INSIGHTS

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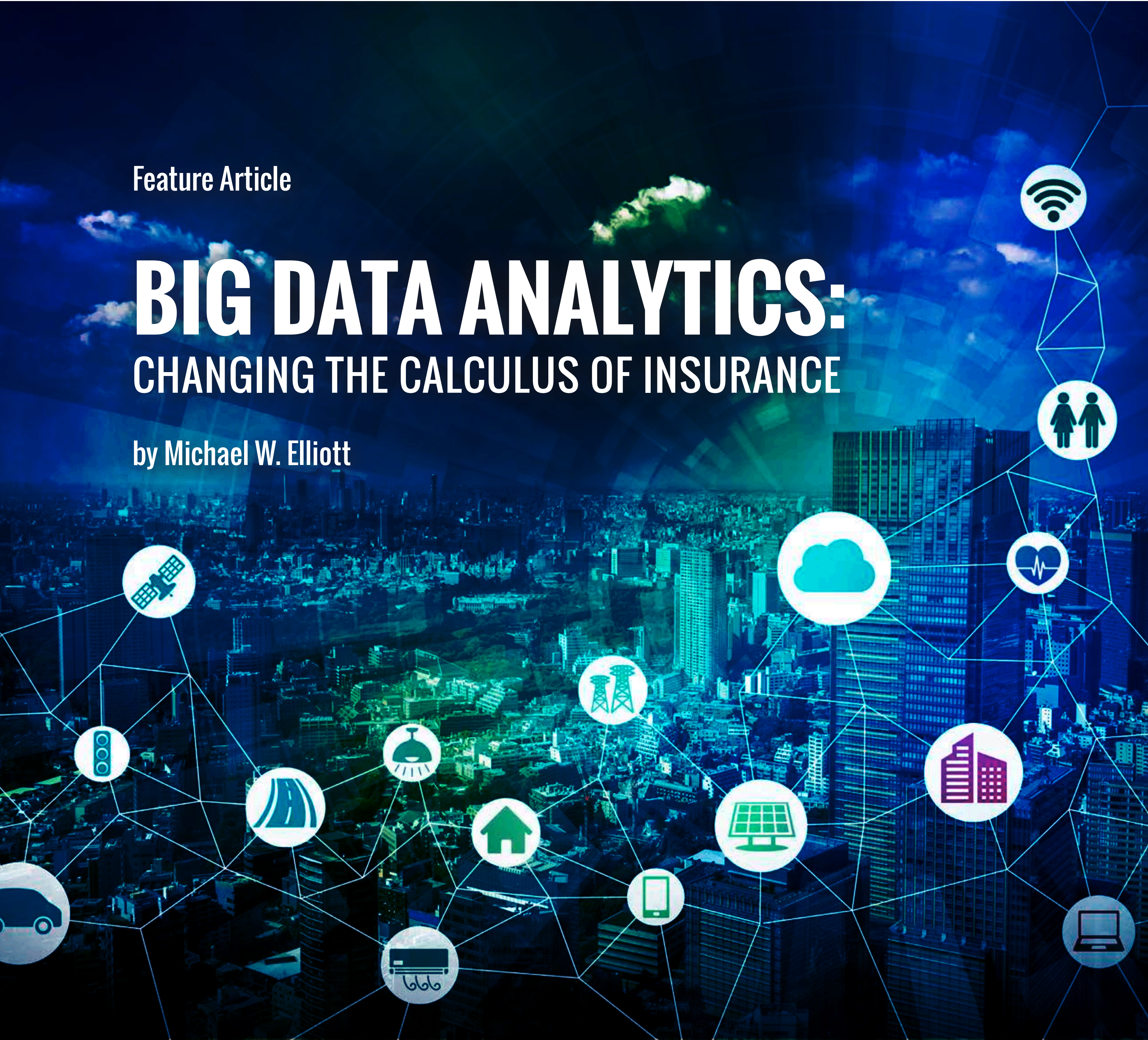

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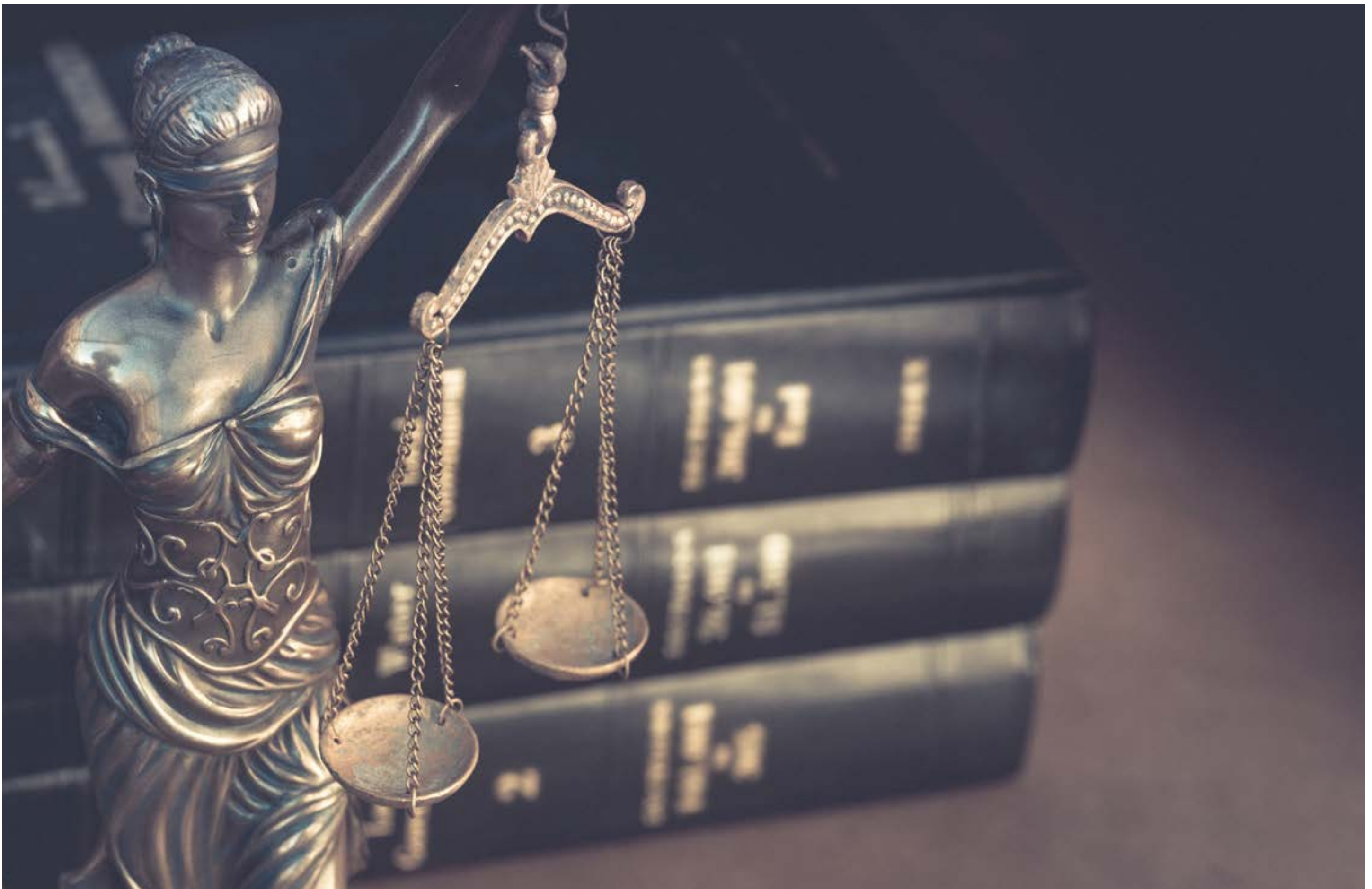

Insurance Agent E&O Claims Prevention and Defense—The Road Ahead

by Timothy G. Ventura and David W. Henry

Abstract
This article identifies emerging trends in errors and omissions (E&O) claims against insurance agents and brokers, with a quick look at some recent national cases that address the expanding special relationship/duty to advise, with a focus on the current state of E&O law. While recognizing areas ripe for claims, we conclude with suggestions to mitigate E&O exposure.

The rule that an insurance agent or broker[1] has a duty to exercise reasonable care is the traditional standard, but a greater standard is more frequently applied—if not expressly, then implicitly—in the evolving case law. For years, courts relied on the principle that if a broker fails to exercise reasonable care, and if such insufficient care is the direct cause of loss to a customer, then the broker is liable for such loss.[2] In other words, the agent has a duty to use the degree of care expected of a reasonably competent agent under the same or similar circumstances.

This evolution of the law arises from the notion that in some cases, the agent's duty goes beyond mere procurement to include a duty to advise or warn. Under a duty to procure, the broker's role is more passive—finding the coverage requested by the insured, with a concomitant duty to notify clients of an inability to obtain the coverage or secure renewal. This duty is largely limited after the policy is bound, barring any affirmative misrepresentations during the policy term.

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On the other hand, a growing number of courts have held that a special relationship between a broker and customer may trigger a heightened duty to advise that more closely resembles a fiduciary relationship, as well as a duty to safeguard the insured's interests, suggest coverages, or make recommendations, even in the absence of specific requests. The struggle comes as courts identify factors that may give rise to a special relationship and duty to advise.

Apart from payment in addition to commission, many of the following factors are common to ordinary duty-to-procure relationships:

- The client pays a broker's fee for services beyond standard commission (10 percent to 15 percent of total premium).
- Advertisements by an agent that suggest expertise or invite reliance by a client on the agent—e.g., hospitality, aviation, marine, schools, condominium exposures, etc.—recognizing that holding oneself out as having expertise is an important factor in determining whether a special relationship exists.[3]
- An agent provides advice on a specific coverage issue.
- A longstanding or exclusive relationship between broker and client.
- Purchasing decisions and coverage selections made by the agent.
- Engagement letter/contract language.

A recent case involving a midsize insurance agency brokerage hinged on 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.*[4]

> "…a growing number of courts have held that a special relationship between a broker and customer may trigger a heightened duty to advise"

The plaintiff's counsel seized on this agreement as a smoking gun, claiming that it triggered a special relationship and a duty to advise, appraise, and evaluate the customer's insurance needs, as well as to recommend and instruct the client as to the type and amount of commercial coverage needed for its commercial building, business personal property, and business income interruption exposure.

Agencies should be wary of using documents like this that include additional fees for services beyond procurement. However, engagement agreements are helpful if they contain language to the effect that it does not alter or modify the duty of care beyond that implied in the common law. Such an agreement might specify that nothing in it creates a special or fiduciary relationship.

Recent Decisions Regarding Special Relationships

Traditional theories are based on negligence, breach of contract for failure to procure, negligent advice, and misrepresentation. Additionally, some states permit policyholders to bring suit under consumer-related deceptive and unfair trade practice statutes, such as Pennsylvania's, which provide for attorneys' fees, costs, and treble damages. However, depending on statutory language, these consumer-protection statutes may not be applicable to commercial products and accounts.

Unfortunately for defendants, courts tend to hold that the special-relationship issue is a question of fact for a jury rather than a question of law. Duty, however, is a question of law. So in effect, the courts have held that the duty issue is a mixed question of law and fact. This means that resolution before trial is increasingly less likely.

Below, recent decisions surrounding special relationships are discussed.

In *Tiara Condominium Association v. Marsh, USA, Inc.*, Florida recognized the special-relationship exception to the general rule that agents/brokers have no duty to advise and consided it a question of fact. In this case, after an alleged windstorm loss, a sophisticated condominium association sued for Marsh's alleged failure to advise the Tiara Condominium Association on the adequacy of its coverage and for failure to procure per occurrence (as opposed to aggregate) limits of liability.

The policy was interpreted as providing per occurrence coverage, eliminating that claim but leaving open the claim that Marsh left the client inadequately insured and failed to recommend an updated appraisal to determine insurable value. The agent's motion for summary judgment was denied. The court noted that the contract stated that the agent/broker would act as "risk manager" for the client; therefore, a factual question existed as to whether there was a special relationship and whether the broker had a duty to advise. The jury later found that no special relationship existed.

This logical inconsistency exists because the special-relationship test speaks to the duty owed by the agent, and under long-standing Florida law, the duty element of a tort is unequivocally a question of law for the court, not for the jury.[5] This leaves defendants searching for summary judgment on a no-duty/no-special-relationship theory—but with the prospect that the court will allow the jury to decide whether a special relationship exists.

In a 2015 opinion, *Indiana Restorative Dentistry, P.C. v. Laven Insurance Agency, Inc.*, the Supreme Court of Indiana held that summary judgment was proper according to an implied-contract theory (which is good for the defense because there is no comparative negligence under a contract theory). But it also held that there was a question of fact as to whether the parties enjoyed a special relationship that created a duty to advise.

In this case, a dentist's office had maintained a policy for more than thirty years. After a fire, the insured discovered that the contents coverage of its policy was inadequate to cover the loss. The 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.

> "...in effect, the courts have held that the duty issue is a mixed question of law and fact. This means that resolution before trial is increasingly less likely"

They also disputed whether their past dealings showed a "meeting of the minds" on an implied contract, which would require the agent to procure a policy that covers all losses to office contents. The court reasoned:

> *All special relationships are long-term, but not all long-term relationships are special. "It 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[s] 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.*

The court's rationale was sharply criticized in the dissent, as the majority noted that customary facts about the relationship could be considered special-relationship factors, including annual questionnaires sent to the customer, marketing material touting industry expertise in dentistry, publicized ties with an industry trade association, and a relationship of more than ten years. This is a dangerous precedent because it fails to appreciate that duty is always a question of law for the court to decide in the first instance, and many of these factors are common in ordinary insurance agency practice.

There is some helpful case law, though. Defendants must focus on the line of authority that holds "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."[6] Although such discussion is beyond the scope of this article, defense attorneys and claims professionals should note that some states recognize a duty to advise within the ambit of ordinary negligence standards without expressly discussing the special-relationship test.

Breach of Fiduciary Duty and Restatement § 552

Claims for breach of fiduciary duty and/or Restatement (Second) of Torts § 552 are creating another mechanism for imposing liability. Some courts hold that insurance agents and their clients have a fiduciary relationship akin to that of lawyers or accountants and their clients. Agents would therefore be required to exercise utmost good faith, and mere silence could be actionable.[7] This trend does not favor agencies. Some courts recognize some fact-specific distinctions, but this is not

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much help in terms of motions to dismiss or for summary judgment. As one court noted, "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."[8]

Most states have adopted Restatement (Second) of Torts § 552, which imposes liability on those who, in the course of their profession, supply information to guide others. This applies, for example, when a broker negligently conveys information to an insured about the coverage available under a policy.[9] Outside insurance, most states already use Restatement (Second) of Torts § 552 to create liability for other professionals (accountants, engineers, appraisers, bank officers, etc.).

Declaratory Judgment Actions and Suits by Carriers

Aside from the analysis of special relationships, other litigation trends include insurers as plaintiffs pursuing brokers in E&O claims. An insurer may claim that it would never have issued the policy or charged a higher premium had application questions been answered accurately. An insurer may also sue an agency for fraud or misrepresentation while simultaneously seeking to rescind the policy. In such cases, the insurer claims that if coverage is owed for an underlying loss, then the agent is liable for damages related to the defense costs and indemnity payments incurred by the insurer (up to the policy limits) in connection with the claims.

A host of defenses to these rescission/tort cases are available. A plaintiff's declaratory action against a policyholder is an equitable claim seeking policy rescission and should be adjudicated separately as a threshold issue. If the insurer prevails on rescission and the court rules that the insurer owes no coverage under the policy, the plaintiff's tort claims against the broker are extinguished because the plaintiff arguably has suffered no damage.

Second, the insurer's tort claims against the agent should fail because the agent or broker owed no tort duties to the insurer. (The agent's tort duties flow to the policyholder.) The argument is that if the agent is the agent of the insured, it is unreasonable to consider the agent a dual agent and impose a duty running from the agent to the insurer—and even more so to permit reasonable reliance by the insurer on the insured's agent.

Alternatively, if there is an agency agreement, whatever duties exist are memorialized in the agency contract, and the economic loss rule should preclude the imposition of extracontractual duties in tort. The rationale is that whatever obligations the parties sought to impose and reduced to writing should be memorialized in the agreement, and unwritten obligations were either assumed or could not be negotiated.

Third, the insurer and its managing general agent (MGA) may have been comparatively or contributorily negligent for failing to perform their due diligence in writing and binding the policy by not adequately inspecting the commercial property and reviewing information provided by the broker in the application process (for example, loss runs from a prior insurer).

Fourth, the agent may argue that the retail broker had no duty to conduct an independent investigation into the truthfulness and accuracy of information supplied by the policyholder and that the broker had no actual knowledge of the alleged misrepresentations.

Lastly, one can argue that the insurer or MGA still would have issued the policy, albeit at a higher premium, and incurred the loss, so the insurer's damages recoverable against the broker should be limited to the difference in charged premium. Claims by insurers against agencies are not as common as traditional policyholder claims, but what they lack in frequency, they make up for in severity.

Suggested Practices to Reduce E&O Exposure

E&O exposure is ultimately based on the relationships formed by the agency and its ability to attract and keep diligent, forward-thinking employees. These are some suggestions to reduce that risk:

- Use engagement letters to define/limit scope of services.
- Provide the customer with documented affirmative choices and options.
- Document customers' rejection of advice and poor purchasing decisions.
- Reduce to writing all telephone conversations involving limits, coverage, additional insureds, loss payees, indemnity terms, and deductibles.
- Do not promise to assume duties beyond your scope of knowledge unless you must do so to keep the account or intend to charge for those services.
- Underwrite the experience and expertise of the wholesaler and ensure that coverage is bound as requested, with no gaps or strange endorsements inserted by the surplus lines agent, wholesaler, or MGA. E&O claims are more frequent in the wholesale market.
- Work hard to avoid employee turnover among account managers and customer service representatives. High turnover or loss of long-time employees may be a harbinger of later claims.

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- Review a new client's existing coverage before placing the risk.
- During the application or renewal process, make sure that the insured receives and signs the application.
- Educate support staff and reduce or eliminate unlicensed personnel.
- Engage in careful client selection, and be prepared to terminate relationships with high-maintenance, low-dollar clients.
- Look for better markets. Agencies that use insurers with low financial stability ratings have a higher rate of insolvency and E&O claims. ■

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Endotes

1. The definitions of "agent" and "broker" are jurisdictionally specific and readily interchangeable within the insurance industry. This article refers primarily to retail insurance brokers/agents who deal directly with the policyholder. Wholesalers may have some of the same concerns, depending on their relationship with the retailer and the markets they represent. Most states treat the retail agent as the agent of the insured, absent specific appointments and authority. See *Regis Ins. Co. v. Rathskellar* (Pa. Super. 2009).
2. See *Industrial Valley Bank and Trust Co. v. The Dilks Agency, et. al.*, 751 F.2d 637 (3rd Cir., 1985). See also *Al's Cafe v. Sanders Ins. Agency*, 820 A.2d 745, 751 (Pa. Super. Ct. 2003).
3. See *Williams v. Hilb, Rogal & Hobbs Ins. Servs. of Cal., Inc.*, 98 Cal. Rptr. 3d 910, 919 (Ct. App. 2009).
4. The authors note that this case was handled for a client that resolved the matter through a confidential settlement. Accordingly, the specific case cannot be cited.
5. See *McCain v Florida Power Corp.*, 593 So.2d 550 (Fla. 1992).
6. *Murphy v. Kuhn*, 90 N.Y. 2d 266, 682 N.E. 2d 972 (N.Y. 1997).
7. See *Randolph v. Mitchell*, 677 So.2d 976 (Fla. 5th DCA 1996); *Triarsi v. BSC Group Services, LLC*, 422 N.J. Super 104 (2011).
8. *Mark Tanner Construction v. Hub International Insurance Services*, 169 Cal. Rptr. 3d 39, 48 (Ct. App. 2014).
9. See *Liberty Surplus Insurance Co. v. First Indemnity Insurance Services*, 31 So.3d 852 (Fla. 4th DCA 2010); *Rempel v. Nationwide Insurance*, 370 A.2d 366 (Pa. 1977).

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