BROKERS' DILEMMA

by

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November 2019

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Insurance brokers and agents[2] are increasingly being brought into litigation when customers suffer a loss. Almost invariably the customer will claim that he or she relied on the advice given by the broker with respect to insurance, including both limits and coverage. But under what circumstances can the broker (and the broker's professional liability insurer) be held liable to the customer?

A lot has happened since the days of the 1971 case of *Greenfield v. Insurance Incorporated*,[3] wherein a broker was held liable for advising the customer that coverage had been obtained, when in fact it had not. The resolution of the case was based upon the broker's failure to exercise reasonable care in the placement of insurance. Today the focus of broker liability has shifted to the concept of a "special relationship" between a broker and the customer formed as a result of the broker's conduct.[4]

The general rule, broadly stated, is that a broker cannot be held liable to a customer for the customer's uncovered loss unless there is a special relationship between the broker and the customer.[5] In other words, the broker must have done something to take the relationship beyond the normal broker-customer relationship whereunder the broker is only obligated to use reasonable care in obtaining the coverage requested by the customer, or to advise the customer why the requested coverage is unavailable. Failure to notify a customer that insurance is not

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2 The terms "broker" and "agent" are used interchangeably. In many references the term "broker" is used herein for both brokers and agents.

3 19 Cal. App. 3d 803, 97 Cal. Rptr. 164 (1971).

4 *See also Goldberg v. Aon Risk Servs., Ne., Inc.*, 2018 U.S. Dist. LEXIS 156373 (S.D. Fla., Sept. 12, 2018); *Murphy v. Kuhn*, 90 N.Y.2d 266, 682 N.E.2d 972, 974, 660 N.Y.S.2d 371 (N.Y. 1997)); *cf*., *Luzzi v. Hub Int'l Northeast, Ltd.*, 2018 U.S. Dist. LEXIS 141542 (D.N.J., Aug. 21, 2018).

5 *See Sadler v. Loomis Co.*, 139 Md. App. 374, 776 A.2d 25 (2001); *Schlossberg v. B.F. Saul Ins. Agency of Md., Inc.*, 148 F. Supp. 3d 462 (D. Md. 2015); *Hansmeier v. Hansmeier*, 25 Neb. App. 742, 912 N.W.2d 268, 275-276 (2018), citing *Dahlke v. John F. Zimmer Ins. Agency*, 245 Neb. 800, 515 N.W.2d 767 (1994); *Junfang He v. Norris*, 3 Wn. App. 2d 235, 415 P.3d 1219, 1221 (2018); *Holborn Corp. v. Sawgrass Mut. Ins. Co.*, 304 F. Supp. 3d 392 (S.D.N.Y. 2018).

available may render the broker liable to the client for negligent breach of the agent's duty.[6] So, too, may liability attach where the customer has clearly stated what the customer wants, but the broker fails to follow the customer's instructions.[7] At the same time, insurance brokers owe a limited duty to their clients, which is only "to use reasonable care, diligence, and judgment in *procuring* the insurance requested by an insured."[8] An insurance broker does not breach its duty to customers to procure the requested insurance policy unless "(a) the [broker] misrepresents the nature, extent or scope of the coverage being offered or provided ... , (b) there is a request or inquiry by the insured for a particular type or extent of coverage ... , or (c) the [broker] assumes an additional duty by either express agreement or by 'holding himself out' as having expertise in a given field of insurance being sought by the insured."[9]

A broker is not obligated to give advice to a customer, and failure to do so will not necessarily result in liability. For example, in *Pabitzky v. Frager*,[10] an agent failed to advise the customer "to carry uninsured motorist insurance in an amount greater than the statutory minimum." Summary judgment was entered for both the insurer and the agent, with the court observing, "[t]here is no duty on the part of an insurance broker to do more than to call the attention of his customer to the availability of the statutory provision and, unless expressly told to omit it, to see that the policy complies with the statute."

The issue which arises most frequently is that of a "special duty," *i.e.*, was something done or said which altered the traditional role of the broker. There is a "special relationship" exception to the general rule of no duty to advise. "The exception becomes operative when an insurance broker encourages and engages in a 'special relationship' with its client, thereby triggering an enhanced duty of care to advise the client about the amount of coverage prudently needed to meet its complete insurance needs." Special relationship can be based upon several factors: "(1) representations by the broker about its [sic] expertise; (2) representations by the broker about the breadth of coverage obtained; (3) the length and depth of the relationship; (4) the extent of the broker's involvement in the client's decision making about its insurance needs; (5) information volunteered by the broker about the client's insurance needs; and (6) payment of

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6 *Bell v. O'Leary*, 744 F.2d 1370 (8th Cir. 1984).

7 *De Smet Farm Mut. Ins. Co. v. Gulbranson Dev. Co*., 2010 SD 15, 779 N.W.2d 148, 158 (S.D. 2010); *Kendall S. Med. Ctr., Inc. v. Consol. Ins. Nation, Inc.*, 219 So. 3d 185 (Fla. App. 2017).

8 *Pacific Rim Mechanical Contractors, Inc. v. AON Risk Insurance Services West, Inc*., 203 Cal. App. 4th 1278 (2012)

9 *Mark Tanner Construction, Inc. v. HUB International Insurance Services, Inc*., 224 Cal. App. 4th 574 (2014).

10 164 Cal. App. 3d 401 (1985). See also *Jones v. Grewe*, 189 Cal.App.3d 950, 954 (1987) (Insurance brokers owe a limited duty to their clients, which is only "to use reasonable care, diligence, and judgment in *procuring* the insurance requested by an insured.")

additional compensation for advisory services."[11]

An early California case illustrates the "special duty" point. In September 1982, Connecticut residents David and Joan Aherns wanted to purchase an automobile insurance policy that would provide coverage for anticipated travel in Europe. The Aherns contacted broker Ray Dillenback and told Dillenback they wanted a foreign policy that would provide full coverage or the "best coverage that exists." Dillenback filled out an overseas automobile insurance application from International Service Insurance Agency ("ISIA"). ISIA in turn obtained a policy from National Union Fire Insurance Company of Pittsburgh, Pennsylvania ("National Union"). The policy was duly renewed the following year.

On June 8, 1984, Joan Ahern, while driving her automobile in France, was seriously injured in a hit-and-run automobile accident with an unidentified and uninsured motorist. Her leg was amputated as a result of the accident. Insurance benefits under the policy were timely sought by the Aherns, but the claim was denied on the grounds that the policy did not provide coverage for collision; medical payments, or uninsured motorists.

The Aherns filed a lawsuit against Dillenback, his agency, National Union and ISIA alleging negligent procurement of insurance and loss of consortium. National Union filed a motion for summary judgment, which was joined by ISIA. On the invitation of the trial court, Dillenback and his agency joined the motion for summary judgment. Counsel for the Aherns stipulated to dismissing the Aherns' claims for negligent failure to procure collision and medical payments coverages so the matter could be immediately appealed. The trial court then granted summary judgment in favor of all defendants.

On appeal, the Court of Appeal affirmed, citing the landmark case of *Jones v. Grewe*[12] wherein the court pointed out:

> Ordinarily, an insurance agent assumes only those duties normally found in any agency relationship. This includes the obligation to use reasonable care, diligence, and judgment in procuring the insurance requested by an insured. [Citation.] The mere existence of such a relationship imposes no duty on the agent to advise the insured on specific insurance matters. [Citations.] "An agent may point out to [the insured] the advantages of additional coverage and may ferret out additional facts from the insured applicable to such coverage, but he is under no obligation to do so; nor is the insured under an obligation to respond." [Citation.][13]

It is accepted that an insurance agent does not have a duty to volunteer to an insured that the latter should procure additional or different insurance coverage. The rule changes when--but

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[11] *Tiara Condo. Ass'n v. Marsh, USA Inc*., 991 F. Supp. 2d 1271, 1280-12181 (S.D. Fla. 2014).

[12] 189 Cal.App.3d 950, 234 Cal.Rptr. 717 (1987).

[13] *Id*. at 954.

only when--one of the following three things happens: (a) the agent misrepresents the nature, extent or scope of the coverage being offered or provided, (b) there is a request or inquiry by the insured for a particular type or extent of coverage, or (c) the agent assumes an additional duty by either express agreement or by "holding himself out" as having expertise in a given field of insurance being sought by the insured.[14]

Under some circumstances a broker may have created an obligation to advise a customer of changes in the law affecting the customer's insurance policies. Where a broker has a practice of informing customers about changes in the law affecting their policies, the broker may have an obligation to continue to do so. For example, in *Baughman v. State Farm Mut. Auto. Ins. Co*.,[15] State Farm had a pattern of informing its policyholders of changes in the law which could affect their policies. But when the Ohio Supreme Court released its opinion in *Martin v. Midwestern Group Ins. Co*.,[16] which changed the law on uninsured motorist provisions in automobile policies, State Farm made no mention of the change, ostensibly because it would have had an adverse financial impact on State Farm. The *Baughman* court held that because of State Farm's pattern of informing policyholders, it assumed the obligation to continue to do so, even if the impact would have been adverse to State Farm's interests.[17]

Similarly, in *Certain Interested Underwriters at Lloyd's v. Bear, LLC,*[18] in 2006, the owner and managing member of Bear, LLC, entered into a contract for the construction of a yacht valued at $17 million. The yacht *Polar Bear* was duly constructed and insurance was obtained through Marsh's Yacht Group. The policy was renewed annually. In 2011 a copy of the 2011-2012 policy was provided to Bear along with a cover note which reminded the policyholder "to keep in mind the warranties and exclusions of the policy, especially those related to liabilities assumed under contract which are excluded unless approved by underwriters beforehand."

Among the conditions in the 2013 policy was a provision which provided:

> It is hereby understood and agreed that this insurance will remain in full force whilst your yacht is undergoing annual maintenance, repair of any part or replacement of any part like for like.

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[14] *Fitzpatrick v. Hayes*, 57 Cal.App.4th 916, 927 (1997); *see also Kotlar v. Hartford Fire Insurance Co*., 83 Cal. App. 4th 1116 (2000); *Hydro Mill Co., Inc. v. Hayward, Tilton & Rolapp Ins. Associates, Inc.*, 115 Cal.App.4th 1145, 1153 (2004).

[15] 2005-Ohio-6980 (2005), dismissed by stipulation, 2007-Ohio-2063, 865 N.E.2d 908 (2007).

[16] 70 Ohio St.3d 478, 1994 Ohio 407, 639 N.E.2d 438 (1994).

[17] *See also Berlin Corp. v. Cont'l Cas. Co.*, 2010 Conn. Super. LEXIS 1479, 2010 WL 2817269 (Conn. Super., June 2, 2010).

[18] 260 F. Supp. 3d 1271 (S.D. Cal. 2017).

> Notwithstanding the foregoing it is a condition precedent that if the vessel is currently undergoing or may undergo major refit or repairs, alterations, remodeling or where hot work is being undertaken (other than soldering) or that the yard has requested a waiver of subrogation from the Owner or his Legal Representative(s), then prior agreement must be obtained from participating insurers hereunder.

On May 6, 2014, the *Polar Bear* ran aground at the entrance of the San Diego Harbor and suffered considerable damage. During repairs, while welders were performing hot work, the *Polar Bear* was consumed by fire, resulting in its total loss. Underwriters were given prompt notice of the loss.

Underwriters responded by filing an action seeking a declaration that there was no coverage for the loss due to the policyholder's failure to comply with the conditions precedent. Not surprisingly, Bear filed a third party complaint against Marsh. Bear argued that Marsh had a special relationship to advise and recommend policies based on Bear's needs and because Marsh held itself out as an expert in yacht insurance and Bear relied on that expertise. Bear also argued that a better policy which would have provided coverage was available and Marsh should have recommended purchase of the better policy. The court granted summary judgment in favor of Marsh in part, but held there was a triable issue as to Bear's claim for breach of an enhanced duty as it related to the better policy.

The general rule is that a comparative negligence defense is unavailable to a professional insurance broker who asserts that the customer failed to read a policy and failed to detect the broker's own negligence. It is the broker, not the insured, who is the expert and the client is entitled to rely on that professional's expertise in faithfully performing the very job he or she was hired to do. Increasingly, however, the courts are requiring policyholders to read their policies and have some understanding of its contents. Some older cases have excused policyholders from that responsibility, but the modern trend is to the contrary, particularly in the case of sophisticated business customers.

Brokers may also incur liability to an insurer where the insurer issues a policy based upon false statements in an application where the broker knows, or reasonably should have known, that disclosure of the truth would have resulted in the insurer rejecting the application. In *Century Surety Co. v. Crosby Insurance, Inc.*[19] a broker was held liable to an insurer where the broker submitted an application identifying a general contractor as only a drywall contractor.

Most claims against brokers allege a breach of the standard of care required of brokers, since compliance with the standard of care would *ipso facto* defeat any claim for professional negligence. A breach of the standard of care, however, must be established through expert testimony. Failure to provide expert testimony will result in the professional negligence claim

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[19] 124 Cal. App. 4th 116, 21 Cal. Rptr. 3d 115 (2004).

being dismissed.[20]

Passage of time does not create a special relationship. Simply because a broker has handled a customer's insurance purchases over a long period of time does not, standing alone, create a duty on the part of the broker to advise the customer about its insurance needs or adequacy. However, where there is a long course of dealing during which the broker is instructed by a customer to keep the owner's property insured, take out policies thereon, and is authorized to obtain insurance in lieu of expired or canceled policies, a special duty has arisen.[21]

There is a very thin line between conduct which creates a special relationship and conduct which does not. Almost invariably the issue is a question of fact which must be resolved by a trier of fact, i.e., a court or a jury. Nevertheless, a broker can not be held liable for failing to obtain insurance coverage which the customer did not request. For example, in *Schlossberg v. B.F. Saul Ins. Agency of Md., Inc.,*[22] DTM, a security company, sought general liability coverage but in its application never mentioned a need for alarm system coverage. As a result alarm system coverage was excluded. Although the company indicated it didn't handle alarm systems, some the DTM guards were assigned to a plant where they were required to monitor the alarm system. They failed to do so properly, with the result that the plant sustained $3.6 million in damage to specialized computer equipment at the facility.

DTM sued its broker claiming that alarm system coverage should have been provided. The court entered summary judgment for the broker, ruling that the broker had no duty to

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[20] *See*, *e.g.*, *United States Fidelity & Guaranty Co. v. Lee Investments, LLC*, 641 F.3d 1126, 1138-1139 (9th Cir. 2011); *Energy 2001 v. Pacific Insurance Company Ltd., Inc*., 2011 U.S. Dist. LEXIS 142088 (E.D. Cal., Dec. 9, 2011); *151 First Side Assocs., L.P. v. Hostetler*, 131 A.3d 101 (Pa. Super. 2015); *Barrett v. JP Morgan Chase Bank*, 2016 U.S. Dist. LEXIS 83950 (S.D. Cal., June 27, 2016); *Ehrhardt v. Amguard Ins. Co.*, 2017 N.J. Super. Unpub. LEXIS 3018 *; 2017 WL 6048119 (N.J. Super., Dec. 7, 2017); *Estvold Oilfield Servs. v. Hanover Ins. Co.*, 2018 U.S. Dist. LEXIS 146147, 2018 WL 4101504 (D.N.D., Aug. 28, 2018); *Hice v. Lott*, 223 P.3d 139 (Colo. App. 2009); *Loomcraft Textile & Supply Co. v. Schwartz Bros. Ins. Agency*, 2017 IL App (2d) 160557-U (2017); *Omega Fin. Servs. v. Aspen Specialty Ins. Co.*, 2014 N.J. Super. Unpub. LEXIS 2333 (N.J. Super., Sept. 22, 2014); *Optica, Inc. v. Metro Pub. Adjustment, Inc.*, 2005 U.S. Dist. LEXIS 15281 *; 2005 WL 1719134 (D.N.J., July 21, 2005); *Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc*., 351 S.C. 459, 570 S.E.2d 197 (2002); *Spires v. Acceleration Nat'l Ins. Co.*, 417 F. Supp. 2d 750 (D.S.C. 2006); *United States Fid. & Guar. Co. v. Lee Invs. LLC*, 551 F. Supp. 2d 1114 (E.D. Cal. 2008); *Vineland 820 N. Main Rd. v. United States Liab. Ins. Co.*, 2018 U.S. Dist. LEXIS 168826 (D.N.J., Sept. 29, 2018); *cf*., *Lee v. Calfa*, 528 N.E.2d 336 at 343, 174 Ill. App. 3d 101 (1988); *Wheaton Nat. Bank v. Dudek*, 59 Ill. App. 3d 970, 376 N.E.2d 633 (1978).

[21] *Graham v. Lloyd's Underwriters at London*, 964 So.2d 269, 275 (Fla. Dist. Ct. App. 2007) (once a broker or agent procures the insurance requested by the insured, his or her employment and duty end; however, where "a broker or agent is instructed by an owner with the duty of keeping the owner's property insured, taking out policies thereon, and authorized to obtain insurance in lieu of expired or canceled policies, the broker or agent is the general agent of the owner in these respects as to the latter's insurance.") *Cat'N Fiddle, Inc. v. Century Ins. Co*., 213 So.2d 701, 704 (Fla. 1968) (quoting *Stuyvesant Ins. Co. v. Barkett*, 226 Ky. 424, 11 S.W. 2d 87, 89 (Ky. Ct. App. 1928)).

[22] 148 F. Supp. 3d 462 (D. Md. 2015).

procure coverage for alarm monitoring where DTM never requested such coverage, nor alerted the broker that DTM guards monitored alarms.

Cheaper is not necessarily better, and the consequences of untrained or unknowledgeable agents or brokers can be catastrophic. For example, in *Liberty Mut. Fire Ins. Co. v. Woolman,*[23] Dennis Woolman, former president of The Clemens Coal Company, delegated the responsibility for procuring insurance to an outside consultant. The consultant duly obtained quotations for workers' compensation and employer liability coverage. The lowest quote obtained came from Liberty Mutual Fire Insurance Company. The broker usually used by the consultant warned that because of the low quote "suggested that the policy provided different coverages."

Due to the low quote from Liberty, the consultant placed the coverage with Liberty. Neither Woolman nor the consultant realized that the policy as issued contained exclusions for federal occupational disease claims, including those arising under the Federal Coal Mine Health and Safety Act of 1969, as amended by the Black Lung Benefits Act (the "Act").[24] The Act requires coal-mine operators to provide benefits to miners whose contraction of pneumoconiosis, *i.e.*, "black lung" disease from prolonged exposure to coal dust renders them totally disabled. Failure to procure such insurance could expose Clemens Coal's president and its officers to individual personal liability for black-lung benefits as well as for civil penalties.[25]

In the ensuing litigation, Woolman contended that Liberty breached a duty owed by failing to provide coverage for black lung disease. The district court found that Liberty owed no such duty and following a bench trial entered judgment in favor of Liberty. On appeal, the Tenth Circuit agreed with the district court. Noting the well-established rule that estoppel cannot be used to expand coverage where none has been contracted for, the appellate court affirmed the district court's judgment in favor of Liberty, leaving Woolman and his fellow officers potentially liable.

Choice of law provisions in brokerage agreements can have a potentially dispositive outcome of broker-customer agreements. For example, in *C-Bons Int'l Golf Group, Inc. v. Lexington Insurance Co*.,[26] C-Bons suffered claimed damages of $31,000,000 to its properties from Hurricane Harvey. Lexington refused to pay the total amount of the loss, arguing that much of the loss was due to flooding, an excluded cause of loss. C-Bons then looked to its broker, Willis of Illinois, Inc. & Willis Towers Watson U.S. LLC's (collectively "Willis")[27] to cover any

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[23] 2019 U.S. App. LEXIS 1149, 10th Cir., January 14, 2019.

[24] 30 U.S.C. §§ 901-945.

[25] *Id*.§ 726.302(c)(1)-(2).

[26] 2019 U.S. Dist. LEXIS 183295, 2019 WL 5427574 (N.D. Tex., Oct. 22, 2019).

[27] It was contended that Willis Towers Watson U.S. LLC was not a proper party to the action, but the Court did not reach a decision on that issue in its current ruling.

shortfall after payments by Lexington, alleging breach of fiduciary duty as well as violations of the Texas Insurance Code.

Willis moved to dismiss the counts for breach of fiduciary duty and violations of the Texas Insurance Code arguing that Illinois law should apply. The brokerage agreement between C-Bons and Willis provided, among other provisions, that "[o]ur agreement for services shall be governed by and construed in accordance with the laws of the state in which our office is located." Willis is headquartered in Illinois but has eight offices in Texas. Which state's law applies would result in a markedly different outcome.

Illinois insurance law provides:

> No cause of action brought by any person or entity against any insurance producer . . . shall subject the insurance producer . . . to civil liability under standards governing the conduct of a fiduciary or a fiduciary relationship except when the conduct upon which the cause of action is based involves the wrongful retention or misappropriation by the insurance producer . . . of any money that was received as premiums, as a premium deposit, or as payment of a claim.[28]

"Texas recognizes both formal fiduciary relationships and informal ones arising from a 'moral, social, domestic or purely personal relationship of trust and confidence, generally [associated with] a confidential relationship.'"[29] As the Court noted, "Therefore, under Texas law, a claim for a breach of a special and/or fiduciary relationship may be plausible here."[30]

In other words, if Illinois law is applied, there is little likelihood that Willis would be held liable for any shortfall between Lexington's coverage at the actual loss, whereas if Texas law is applied the result could be quite different. Never ignore the choice of law to be applied.

Coverage and liability issues will continue to plague the brokerage industry, but with careful attention many issues can be avoided. Brokers today would be well advised to remember the old legal adage: "If it isn't in writing, it didn't happen!" The best defense against claims of a special relationship, breach of the standard of care, or breach of fiduciary duty, is a contemporary memorandum memorializing the facts of the transaction and the interaction and reasonable expectations of the parties.

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[28] 735 ILCS 5/2-2201(b). An insurance broker under Illinois law is an "insurance producer." *See Skaperdas v. Country Casualty Insurance Co*., 28 N.E.3d 747(Ill. 2015).

[29] *See CIC Prop. Owners v. Marsh USA, Inc*., 460 F.3d 670, 672 n.1 (5th Cir. 2006) (quoting *Associated Indem. Corp. v. CAT Contracting, Inc*., 964 S.W.2d 276, 287 (Tex. 1998)).

[30] *Id*.