fiduciary Duty (brokers owe duty of good faith and fair dealing to insureds in PA and other states)
- Deceptive or Unfair Trade Practices Statutes, (e.g., PA UTPCPL,73 P. S. §201-1 et. seq) (fee shifting, costs and treble damages recoverable in PA) (arguably not applicable to commercial products); application of statute varies greatly by state law (compare PA, NC, FLA).

Contributory Negligence Defense in Pennsylvania

When defending brokers against negligence claims in Pennsylvania, we raise the contributory negligence defense for fault of the policyholder/plaintiff, e.g., failure to read the policy or determine the value of his own property. Unlike many other states, in Pennsylvania, the doctrine of contributory negligence still exists with respect to actions seeking purely economic loss against professionals, and should bar recovery where Plaintiff is at least 1% responsible for the damages claimed.

Under Gorski v. Smith, 812 A.2d. 683 (Pa. Super. 2002), when pure monetary losses are sought, and one is not seeking damages for death, injury to person or property, the Comparative Negligence statute (42 Pa. C.S.A. §7102) does not apply. In Gorski, the Pennsylvania Superior Court held that, when pure monetary losses are sought, "malpractice actions are outside the scope of the comparative negligence act, and hence the doctrine of contributory negligence should apply."[2]

Applying contributory negligence principles in a professional negligence action *against insurance brokers*, the Third Circuit stated that, "**Although an insurance broker owes a duty of care to its customer, *that duty is not unaffected by the conduct of the customer itself***." (emphasis added). Industrial Valley Bank and Trust Co. v. The Dilks Agency, et. al., 751 F.2d 637 (3d Cir. 1985). The Third Circuit in Dilks went on to confirm the duty of insurance brokers in Pennsylvania as follows:

> An insurance broker is under a duty to exercise the care that a reasonably prudent businessman in the brokerage field would exercise under similar circumstances and if the broker fails to exercise such care and if such care is the direct cause of loss to his customer, then he is liable for such loss ***unless the customer is also guilty of failure to exercise care of a reasonably prudent businessman for the protection of his own property and business which contributes to the happening of such loss.***

Dilks at 639; see also Al's Cafe v. Sanders Ins. Agency, 820 A.2d 745, 751 (Pa. Super. Ct. 2003).

Yet, other Pennsylvania cases demonstrate a theoretical conflict we see across other states. In Drelles (Pa. Super. 2005), the court found an insured has the right to rely on the representations made by an insurance agent because of the agent's expertise in a "complicated subject." Considering the trust placed in insurance agents, the court found it is "not unreasonable" for consumers "to rely upon the representations of the expert rather than on the contents of the insurance policy itself," or to "pass" when the time comes to read the policy.

Last year, in Sherman v. John Brown, (W.D. Pa. 2014), the court rejected the economic loss doctrine defense (not contrib.) to negligence claims seeking purely economic damages -- and found that brokers fall within professional

liability exception to the rule. (Contrast with N.J. - not professionals).

IV. COMMON LEGAL DEFENSES OF BROKERS IN PENNSYLVANIA (AND ELSEWHERE)

- Contributory Negligence; 1% bars recovery. Gorski; Ind. Valley Bank; (limited protection to negligence claims only); Most states recognize comparative negligence rather than contrib. as complete bar.
- Insured has both the capacity and a duty to inquire about the scope of insurance coverage, rather than rely on "hand holding and substituted judgment." Kilmore v. Erie Ins. Co., (Pa. Super 1991).
- Brokers have no duty to speak about other policy options before policyholders purchase their insurance policy. *Weisblatt*, (E.D.Pa., 1998).
- Insurance brokers have no legal duty to inspect a business property for purposes of offering insurance. Wisniski (Pa. Super. 2006).
- Expert report is required to establish the duty owed by an insurance agent and a breach of that alleged duty. River Deck Holding Corp.,2004 Phila. Ct. Com. Pl. (Mar. 23, 2004), citing *Storm,* (Pa. Super. Ct. 1988).
- Tort duties owed to Policyholder, Not Carrier.
- Effect of Declaratory Judgment Action; If policy rescinded, carrier arguably has no damages against broker.
- MGA /Wholesaler liability.
- Insured has a non-delegable duty to review and read an insurance Application before signing it. Rony; Young (E.D. Pa. 1997).
- An applicant for insurance "may not avoid the responsibility imposed by the application by signing a blank form and leaving it to another to fill in the appropriate responses." American Franklin Life Ins. Co., (E.D. Pa. 1991).
- Insured cannot avoid the consequences of an insurance policy by alleging failure to read or understand the policy. Standard Venetian Blind., (Pa. 1983).
- Gist of the Action doctrine/Economic Loss doctrine (claims limited to contract or tort, not both).
- Some plaintiffs attempt to plead bad faith against broker under statute (42 Pa.C.S.A. 8371), but broker does not meet statutory definition of "insurer."

V. BROKER BEST PRACTICES TO REDUCE E&O EXPOSURE

Lastly, a non-exhaustive list of best practices for retail brokers to reduce E&O exposure in 2016:

- Service Engagement Letters to define/limit scope of services;
- Provide Customer with Options for their Selection/Decision;
- Document Everything – Especially Poor Decisions by Customer:
    - Annual mailings w/ enclosures, dec. sheets, policies, notices of renewal/termination
    - When client declines coverage or higher limits
    - When client is informed of reduced, changed or deleted coverage
    - Quote/proposal with sign-offs if appropriate
    - Phone conversations/all communications reduced to writing
- Do not assume duties beyond scope of knowledge (e.g., business valuations, appraisals, inspections, "risk management");
- Read and communicate all terms, quotes and binders from MGA's;
- Review existing coverage of new client before placing the risk;
- Application Process -- Insured Must See and Sign the Application;
- Educate broker's support staff.

Timothy G. Ventura *is an associate in the Professional Liability Department of the law firm Marshall, Dennehey, Warner, Coleman & Goggin, P.C. in Philadelphia, PA. Tim focuses his practice on the defense of claims and suits brought against insurance agents and brokers, construction companies, attorneys, financial entities, large product manufacturers, and other professionals. He is a member of the Defense Research Institute, PLUS, and the American, Pennsylvania and Philadelphia Bar Associations. Tim can be reached at tgventura@mdwcg.com or 215.575.2582.*