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Insurance Broker Liability to Policyholders for Denied Claims: Latest Case Law Developments

Navigating the Evolving Scope and Breadth of a Broker's Duties and Obligations

WEDNESDAY, MAY 11, 2016

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INSURANCE BROKER LIABILITY TO POLICYHOLDERS FOR DENIED CLAIMS: Latest Case Law Developments

Strafford Webinar: May 11, 2016



Speakers

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Overview of Presentation

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- What Is an Insurance Broker?
- Understanding the Broker's Relationship to the Insured
- Identifying the Broker's Duties v. an Insured's Duties
- "Special relationships" Between Broker and Insured
- Claims Insureds Bring Against Brokers
- Best Practices for Brokers and Insureds

Defining Insurance Broker - 1

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- Intermediary
- Independent from insurers
- Different than an insurance “agent”
- Intermediary’s duties determined by specific role and task at the time in question

Defining Insurance Broker - 2

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- Brokers play significant role in the marketplace
- Connect insureds to insurers
- Insureds often depend heavily on brokers
- Brokers often cultivate close relationships with insureds

Brokers' Expanding Roles: Not Just Selling Insurance

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- Larger insurance brokers do much more than assist in securing insurance
 - ▣ Advise on issues that touch insurance, but are not insurance:
 - Human resources and vetting individuals
 - Corporate transactions, including structure and strategy for mergers and acquisitions
 - Fire protection engineering, including compliance with regulations and standards
 - Planning, prevention and response advice for food and product recalls
 - Quantifying risk exposure for certain types of events, such as weather and terrorism
- Brokers tout their substantive and geographical (global) reach
- “Trusted Advisors” can be found on almost every broker’s website

Brokers' Expanding Roles: Claim Handling

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- Many Brokers Offer to Handle Recovering Insurance Proceeds
 - Tout access to or relationship with insurers
 - Opens brokers up to potential liability beyond notice traps
 - Inadvertent disclosure of confidential or privileged information or communications?
 - Inadvertently undermine claim based on early claim conduct/positions
- Query: Are boards of directors obligated to ensure that insurance recovery for high-dollar claims has been maximized? Will brokers provide a legal opinion that this has been satisfied?

Broker Independence From Insurers - 1

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- Brokers cannot be salaried by insurer
- Brokers CAN be compensated by insurer
 - ▣ Typically compensated by commission on premium
 - ▣ May be that insurers consider total sales or profit/loss ratios of a broker's sale of their policies
- Compensation by insurer does not compromise brokers' independence. See, e.g., *Royal Maccabees Life Insurance Co. v. Malachinski*, 161 F. Supp. 2d 847, 852 n.2 (N.D. Ill. 2001).

Broker Independence From Insurers - 2

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- Typically procure insurance from multiple carriers
- Not bound by contract to work for any one insurer
- Not necessarily limited to lines of coverage or geographic regions
- Cannot bind coverage for an insured without an insurer's approval
- *See, e.g., Amstar Insurance Co. v. Cadet*, 862 So. 2d 736 (Fla. Dist. Ct. App. 2003).

The Broker Agency Relationship - 1

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- Basic agency principles apply
- Broker generally acts as the agent of the insured to procure insurance. *See, e.g., Evtex Co. v. Hartley Cooper Assocs., Ltd.*, 911 F. Supp. 732, 738 (S.D.N.Y. 1996).
- There are situations where broker may be agent of insurer (e.g., insurance application, collecting insurance premiums, transmitting claims)

The Broker Agency Relationship - 2

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- Broker may have dual duty
- Factors that bear on whether a broker is acting as agent of insured or insurer:
 - ▣ 1) who called the intermediary into action;
 - ▣ 2) who controls intermediary's actions; and
 - ▣ 3) whose interests does the intermediary represent
- See, e.g., *Royal Maccabees Life Insurance Co. v. Malachinski*, 161 F. Supp. 2d 847, 851-52 (N.D. Ill. 2001).

Broker Obligations and Duties To Insured:

Duty to Procure

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- Basic duty of broker is to procure insurance for insured – Broker as “Order Taker”
- Traditional view is that duty to procure only obligates broker to use “reasonable care, skill and diligence in procuring insurance” requested by the insured
- *See Emerson Electronic Co. v. Marsh & McLennan Cos.*, 362 S.W.3d 7 (Mo. 2012).

Broker Obligations and Duties To Insured:

Typically Limited to Duty to Procure

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- Typically no duty to advise on the adequacy of coverage or limits requested or to procure complete coverage for insured
 - *Sadler v. The Loomis Co.*, 776 A.2d 25 (Md. 2001) (distinguishing duty to advise as to optional UIM coverage in umbrella policy v. duty to advise as to adequacy of limits).
 - *Murphy v. Kuhn*, 660 N.Y.S.2d 371, 375 (N.Y. Slip. Op. 1997) (“Insurance agents or brokers are not personal financial counselors and risk managers, approaching guarantor status.”).
 - *Indiana Restorative Dentistry, P.C. v. Laven Ins. Agency, Inc.*, 999 N.E. 2d 922, 929 (Ind. Ct. App. 2013) (holding that “something more than the standard insurer-insured relationship is required” to impose heightened duties on broker).

Broker Obligations and Duties To Insured:

Unclear Fiduciary Duty

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- Unclear whether fiduciary relationship exists between brokers and insureds:
 - *Hydro-Mill Co. v. Hayward, Tilton and Rolapp Insurance Associates, Inc.*, 10 Cal. Rptr. 3d 582, 592-93 (Cal. Ct. App. 2004) (noting that many courts have held that the broker/insured relationship is not a fiduciary relationship).
 - *Garrick v. Meisrow Fin. Holdings, Inc.*, 994 N.E.2d 986, 990 (Ill. Ct. App. 2013) (finding that “[t]he relationship between an insured and his broker or producer, acting as insured’s agent, is a fiduciary one”).
 - *President v. Jenkins*, 357 N.J. Super. 288, 308 (N.J. App. Div. 2003) (“Without question, insurance brokers and agents owe a fiduciary duty of care to insureds.”).
 - *Bruckmann, Rosser, Sherrill & Co., L.P. v. Marsh USA, Inc.*, 885 N.Y.S.2d 276, 278 (N.Y. App. Div. 2009) (“[A]bsent a special relationship, a claim for breach of fiduciary duty does not lie.”).

A “Special Relationship” Between Broker and Insured May Add to a Broker’s Duties

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- The existence of a “special relationship” may add to a broker’s duties to insurer beyond the duty to secure insurance coverage for the insured
- High burden to demonstrate relationship
- Some states require a written agreement to establish special relationship
- Other states require only showing of relationship through the parties’ prior dealings. *See, e.g., Buelow v. Madlock*, 206 S.W.3d 890 (Ark. 2005).

Determining Whether There is a “Special Relationship”

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- Circumstances where there may be a “special relationship”:
 1. Broker holds himself/herself out as insurance specialist (and receives additional related compensation);
 2. Broker misrepresents the nature, extent, or scope of coverage being offered;
 3. Long-standing relationship with broker (or written agreement), some exchange concerning the coverage at issue, insured’s reliance on broker’s purported expertise to its detriment, and broker’s awareness of that reliance;

Determining Whether There is a “Special Relationship” (cont.)

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- Circumstances where there may be a “special relationship”:
 - 4. Broker counsels insured concerning coverage issues; and/or
 - 5. Broker exercises broad discretion in ensuring that the insured’s needs are met.
- Also articulated as a question of “entrustment”
 - *See Valley Equip. Leasing, Inc. v. McGriff, Seibels & Williams of Or., Inc.*, 2016 U.S. Dist. LEXIS 56735 (D. Colo. Apr. 28, 2016) (Colorado law; question is whether the . . . broker assumes additional responsibilities beyond those which attach to an ordinary, reasonable agent possessing normal competencies and skills.”)

Long Relationship \neq “Special Relationship”

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- The length of the broker-insured relationship may not be sufficient to show a special relationship without other evidence of a pattern or course of dealing showing that the broker knew:
 - (1) of the insured’s specific insurance needs; and/or
 - (2) that the insured would rely upon the broker for advice as to those needs.
- *E.g., Bigger v. Vista Sales & Marketing, Inc.*, 505 S.E.2d 891, 893-94 (N.C. Ct. App. 1998) (a 28-year relationship was not enough);
McClammy v. Cole, 243 P.3d 932, 934-35 (Wash. Ct. App. 2010).

Broker Licensing ≠ Broker Duties

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- Required to fulfill certain state licensing requirements
- Typically must be licensed by states in which they conduct business
- Typically states license by lines of business (e.g., property and casualty, surplus lines, life insurance, etc.)
- Even if a broker procures insurance without required licensing, the insurance an insured purchases likely will be valid and enforceable. *See Equity Diamond Brokers, Inc. v. Transnational Insurance Co.*, 785 N.E.2d 816, 821 (Ohio Ct. App. 2003).

Examples of “Special Relationship” Cases

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- *Fitzpatrick v. Hayes*, 67 Cal. Rptr. 2d 445, 452 (Cal. Ct. App. 1997).
- *American Building Supply Corp. v. Petrocelli Group, Inc.*, 979 N.E.2d 1181, 1186 (Ct. App. N.Y. 2012).
- *Voss v. Netherlands Ins. Co.*, 8 N.E.3d 823 (N.Y. 2014).
- *Core-Mark Int’l v. Swett & Crawford Inc.*, 898 N.Y.S.2d 206 (N.Y. App. Div. 2010).
- *Collins v. Farm Bureau Gen. Ins. Co.*, No. 314522, 2014 WL 2600580 (Mich. Ct. App. June 10, 2014).
- *McClammy v. Cole*, 158 Wash. App. 769 (2010).

But see, e.g., Non-Special Relationship Cases

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- *Hoffend & Sons, Inc. v. Rose & Kiernan, Inc.*, 851 N.E.2d 1149 (N.Y. 2006).
- *Sawyer v. Rutecki*, 937 N.Y.S.2d 811 (N.Y. App. Div. 2012).
- *DeHayes Grp. v. Pretzels, Inc.*, 786 N.E.2d 779 (Ind. Ct. App. 2003).

Absence of “Special Relationship” May Protect Broker From Liability

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- Broker not required to deliver best-priced insurance or disclose commissions in absence of “special relationship”
 - ▣ *See, e.g., Emerson Electronic Co. v. Marsh & McLennan Cos.*, 362 S.W.3d 7 (Mo. 2012).
- Broker not required to advise concerning adequacy of policy’s limits in absence of “special relationship”
 - ▣ *E.g., McLammy v. Cole*, 243 P.3d 932 (Wash. Ct. App. 2010).

Potential Claims Against Brokers

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- “Failure to Procure” - Insured alleges that the broker committed wrongdoing with respect to the procurement of coverage for the insured
 - ▣ Failure to procure requested coverage and/or advise on or secure adequate coverage;
 - ▣ Submission of inaccurate application;
 - ▣ Failure to comply with continuing duty on coverage;
- Claims Handling - Insured alleges wrongdoing with respect to the broker’s handling of a claim or potential claim
 - ▣ Failure to properly advise insured regarding claims
 - ▣ Failure to provide notice of claim or potential claim or advise insured to do so

Failure to Procure Requested Coverage

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- Coverage obtained was different than coverage requested
 - ▣ *American Building Supply Corp. v. Petrocelli Group, Inc.* 979 N.E.2d 1181 (N.Y. 2012);
 - ▣ *Aden v. Fortsh*, 776 A.2d 792, 801 (N.J. 2001);
 - ▣ *Desai v. Farmers Insurance Exchange*, 55 Cal. Rptr. 2d 276, 281 (Cal. Ct. App. 1996).

Submission of Inaccurate Application Materials

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- Insurer can rescind policy based on material misrepresentation even if due to the fault of the broker
 - ▣ *See, e.g., Mitchell v. United National Insurance Co.*, 25 Cal. Rptr. 3d 627 (Cal. Ct. App. 2005).

Reporting of Claims to Insurer

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- Notice to broker may be construed as notice to insurer (depending upon specific jurisdiction)
- Failure by broker to provide timely notice may result in denial of coverage based on notice
 - *See, e.g., Farm Bureau Life Insurance Co. v. Chubb Custom Insurance Co.*, 780 N.W.2d 735, 739–42 (Iowa 2010) (upholding denial of coverage based on late notice).
- Denial of coverage may, in turn, lead to claim by insured against broker
 - *See, e.g., Ben Heller, Inc. v. St. Paul Fire & Marine Insurance Co.*, 435 N.Y.S.2d 669, 670–71 (N.Y. App. Div. 1981).

Typical Legal Theories Asserted Against Brokers

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- Negligence: Insured must demonstrate that its loss resulted from the broker's breach of its duties owed to the insured
 - ▣ *See, e.g., Pressey Enterprises v. Barnett-France Insurance Agency*, 724 N.W.2d 503, 505 (Mich. Ct. App. 2006).
- Breach of Contract: Insured must demonstrate that there was an agreement between the insured and broker (written or oral) and that the broker breached that agreement
 - ▣ *See, e.g., Hydro-Mill Co. v. Heyward, Tilton and Rolapp Insurance Associates, Inc.*, 10 Cal. Rptr. 3d 582, 590 (Cal. Ct. App. 2004).

Other Potential Legal Theories

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- Breach of Fiduciary Duty: Not recognized by all states
- Negligent Misrepresentation: (1) broker makes false statement; (2) that broker intended for the insured to rely upon; (3) that the broker knew the insured was likely to rely upon and suffer harm as a result; and (4) that the insured relied upon and was justified in doing so. *See, e.g., Twelve Knotts Ltd. Partnership v. Fireman's Fund Insurance Co.*, 589 A.2d 105, 111 (Md. Ct. Spec. App. 1991).
- Fraud / Bad Faith: (1) broker's knowingly false representation; (2) made with intent to deceive insured; (3) upon which insured justifiably relied; and (4) that resulted in harm to insured. *See, e.g., id.*

Procedural Scenario for Claims

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- Frequently, claims are brought against both broker and insurer. *See, e.g., 3094 Brighton, LLC v. Zurich Specialties.*, 880 N.Y.S.2d 876 (N.Y. Sup. Ct. 2009).
- Sometimes the insurer's non-liability is undisputed and claims involve only insured and broker. *See, e.g., Rayfield Properties, LLC v. Business Insurers of the Carolinas, Inc.*, No. COA12-791, 2012 N.C. App. LEXIS 1429 (N.C. Ct. App. Dec. 18, 2012).

Insured's Possible Recovery From Broker

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- Insured may be able to recover the amount that would have been due under policy had broker procured such insurance
 - *See, e.g., Carpenter v. Scherer Mountain Ins. Agency*, 733 N.E.2d 1196, 1203 (Ohio Ct. App. 2000).

- Insured may be able to recover cost of litigating action against insurer
 - *See, e.g., Third Eye Blind, Inc. v. Near North Entertainment Insurance Services, LLC*, 26 Cal. Rptr. 3d 452, 463-64 (Cal. Ct. App. 2005).

Potential Defenses to Claims of Broker Liability

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- Insured's Duty to Read
 - *See, e.g., Leonard v. Nationwide Mut. Ins. Co.*, 499 F.3d 419, 439 (5th Cir. 2007); *Zaremba Equipment, Inc. v. Harco National Insurance Co.*, 761 N.W.2d 151 (Mich. Ct. App. 2008) (insured's failure constituted comparative negligence). *But see American Building Supply Corp. v. Petrocelli Group, Inc.*, 19 N.Y.3d 730 (N.Y. 2012) (does not provide complete defense for broker).
- Defense may not apply if a “special relationship” exists between broker and insured
 - *See, e.g., Canales v. Wilson Southland Insurance Agency*, 583 S.E.2d 203 (Ga. Ct. App. 2003).

Potential Defenses to Claims of Broker Liability

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- No coverage would have been available even absent broker's wrongdoing
 - ▣ *See, e.g., Farm Bureau Life Insurance Co. v. Holmes Murphy & Associates, Inc.*, 831 N.W.2d 129 (Iowa 2013) (affirming summary judgment for broker because policy would not have provided coverage even absent broker's alleged failure to provide notice); *Roger H. Proulx & Co. v. Crest-Liners, Inc.*, 119 Cal. Rptr. 2d 442, 450 (Cal. Ct. App. 2002).
- This defense could lead to the alternative claim that the broker failed to procure adequate coverage

Potential Defenses to Claims of Broker Liability

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- Coverage for non-covered claim against insured was not available in the marketplace
- Economic loss doctrine?
 - *Tiara Condo. Ass'n v. Marsh & McLennan Cos.*, 110 So. 3d 399 (Fla. 2013) (in responding to a certification from the Eleventh Circuit U.S. Court of Appeals, Florida Supreme Court rejected broker's argument that the economic loss doctrine should limit the insureds recovery in broker-negligence case)

Assessing Potential Claims Against Brokers

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- Determine the governing law and that jurisdiction's approach to the broker-insured relationship and to the broker's duties
- Determine nature and extent of the relationship between insured and broker
- If necessary under applicable law, determine whether "special relationship" exists between insured and broker
- Assess broker's potential defenses to liability
- Solicit expert testimony

Recent Trends - Growing Role of Broker

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- Approximately 2/3 of insurance policies are placed through brokers
- Brokers may cultivate certain types of clients
- Brokers may hold themselves out as “full-service” insurance professionals
- Brokers may not provide full copies of policies to clients
- Brokers may answer client’s policy questions
- Brokers may act as go-between for insured and insurer

Brokers' Promises

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- Examples:
 - “range of experience in specific industries to offer you exactly the coverages you need”
 - “tailor-made risk management solutions based on expert advice”
 - “design comprehensive and complete programs for both insurance and risk management”
 - “create the best products and services for your needs”
 - “From insurance to contractual risk and claims management to loss control and loss experience, we’re ready to handle all your [insurance] needs.”

Recent Litigation Trends - Increasing Claims

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- Trend towards finding brokers responsible for procuring adequate coverage
 - *See e.g., American Building Supply Corp. v. Petrocelli Group, Inc.*, 19 N.Y.3d 730 (N.Y. 2012) (finding that broker failed to procure the requested coverage).
 - Compare with *Emerson Electric Co. v. Marsh & McLennan Cos.*, 362 S.W.3d 7 (Mo. 2012) (finding that broker is only obligated to make reasonable efforts).

Best Practices - Brokers

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- Obtain clear coverage request from client
- Document every interaction with insured
- Do not take on work that exceeds the scope of what you intend to do for the insured
- Provide complete copies of insurance information and policies to clients
- Transmit all information regarding potential claims to insurer(s)

Best Practices - Insureds

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- Written agreement with broker regarding broker's duties
- Review and understand all insurance application materials / provide accurate information and truthful answers
- Document all requests for coverage and questions in writing
- Obtain complete copies of insurance materials from broker
- Don't think of your broker as your insurance coverage lawyer
- Provide notice of all potential claims as required by the terms of your policy, typically to your insurer directly

Best Practices – Insureds (cont.)

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- Establish which law will apply to disputes between you and your broker – negotiate applicable law if unfavorable
- Ask broker in writing to set forth its responsibilities to insured
- Review and understand all insurance application materials / provide accurate information and truthful answers

Best Practices – Insureds (cont.)

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- Internally document all requests for coverage and questions in writing
 - ▣ Evaluate potential to keep privileged
- Press broker to provide complete copies of insurance materials as soon as possible
- Your broker is not an insurance coverage lawyer, so don't treat it like one
- Get broker's recommendation on providing notice of claims and/or circumstances in writing

Conclusion

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- Brokers' Relationships With and Duties to Insureds
 - ▣ Duty to Procure Requested Coverage
 - ▣ Expanded Duties – “Special Relationship”
- Claims Against Brokers, Defenses, and Potential Recovery
 - ▣ Failure to Procure
 - ▣ Claims Handling
- Best Practices
 - ▣ Brokers
 - ▣ Insureds
- Document, Document, Document!

Additional Cases

- *Baseball Office of the Comm’r v. Marsh & McClennan*, 742 N.Y.S.2d 40 (N.Y. App. Div. 2002).
- *Drelles v. Mfg. Life Ins. Co.*, 881 A.2d 822 (Pa. Super. Ct. 2005).
- *Tornado Techs., Inc. v. Quality Control Inspection, Inc.*, 977 N.E.2d 122 (Ohio Ct. App. 2012).
- *Peter v. Schumacher Enter., Inc.*, 22 P.3d 481 (Alaska 2001).
- *Herdendorf v. GEICO Ins. Co.*, 77 A.D.3d 1461 (N.Y. App. Div. 2010).
- *Ethridge v. Assoc. Mut. Ins.*, 288 S.E.2d 58 (Ga. Ct. App. 1981).
- *Kotlar v. Hartford Fire Ins. Co.*, 83 Cal. App. 4th 1116 (2000).
- *Phillips v. State Farm Mut. Auto. Ins. Co.*, 497 S.E.2d 325 (N.C. Ct. App. 1988).
- *Van Den Heuvel v. A1 Credit Corp.*, 951 F. Supp. 2d 1064 (E.D. Wisc. 2013).

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