



*Whaddya Mean It's Not Covered?!?!
Assessing Potential Broker Liability for Claims Insurers Deny*

Broker Liability: An Overview of Key Considerations and Emerging Issues

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I. Introduction

When an insurance claim is denied or a policy's limit of liability is insufficient to cover the claim, an insured may begin looking for other possible sources from which to recover its losses—this is particularly true when the denial or insufficiency comes as a surprise to the insured. One potential source of recovery on which the insured may focus is its insurance broker.

In this paper, after first addressing what an insurance broker is, the relationship(s) brokers have with insureds, and the nature of the duties brokers potentially owe to each, the various sections below address whether, and in what circumstances, a broker may be liable to an insured for breaching those duties. As part of that overview, this paper includes discussions of a number of real-world, non-litigated claims, which led the broker or agent involved to seek coverage from its Errors & Omissions (E&O) insurer.¹ Taken together, many of the cases and examples discussed herein highlight one of the more prominent tensions in broker liability disputes: the tension between a broker's duties and an insured's obligation to read its policies and understand and clearly state to the broker its own insurance needs.

Finally, because an insurance broker faced with a claim frequently turns to its own E&O insurer for coverage, this paper concludes with a discussion of issues that can arise with respect to such coverage and the ways in which an E&O insurer may respond.

II. What Is an Insurance Broker?

An insurance broker, like an insurance agent, is an intermediary between insureds and insurers that helps facilitate the sale and purchase of insurance. Although the terms broker and agent are sometimes used interchangeably, there is a distinct difference between the two. Agents usually are employed by or serve a single insurer and generally act as agents of those insurers. They typically sell specific lines of insurance coverage in one designated geographic area or to certain types of businesses. In contrast, brokers are independent contractors who procure insurance from multiple insurers on behalf of their insured clients and generally act as agents of the insureds. However, although the roles of agents and brokers are unique, a single entity or individual may act as both. As set forth in greater detail in Section III below, to determine whether an intermediary is acting as an agent for the insured, the insurer, or both, it is the role in which the intermediary is functioning, and the specific task(s) it is performing at a particular time that is determinative.²

A. Significance of Brokers in the Marketplace

The majority of insurance in the marketplace is sold to consumers through insurance brokers, and, for that reason, brokers play an important role in most insurance transactions. They do so by helping connect insureds with lines of coverage that will satisfy the insureds' specific needs and to insurers providing that coverage. In performing this function, a broker may be responsible for

¹ This paper includes examples of claims that one of its authors, Lisa Kauffman, has directly or indirectly handled or observed in her capacity as a Claim Specialist at Fireman's Fund Insurance Company. These examples are particularly useful in understanding the issues addressed in this paper because many claims and potential claims against insurance brokers are resolved at a time and in a manner designed to avoid litigation. Consequently, the experience of the claims professionals involved often is one of the only sources of information concerning those claims.

² See DOUGLAS R. RICHMOND, 1-2 APPLEMAN ON INSURANCE § 2.03 (2012).

obtaining information about the insured and the insured's business to help identify the coverage needed, assisting with the completion of insurance application forms, and/or submitting those applications to one or more insurers to find the best combination of coverage and price. Of course, not all brokers are the same, and a particular broker may specialize in servicing certain kinds of businesses or in securing certain lines of coverage.³

The broker's role is significant because insureds, whether or not based on any written agreements with brokers, often rely in large part on their brokers to determine the appropriate types and amounts of coverage they should obtain and to then help place that coverage with a particular insurer.⁴ This tendency of insureds to rely on their brokers has grown over time, and the importance of the broker's role has grown with it as insurance programs have become more complex. Often, disputes arise because it is not entirely clear to both parties where a broker's duties to the insured ends and when an insured's own obligations preclude reliance on the broker.

B. Brokers Must Maintain Their Independence From Insurers

To be considered a broker, as opposed to an agent for an insurer, an insurance intermediary must act independently of insurers in facilitating the purchase of insurance by insureds. Thus, for example, a broker should not be a salaried employee of a single insurer. Rather, a broker typically will contract with multiple insurers for purposes of procuring insurance for its clients. Such contracts might provide for compensation to be paid to the broker in the form of a commission by the insurer with whom the broker places coverage. Such commissions frequently are calculated as a percentage of the premium the insurer earns for the coverage placed, as well as the total sales or total profits of all lines of coverage secured by the broker. The fact that the broker is compensated in this way by the insurer does not, in most circumstances, render the broker an agent of the insurer. *See, e.g., Royal Maccabees Life Ins. Co. v. Malachinski*, 161 F. Supp. 2d 847, 852 n.2 (N.D. Ill. 2001) (noting that this fact is not determinative because most brokers receive their commissions from insurers even if acting as agents of insureds).

An example of the criteria used to determine whether an intermediary is an independent broker rather than an agent of an insurer was provided by the Florida Court of Appeals in *Amstar Insurance Co. v. Cadet*, 862 So. 2d 736 (Fla. Dist. Ct. App. 2003). There, the court found that the intermediary at issue was an independent broker because it "solicited insurance business from the general public and had relationships with numerous insurance companies with which it placed applications for insurance on behalf of its customers." *Id.* at 739, 741. Therefore, the court held, the broker was not "bound by contract to work for or solicit insurance for any particular insurance company." *Id.* Moreover, the broker's written agreement with the insurer limited its authority "to solicit[ing], receiv[ing] and transmit[ing] applications for insurance contracts for which a commission is specified in the prevailing Commission Schedule." *Id.* at 740. Importantly, the insured's application for insurance coverage "clearly informed" the insured that the broker did not have the authority to bind coverage "without first obtaining" approval from the insurer or to "MAKE, ALTER, MODIFY or DISCHARGE any CONTRACT or POLICY issued on the basis of this application." *Id.* (emphasis in original). Thus, the fact that the broker "acted outside the scope of its apparent authority" by accepting premium payments from the insured did not indicate that the broker was acting as an agent of the insurer. *Id.* at 742.⁵

³ See 1-2 APPLEMAN ON INSURANCE, *supra* § 2.01.

⁴ Whether a broker has a duty to provide advice to an insured with respect to these issues depends on the nature of the relationship between the broker and insured. This is discussed further in Section III below.

⁵ See also *Mark Andy, Inc. v. Hartford Fire Ins. Co.*, 229 F.3d 710 (8th Cir. 2000). There, the court found that, under Missouri law, a broker was acting on behalf of the insured. Although there are "special

C. Broker Licensing Requirements

Although brokers and agents must be licensed by the states in which they do business,⁶ licensing does not provide a significant guidepost for determining broker duties and obligations. In fact, many brokers now are referred to simply as “producers,” without a focus on specific insurance expertise. This tends to leave to common law issues concerning the relationship between brokers and insureds and the duties brokers owe to insureds.

Licensing as a liability issue does sometime arise in coverage disputes related to the enforceability of insurance policies sold by unlicensed brokers. Notably, though, even if a broker is not licensed, any insurance policy that a broker sells likely will be valid and enforceable. A policyholder is unlikely to void policy terms or conditions—even if particularly unfavorable to the policyholder—by asserting violations of state licensing requirements. The premise for such a result is that insurance policies ultimately are contracts between policyholders and insurers, and the broker’s conduct does not change that fact.⁷

III. Identifying and Defining Brokers’ Obligations

A. Significance Of a Broker’s Agency Relationship

A critical step in understanding the role an intermediary plays in an insurance transaction is correctly assessing the agency relationships between the parties and on whose behalf the intermediary is acting. “The basic elements of agency are ‘the manifestation by the principal that the agent shall act for him, the agent’s acceptance of the undertaking and the understanding of the parties that the principal is to be in control of the undertaking.’” *Comcast Spectacor L.P. v. Chubb & Son, Inc.*, No. 05-1507, 2006 U.S. Dist. LEXIS 55226, at *36 (E.D. Pa. Aug. 8, 2006) (citations omitted) (finding that brokers were agents of insured). Many courts have held that a broker generally acts as the agent of the insured, not the insurer, in soliciting and securing insurance coverage on the insured’s behalf. However, in so holding, many of these same courts also acknowledge that the broker may act as the agent of the insurer in a separate context, or even as the agent of both for separate purposes in the same transaction. Thus, the broker’s role may expand beyond that of agent for the insured solely for purposes of securing coverage. In determining whether a broker is an agent for the insurer or insured, courts may look at whether the broker has actual or apparent authority to act on behalf of one party or another. They also will look to the role or roles the broker is playing for each party in the insurance transaction and how that relates to the dispute in question. From identifying possible coverage, preparing and submitting insurance applications, and securing and binding coverage, to receiving and transmitting premiums and transmitting notice of claims, a broker may be involved in multiple

circumstances that allow a broker to be an agent for both the insured and the insurer when the broker is procuring insurance,” such as when there also is a broker-insurer agreement of some kind, that does not change the fact that when a broker is seeking and receiving “bids from multiple insurers, and aiding [the insured] in weighing them to select the best possible bid,” the broker is acting as the agent of the insured. *Id.* at 717.

⁶ Most states grant separate licenses for different insurance lines, such as property and casualty, surplus lines, life insurance, etc. See, e.g., Va. Code Ann. § 38.2-1824 (2012) (licensing by line of insurance). License requirements vary, but typically include submitting an application that must be approved and completing some specified amount of training.

⁷ See, e.g., *Equity Diamond Brokers, Inc. v. Transnational Ins. Co.*, 785 N.E.2d 816, 821 (Ohio Ct. App. 2003) (holding that the possibility that broker was not licensed to sell insurance in Ohio did not allow the insured to circumvent unattended vehicle exclusion and impose liability on the insurer).

phases of a single transaction or series of transactions between an insured and its insurance carrier.

For example, “[t]he courts in New York long have held that insurance brokers act as agents on behalf of an insured and not the insurer.” *Evvtex Co. v. Hartley Cooper Assocs., Ltd.*, 911 F. Supp. 732, 738 (S.D.N.Y. 1996) (citing *Bohlinger v. Zanger*, 117 N.E.2d 338 (N.Y. 1954) and explaining that the “status of an insurance broker as an agent of the insured has been codified” under New York insurance law). Yet, even as a broker acts on the insured’s behalf for purposes of securing coverage, the broker also can serve as the agent of the insurer in another capacity. In *Evvtex*, for example, the broker also “[held] premiums collected by its insured to be forwarded to the insurance company as an agent of the insurer.” 911 F. Supp. at 739. Thus, the broker served in a dual capacity by acting “in a fiduciary capacity whether collecting premiums to be forwarded to the insurer or transmitting claim and/or settlement sums from insurers to insured.” *Id.*

Relevant to the specific circumstances of a broker’s agency relationships to the insured is the existence of an agreement between the insured and broker, either formal or informal. Such an agreement with an insured might obligate the broker to procure coverage of a general or specific nature or obligate the broker to do more than simply procure coverage requested by the insured by identifying possible coverages and/or assisting with issues related to reporting claims to the insurer on behalf of the insured. The broker’s role and its responsibilities and duties depend largely upon the understandings of the parties and the particular tasks the broker is performing.

B. Determining the Nature of the Agency Relationship

Courts look at a variety of factors in assessing the broker’s role. In *Malachinski*, , the Court identified three key factors determining “whether an intermediary is an agent or broker: (1) who called the intermediary into action; (2) who controls its actions; [and] (3) . . . whose interests the intermediary represented.” 161 F. Supp. 2d at 851-52 (citing *Roby v. Decatur Steel Erectors, Inc.*, 375 N.E.2d 1355, 1359 (Ill. App. Ct. 1978) (finding that the broker was the insured’s agent because the insured requested coverage and controlled the broker’s placement of the coverage, and the broker was concerned only with the insured’s best interests)). The *Malachinski* court further noted that the fact of who pays the broker’s commissions (which it identified as a fourth factor) is not determinative because most brokers receive their commissions from an insurer even if acting as the agent of the insured. *Id.* at 852 n.2.

The application of the three factors identified by the *Malachinski* court, and how the nature of the broker’s relationship to insurer and insured can be determinative in a coverage dispute, was born out in the following claim for which a broker sought coverage from its E&O insurer.⁸ The insured was a physician and long-time customer of the agent in question. A second agent placed the physician’s primary homeowners and auto coverage, with the agent in questioning placing only umbrella coverage over the insured’s primary coverage. The agent used a wholesale broker to place the umbrella coverage. The wholesaler also offered the insured uninsured/underinsured motorist (UM/UIM) umbrella coverage with a separate insurer, subject to the requirement that the insured maintain underlying automobile coverage of at least \$500,000. Because the UM/UIM umbrella insurer did not require proof of the underlying limits it failed to discover that the underlying coverage did not reach \$500,000. The insurer bound the UM/UIM umbrella coverage.

What made the situation more atypical was that the wholesale broker, who traditionally would act only as an intermediary between the agent and the insurer, began to directly manage the account pursuant to a verbal agreement with the agent in question. Thus, the wholesaler spoke freely with

⁸ Ms. Kauffman provided information concerning this claim from her experience.

the insured and only sporadically copied the agent on correspondence the wholesaler or insured generated, though not on correspondence they received.

The insured was involved in a hit and run accident that left him with significant injuries. The insured tendered a UM/UIM claim to the umbrella insurer, which denied coverage because the underlying auto limits were less than the required \$500,000. Due to the unusual nature of the relationship between the wholesale broker and the insured, the agent was not fully engaged in the placement or management of the coverage. As such, it was unclear if a request was ever made to the insured for information regarding the underlying limits and whether the insured ever responded to such a request. Nevertheless, the agent in question still was considered the agent for the insured because he was responsible for this underlying coverage and purportedly was representing the insured's interests with regard to that coverage. Thus, the agent may share full liability with the wholesaler for failure to eliminate the gap in coverage.

This example shows how the three factors identified in *Malachinski*—the party who initiates the search for coverage, controls the process of securing coverage, and represents the insured's interests—apply in determining whether the insured may claim that the broker acted as its agent.

C. Brokers' Duties to Insureds

1. The Broker Owes the Insured a Duty to Procure

Absent a “special relationship” between broker and insured, courts generally have construed the duty a broker owes to its client/insured as limited to procuring insurance requested by the insured, and nothing more.⁹ A recent example of a court's assessment of this duty is *Emerson Electronic Co. v. Marsh & McLennan Cos.*, 362 S.W.3d 7 (Mo. 2012). There, the Missouri Supreme Court determined that an insurance broker is only obligated to use “reasonable skill, care and diligence in procuring insurance” for its clients. *Id.* at 17 n.9. This duty does not extend to requiring the broker to deliver the best-priced insurance available or to disclose insurer-paid commissions to an insured. *Id.* at 15, 19.

A broker's duty also generally does not extend to advising an insured as to appropriate types of coverage or limits of liability. The Maryland Court of Special Appeals, in *Sadler v. The Loomis Company*, 776 A.2d 25 (2001), held as much, finding no duty to advise as to the adequacy of limits or to procure a policy for an insured that would provide complete coverage for a claim or claims. *Id.* at 40–41, 46. In so holding, the court distinguished an earlier decision of the Maryland Court of Appeals, *Popham v. State Farm Mutual Insurance Co.*, 634 A.2d 28 (1993), in which the court reversed the dismissal of an insured's claim against her insurer and its agent alleging that they “breached a statutory duty and a common law duty of due care that required them to inform the insureds of their legal right to purchase up to \$1 million . . . of UIM coverage, an amount equal to the liability protection afforded under [an] umbrella policy [that did not contain UIM coverage].” *Sadler*, 776 A.2d at 39. In distinguishing *Popham*, the court stated:

When the insured in *Popham* procured the umbrella policy, the insured had an option to buy UIM coverage of an equal amount, in conjunction with the purchase of the umbrella policy. In essence, then, the optional UIM coverage was an optional component of the umbrella policy itself, available only because the insureds were purchasing the underlying liability coverage. The *Popham* case did not concern an allegation that the agent

⁹ The nature and effect of such special relationships is discussed further below.

failed to advise the insured about what amount of coverage was appropriate, or the cost of additional insurance.

Conversely, this case does not concern an alleged failure by the broker or agent to disclose a legal right to purchase optional coverage available as part of, and because of, the purchase of an automobile liability policy. Rather, this case concerns the issue of whether [the broker] had a duty to advise [the insured] regarding the adequacy of the *amount* of her automobile coverage.

Id. at 40 (emphasis in original).

Likewise, in *Murphy v. Kuhn*, 660 N.Y.S.2d 371 (N.Y. 1997), the court explained that, in New York, “[g]enerally, the law is reasonably settled on initial principles that insurance agents have a common-law duty to obtain requested coverage for their clients within a reasonable time or inform the client of the inability to do so; however, they have no continuing duty to advise, guide or direct a client to obtain additional coverage.” *Id.* at 373. “Insurance agents or brokers are not personal financial counselors and risk managers, approaching guarantor status.” *Id.* at 375. The court concluded that there was no special relationship between the broker and insured obligating the broker to advise the insured as to the sufficiency of its limit of liability, notwithstanding the fact that the insured had worked with the broker for nearly twenty years. *Id.* at 373–74. Because the insured never inquired about limits itself, the broker had no obligation to obtain a higher limit of liability for the insured. *Id.* at 374–75.

2. Determining Whether a Broker Owes a Fiduciary Duty

Of the courts that have examined whether a broker owes a fiduciary duty to an insured, many have held that the broker’s duties do not rise to that level. Others have effectively concluded that the broker’s fiduciary duty is incorporated into the basic duty the broker owes the insured. For example, in *Hydro-Mill Company Inc. v. Hayward, Tilton and Rolapp Insurance Associates, Inc.*, 10 Cal. Rptr. 3d 582 (Ca. Ct. App. 2004), the California Court of Appeals determined that it was “unclear whether a fiduciary relationship exist[ed] between an insurance broker and an insured.” *Id.* at 592; *see also Nor-Cal Products, Inc. v. XL Insurance America, Inc. et al.*, No. 2:12-cv-02193 JAM-CMK, 2012 U.S. Dist. LEXIS 159964, at * 5 (N.D. Cal. Nov. 6, 2012) (relying on *Hydro-Mill* to find that an “insurance broker is not a fiduciary under California law”).¹⁰ Likewise, the Missouri Supreme Court in *Emerson Electronic Co.* recently came to the same conclusion, noting that there is no “inherent fiduciary duty” owed by a broker that gives rise to obligations other than using “reasonable skill, care and diligence in procuring insurance” for its clients. 362 S.W.3d at 19. However, whether the broker has a higher duty to the insured essentially is resolved if the insured can establish that the broker and insured had a “special relationship,” which elevates the broker’s duty to the insured.

¹⁰ New York follows the same rule. “[A]bsent a special relationship, a claim for breach of fiduciary duty does not lie” in New York. *Bruckmann, Rosser, Sherrill & Co, L.P. v. Marsh USA, Inc.*, 885 N.Y.S.2d 276, 278 (N.Y. App. Div. 2009).

3. The “Special Relationship” Between Broker and Insured

If an insured can demonstrate that a special relationship exists between it and its broker, a court may find that the broker owes duties to the insured beyond simply securing the requested insurance coverage for the insured, such as the duty to advise regarding appropriate coverages. However, the burden of demonstrating that such a relationship exists tends to be high, and many of the seminal cases addressing broker duties have not found that such a relationship exists in the particular circumstances at issue.

An insured can show a special relationship with a broker through representations made by the broker and/or through the parties’ prior dealings.¹¹ As the *Sadler* court explained, “an agent ordinarily has no duty to advise the insured on specific insurance matters, or to procure a policy affording complete liability protection. . . . Moreover, . . . the . . . broker does not have a continuing duty to advise, guide or direct the insured’s coverage” absent special circumstances. *Sadler*, 776 A.2d at 46 (quoting 44 C.J.S. *Insurance* § 215, at 411 (1993)). Those circumstances arise in situations where the “broker holds himself or herself out as a highly skilled insurance expert, and the insured relies to his detriment on that expertise.” Alternatively, those circumstances arise where there is “a long term relationship of confidence, in which the agent or broker assumes the duty to render advice, or has been asked by the insured to provide advice, and the adviser is compensated accordingly, above and beyond the premiums customarily earned.” *Id.* at 35. The court further explained:

It is the nature of the relationship, and not merely the number of years associated therewith, that triggers the duty to advise. Some of the factors relevant to developing entrustment between the insured and the insurer include: exercising broad discretion to service the insured’s needs; counseling the insured concerning specialized insurance coverage; holding oneself out as a highly-skilled insurance expert, coupled with the insured’s reliance upon the expertise; and receiving compensation, above the customary premium paid, for expert advice provided.

Id. at 36 (quoting *Parker v. State Farm Mut. Auto. Ins. Co.*, 630 N.E.2d 567, 569–70 (Ind. Ct. App. 1994)). In *Sadler*, the Court found no special circumstances because, even though the insured had worked with the broker in question for many years, she did not work personally with one person, did not meet with anyone from the office, and never responded to the broker’s written offer to discuss the coverage limits with her. *Id.* at 46–47.

Similarly, in *Fitzpatrick v. Hayes*, 67 Cal. Rptr. 2d 445 (Cal. Ct. App. 1997), the Court laid out examples of facts pointing to a special relationship. *Id.* at 452. Such relationships may arise when: (1) the broker misrepresents the nature, extent or scope of the coverage being offered or provided; (2) the insured requests or inquires about a particular type or extent of coverage; or (3) the broker assumes an additional duty either by express agreement or by holding itself out as having certain expertise in a specific field of insurance that relates to the insured’s coverage. Absent one of these three circumstances, a broker “does not have a duty to volunteer to an insured that the [broker] should procure additional or different insurance coverage” for the insured. *Id.* In *Fitzpatrick*, the court found that the agent did not have a duty to advise as to the availability of personal umbrella coverage or to volunteer to the insured that it should procure additional or different insurance coverage because the agent did not misrepresent the scope of coverage, there

¹¹ See, e.g., *Bigger v. Vista Sales & Mktg., Inc.*, 505 S.E.2d 891, 893 (N.C. Ct. App. 1998) (finding that the length of a relationship between broker and insured alone—even if 28 years—was not sufficient to show a special relationship without evidence of a pattern or course of dealings showing that the broker knew of the insured’s specific insurance needs and knew that the insured would rely upon the broker for advice as to those needs) (distinguishing *Fli-Back Co., Inc. v. Philadelphia Mfrs. Mut. Ins. Co.*, 502 F.2d 214 (4th Cir. 1974)).

was no request for additional coverage, and appellees did not assume an additional duty to provide the umbrella coverage. *Id.* at 452–54.

The Washington Court of Appeals likewise found no special relationship in *McLammy v. Cole*, 243 P.3d 932 (Wash. Ct. App. 2010), in which a homeowner brought suit against his insurer and agent following the destruction of his home by fire alleging that the agent failed to advise him concerning the adequacy of the limit of liability of his homeowner’s policy. *Id.* at 934. In upholding the trial court’s grant of summary judgment for the agent, the court first noted that “[o]rdinarily, an insurance agent does not have a duty to advise the insureds as to the adequacy of their insurance policy coverage” and that “[a]bsent [a] special relationship, ‘an insurance agent has no obligation to recommend . . . liability limits higher than those selected by the insured.’” *Id.* (Citations omitted.) Regarding the existence of a special relationship, the court found that such a relationship would exist if “(1) the agent holds himself out as an insurance specialist and receives additional compensation for consulting and advice, or (2) there is a long-standing relationship, some type of interaction on the question of coverage, and the insured relied on the agent’s expertise to the insured’s detriment.” *Id.* The Court concluded that the second factor was dispositive here. Although a long-standing relationship existed, the interactions between the agent and insured, which focused on premium reduction and the reporting of a water damage claim, were insufficient to establish a special relationship that would expand the broker’s duties. *Id.* at 934–35.¹²

In contrast to the above cases, in *Peter v. Schumacher Enterprises, Inc.*, 22 P.3d 481 (Alaska 2001), the Alaska Supreme Court found that there might be a special relationship between a broker and insured. In a case involving the broker’s alleged failure to advise the insured that it could and should purchase higher UM/UIM limits despite questions by the insured about obtaining “full coverage,” the court found that there was a question of fact as to whether a special relationship existed that created a duty to advise and, therefore, remanded the case for a resolution of this issue by the trier of fact. *Id.* at 478–88.

Similarly, New York’s highest court recently issued a decision that parties may construe as supporting the existence of a special relationship as long as the insured can show that it made a specific request to the broker. In *American Building Supply Corp. v. Petrocelli Group, Inc.*, No. 188, 2012 N.Y. LEXIS 3476 (N.Y. Nov. 19, 2012), the court found that, because the insured made a “specific request” for coverage and relied on the broker to procure that coverage, the broker had a duty to provide that specific coverage. *Id.* at *5–8. It therefore allowed the claims to proceed, finding a question of fact as to whether the insured made a specific request for the broker to procure coverage or advise the insured of its inability to do so because “an insured should have the right to ‘look to the expertise of its broker with respect to insurance matters.’” *Id.* at *7–8. Thus, the court upheld the lower court’s decision that a specific request for a broker to procure coverage creates an issue of fact as to the broker’s liability. *Id.* Although the court did not specifically address special circumstances, the dissent referenced the basis for the special circumstances rule in New York, i.e., that “[a]gents and brokers are not ‘personal financial counselors and risk managers, approaching guarantor status.’” *Id.* at *10 (Pigott, J. dissenting). The outcome of this case is that, in forthcoming disputes, the parties may disagree as to whether this case makes it easier for a broker to show that a special relationship exists with its broker and that a broker has breached its duties.

¹² See also *Scott-Huff Ins. Agency v. Sandusky*, 887 S.W.2d 516, 517 (Ark. 1994) (finding no continuing duty to advise insured regarding coverage); *Ray v. Valley Forge Ins. Co.*, 92 Cal. Rptr. 2d 473 (Cal. Ct. App. 1999) (same).

4. Brokers' Duties Sometimes Are Framed In Terms of the Standard of Care Owed

In some instances, rather than focusing on the nature of the duty owed by a broker to an insured or on whether there exists a fiduciary or special relationship, courts focus on the appropriate standard of care applied to the broker's duty to procure. By framing the issue in this way, courts may be more likely to find that a broker is obligated to do more than simply procure the insurance requested by the insured and does, in fact, have a duty to recommend or offer advice on coverage the insured potentially should obtain. For example, in *Southwest Auto Painting and Body Repair, Inc. v. Binsfeld*, 904 P.2d 1268 (Ariz. Ct. App. 1995), the court addressed whether a broker was obligated to advise an insured as to the need for additional coverage. There, the broker never raised the issue of employee dishonesty coverage, which the insured was unaware was available and, therefore, never mentioned to the broker. After an employee embezzled money and the insurer denied a claim due to lack of such coverage, the insured brought suit against the broker for failure to advise the insured to secure employee dishonesty coverage. In reversing the trial court's grant of summary judgment for the broker, the appellate court distinguished between legal duty and standard of care. The court held that the "general duty an insurance agent owes to the insured is to exercise reasonable care, skill and diligence in carrying out the agent's duties in procuring insurance." *Id.* at 1271 (internal citations omitted). The court also held, though, that questions of fact concerning whether the applicable standard of care required more of the broker in this instance and whether the broker satisfied that standard precluded summary judgment for the broker. *Id.*

IV. Disputes Between Brokers and Insureds

A. Types of Claims Insureds May Assert

This section provides an overview of the types of claims insureds may bring against broker, the scenarios in which such claims may arise, and potential defenses available to brokers facing such claims. As a threshold matter, though, and as noted above, significant to determining the types of claims an insured can bring against a broker is the nature and extent of the relationship between the insured and broker and, specifically, whether a special relationship exists between them. *See, e.g., Fitzpatrick*, 57 Cal. App. 4th at 916. Further, the governing a dispute also may determine the outcome of a dispute. This is because states approach the broker/insured relationship, and issues arising from that relationship, very differently. Thus, understanding which state's law applies, particularly in disputes where more than one state's law might apply, is important to analyzing the strengths and weaknesses of an insured's claims or potential claims.

When an insured lacks coverage for a claim made against it, the insured may seek to hold its broker liable if it believes the broker to be responsible for the absence of coverage. Such insured vs. broker claims tend to arise in one of two circumstances: (1) those in which the insured alleges wrongdoing by the broker with respect to the procurement of coverage for the insured; and (2) those in which the insured alleges wrongdoing in the broker's handling of a claim made against an insured.

Regardless of the circumstances, however, insured vs. broker claims typically sound either in negligence or breach of contract.¹³ With respect to the former, an insured must demonstrate that its loss—whether due to a denial of coverage, insufficient coverage, etc.—resulted from the broker's breach of its duties owed to the insured. *See, e.g., Pressey Enters. v. Barnett-France Ins. Agency*, 724 N.W.2d 503, 505 (Mich. Ct. App. 2006). With respect to the latter, claims sounding

¹³ *See, e.g., Fli-back Co.*, 502 F.2d at 217 ("The relationship between an insurance agent and his client is both contractual and fiduciary.").

in contract, an insured must demonstrate that there was an agreement between the insured and broker and that the broker breached that agreement. *See, e.g., Hydro-Mill Co.*, 10 Cal. Rptr. 3d at 590.

Additionally, if permitted by the law of the state governing a particular dispute and supported by the relevant facts, insureds also may bring other claims against brokers, such as claims for fraud, negligent or fraudulent misrepresentation, bad-faith, interference with contract, and/or unjust enrichment. *See, e.g., Twelve Knotts Ltd. P'ship v. Fireman's Fund Ins. Co.*, 589 A.2d 105, 111 (Md. Ct. Spec. App. 1991) (finding that negligent misrepresentation is a permissible claim but that there was no evidence broker made knowing misrepresentation with intent to harm insured); *Pitts v. Farm Bureau Life Ins. Co.*, 818 N.W.2d 91, 111 (Iowa 2012) (finding that life insurance beneficiary could bring claim for negligent misrepresentation against broker for making misleading statements about changing beneficiary designation); *Nast v. State Farm Fire & Cas. Co.*, 82 S.W.3d 114, 123–24 (Tex. App. 2002) (insured brought claim against broker alleging that broker had a duty not to misrepresent material facts concerning insured's eligibility for flood insurance); *see also generally* 1-2 APPLEMAN ON INSURANCE, *supra* § 2.05.

With respect to claims for negligent misrepresentation, courts often have relied on the definition of such a cause of action in the Restatement (Second) of Torts. To state such a claim, an insured must demonstrate that: (1) the broker made a false statement; (2) the broker intended that the insured rely on the statement; (3) the broker knew that the insured was likely to rely on it and that this reliance was likely to result in a loss to the insured; (4) the insured relied on the statement and was justified in doing so; and (5) the insured was harmed as a result. *Twelve Knotts Ltd. P'ship*, 589 A.2d at 111. Because claims for negligent misrepresentation concern only “intangible economic interests, courts have developed more restrictive rules of recovery [than for negligence].” *Pitts.*, 818 N.W.2d at 111. This more restrict approach ensures that “those liable [for negligent misrepresentation] are only those who supply information in an advisory capacity and are manifestly aware of how the information will be used and intend to supply it for that purpose.”¹⁴ *Id.* (citing *Van Stickle Constr. Co. v. Wachovia Commercial Mortg., Inc.*, 783 N.W.2d 684, 691 (Iowa 2010) (internal citations omitted).

The interplay between and among the specific circumstances, the claims an insured may bring, and the significance of controlling state law described above played out in a dispute between an insured and its broker that was resolved out of court.¹⁵ In that dispute, the nature and scope of the duty of care the broker owed to the insured depended on whether Arkansas or Iowa law applied. The matter involved an insured hotel owner and a broker that procured Commercial General Liability (CGL) coverage and Commercial First Party Property coverage for the insured and its hotel properties over a nine-year period. These policies were in effect when one of the hotels suffered a carbon monoxide incident that resulted in a fatality.

The insured tendered a claim to its CGL insurer, which denied coverage based on a pollution exclusion in the policy. Although this type of exclusion in a lodging and hospitality CGL policy frequently is truncated or removed entirely by endorsement to specifically allow coverage for these types of claims, no such change had been made to the policy at issue. Following denial of

¹⁴ Claims against brokers alleging fraud are even more restrictive. The basic elements of such a claim are: (1) a false representation by the broker; (2) made with scienter, or knowledge of its falsity; (3) with an intent to deceive the insured or to induce the insured into acting or refraining from acting; (4) on which the insured justifiably relied; (5) with the proximate cause of damages to the insured. *See, e.g., Twelve Knotts Ltd. P'ship*, 589 A.2d at 111 (finding that insured's claim could not succeed because broker did not intend to defraud insured).

¹⁵ Ms. Kauffman provided information concerning this claim from her experience.

the claim, the insured brought a negligence suit against its broker for failure to procure proper coverage.

The insured argued that the broker held itself out as an expert in the hospitality and lodging field, stating that it could provide a package of commercial insurance that would cover all risks. This argument was underscored by evidence from the agent's own website, detailing its experience in the hospitality industry. The insured argued that, based in part on this evidence and in part on its long-standing relationship with the broker, a special relationship existed between them such that the broker's duty to the insured was expanded beyond simply procuring insurance the insured requested. The broker countered that no special relationship existed, that, consequently, the broker's only obligation was to procure the coverage the insured requested, which it did, and that it renewed the policy, without question from the insured, for nine consecutive years.

At the time, under Iowa law, a broker owed a general duty of care to its customer that ordinarily was met by placing coverage as instructed by the insured—i.e., by essentially acting as the insured's order taker. The broker could not be held to a higher duty with respect to the procurement of coverage absent a formal agreement with the insured specifying such a duty, regardless of the other circumstances in the case—e.g., the length of the relationship between the broker and insured.¹⁶ Thus, the nine-year relationship between the insured and the broker, without a written agreement, did not expand the broker's duties as a matter of law. In contrast, under Arkansas law, a written agreement was not necessary to establish a special relationship between a broker and insured.¹⁷ Such a relationship could be shown by an established and ongoing relationship over a period of time, during which the broker was actively involved in the insured's business affairs and regularly gave advice and assistance in maintaining proper coverage.¹⁸

The broker and insured ultimately settled their dispute. However, it demonstrated the importance of carefully evaluating any potential choice-of-law issues in a dispute between a broker and insured in order to accurately assess the nature and scope of the duties the broker owed to the insured and the broker's potential liability to the insureds.

B. Failure to Advise On or Secure Coverage

One circumstance in which disputes between insureds and brokers often arise is in instances in which the broker may have failed to secure the coverage the insured requested or expected, and/or failed to advise the insured as to coverage the insured should obtain.¹⁹ However, although a broker's alleged failing occurs during the procurement of insurance for the insured, a dispute is unlikely to arise until a claim is made against the insured, or the insured suffers a loss, that it believes would have been covered had the broker performed correctly.

¹⁶ See *Sandbulte v. Farm Bureau Mut. Ins. Co.*, 343 N.W.2d 457, 464 (Iowa 1984). There, the court relied upon *Collegiate Mfg. Co. v. McDowell's Agency, Inc.*, 200 N.W.2d 854, 857–58 (Iowa 1972), to hold that a broker would be held to this higher duty only if there were an “agreement or arrangement which would enlarge defendant's duty beyond the general duty an agent owes his principal.” *Id.*

¹⁷ See *Scott-Huff Ins. Agency*, 887 S.W.2d 516; *Howell v. Bullock*, 764 S.W.2d 422 (Ark. 1989).

¹⁸ See *Buelow v. Madlock*, 206 S.W.3d 890 (Ark. 2005).

¹⁹ As discussed in Section III above, at its most basic level, a broker's duty to an insured is to obtain the insurance coverage the insured requests or, if that is not possible, to explain this to the insured so it can make an informed decision concerning alternative coverage. As also discussed above, whether the broker has an expanded duty to the insured—to, for example, advise the insured concerning the types and amounts of insurance the insured should purchase—depends on whether a special relationship exists between the broker and insured.

In some instances, such as where the insurer's non-liability is undisputed, these cases involve only the 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) (holding in favor of broker in insured's professional negligence and breach of contract claims against broker for failing to procure theft coverage for vacant building).²⁰ In other instances, though, they also involve claims by the insured against its insurer, often supported by the broker, to secure coverage from the insurer. *See, e.g., 3094 Brighton, LLC v. Zurich Specialties.*, Case No. 28907/07, 2009 N.Y. Misc. LEXIS 387, at *14–15 (Sup. Ct. NY, Kings City, Feb. 9, 2009) (addressing insured's claims against both insurer and broker to enforce the duty to defend and indemnify in litigation where insurer had declined coverage based on late notice). In the latter cases, an insured may bring claims against the broker in the alternative as a precautionary strategy in case a court determines that the insurer is not obligated to provide coverage to the insured.

Often, the insured brings suit simultaneously against both its broker and its insurer and broker because a shorter statute of limitations applies to certain claims brought against the broker than to those brought against the carrier, and the insured cannot risk waiting for a resolution on coverage claims against the insurer.²¹ *See generally* HON. H. WALTER CROSKEY, ET AL. CALIFORNIA PRACTICE GUIDE INSURANCE LITIGATION § 2:50.1 (2012) (“Claims against agents and brokers are generally subject to a *shorter statute of limitations* than claims against insurers. As a result, an aggrieved insured should consider suing simultaneously *both* the insurer (for coverage provided) and the agent/broker (e.g., for failing to obtain requested coverage). The insured then may, if it chooses, ask the court to stay the action against the agent/broker pending determination of coverage in the action against the insurer.” (emphasis in original)).

What follows are examples of certain types of claims that insureds may bring against their brokers: (1) disputes involving application issues resulting in non-coverage; (2) disputes involving a broker's alleged failure to apply for proper coverage or obtain necessary endorsements; and (3) a specific set of recent disputes in New York arising out of a broker's alleged failings in placing workers compensation coverage with insurance pools, rather than with the State Workers' Compensation Fund.²²

1. Application Issues Resulting in Non-Coverage

Brokers frequently assist insureds in completing applications for insurance and in submitting those applications to insurers on the insureds' behalf. When done correctly, this is a valuable service to the insured. When done poorly, though, it can result in a lack of coverage for the insured and potential liability for the broker. For example, if a broker submits an application to an insurer that contains material misrepresentations, whether those misrepresentations were made negligently or intentionally, the insurer may use those misrepresentations as a basis on which to rescind the policy in the face of a claim against the insured or to deny coverage for the claim. If the broker was responsible for the misrepresentations, the broker may face liability to the insured.

²⁰ The *Rayfield* court relied on *Baggett v. Summerlin Ins. & Realty, Inc.*, 545 S.E.2d 462, 467–68 (N.C. Ct. App. 2001) (Tyson, J., dissenting), *rev'd*, 554 S.E.2d 336 (N.C. 2001) (adopting the dissenting opinion).

²¹ This difference arises because the statute of limitations for tort claims often is shorter than the state of limitations for contract claims, and many of the claims that an insured might bring against a broker -- such as negligence, negligent misrepresentation, tortious interference, or fraud -- are founded in tort.

²² Although the following are the most common circumstances in which insureds pursue claims against their brokers arising from the broker's alleged failings concerning procuring and/or advising on coverage, this discussion is not exhaustive by any means.

A threshold issue in such circumstances is whether the insurer is, in fact, entitled to rescind the policy or deny coverage based on the misrepresentations. One case holding in favor of an insurer on this issue is *Mitchell v. United National Insurance Co.*, 25 Cal. Rptr. 3d 627 (Cal. Ct. App. 2005). There, the California Court of Appeals held that an insurer can rescind a policy based on a material misrepresentation, even if the misrepresentation was the fault of the broker and not the insured, if the misinformation affected the insurer's decision whether to offer insurance. *Id.* at 633–40. The court reasoned that freedom of contract and the right of an insurer to make an informed decision whether to insure a particular risk are strong public policy considerations that support liberal rescission rights for misrepresentations made at the inception of an insurance contract. *Id.*

If the insurer is entitled to rescind a policy or deny coverage for a claim based on a misrepresentation in the application, the question then becomes whether the broker is liable to the insured for the misrepresentation. One recent case in which a jury concluded that the broker was liable is *Main Street-Santa Anna, LLC v. Kappauf*, No. G044446, 2012 Cal. App. Unpub. LEXIS 3115 (Apr. 25, 2012). There, the plaintiff insured requested that the defendant, its insurance broker, obtain insurance coverage for its office building. *Id.* at *2. In the application, which the broker completed and submitted to the insurer, the broker “incorrectly represented the building had both a central fire alarm and an operational fire sprinkler system. He did not first verify whether the building had fire sprinklers,” which it did not. *Id.* at *2–3. Based on the information in the application, “[t]he insurer issued a policy providing up to \$14,750,000 in coverage for damage to the [building].” *Id.* at *3. The policy required “[a]s a condition of this insurance, that the building maintain as ‘protective safeguards’ . . . an ‘Automatic Sprinkler System.’” *Id.* After an arson fire damaged the building, the insured tendered a claim to the insurer. *Id.* The insurer denied coverage on the basis that “[t]here has been no evidence the Protective Safeguards that are a condition of this insurance were present at [the building] at the time of the occurrence.” *Id.* The insured brought suit against the broker “for breach of contract and negligence.” *Id.*, at *4. Following trial, “[t]he jury returned a special verdict for [the insured] on both causes of action” *Id.* at *14.²³

2. Failure to Apply for Proper Coverage or Obtain Necessary Endorsements

Another circumstance in which a broker may face liability to an insured is one in which the coverage the broker obtained for the insured differed from the coverage the insured requested or the coverage it believed it was purchasing, either in type or amount, or in which the broker failed to properly advise the insured concerning the types and amount of insurance it should obtain. Regarding the former, such claims are premised on the broker's fundamental duty to procure for the insured the coverage the insured requested. Regarding the latter, claims arising from the failure of a broker to advise an insured as to appropriate coverage, are premised on the principle that most policy holders rely on their brokers to advise them as to appropriate coverage and to obtain such coverage for them. Thus, when the requisite special relationship or express agreement is found to exist between the insured and broker, courts sometimes have determined that it is reasonable for the insured to rely on the expertise of the broker to obtain adequate coverage and that brokers have a duty to act reasonably in fulfilling their obligations to insureds.²⁴ See, e.g., *Hynes v. Edgerson*, 240 S.W.3d 189, 195–96 (Miss. Ct. App. 2007) (finding

²³ In response to a motion by the broker, the court granted a new trial, but only with respect to the issue of damages. *Id.* at *16. The insured appealed, and the court of appeals affirmed. *Id.* at *16–30.

²⁴ As noted above, absent a special relationship or express undertaking between the broker and insured, the broker's duties to the insured typically do not encompass a duty to advise the insured as to appropriate coverage. Rather, the broker's duty generally is limited simply to procuring the coverage the insured requests.

that a broker can be held liable for negligent procurement when it failed to review renewal policy as insured requested and therefore failed to notice new exclusion, which resulting in precluding insured from recovering coverage for its loss).²⁵

An example of a claim by an insured against a broker premised on the broker's failure to procure adequate insurance that resulted in a verdict against the broker is *Sempra Energy v. Marsh USA, Inc.*, Case No. 2:07-cv-05431-SJO-SSx (C.D. Cal.). There, an insured brought suit against its broker alleging that the broker failed to obtain the insurance coverage the insured requested. The insured's claim arose from its attempt to obtain political risk insurance to protect against the potential risk that the Argentine government would unilaterally change certain licenses and tariffs in a way that would impair the value of the insured's investment. The insured explained the nature of its investment to its broker and the specific risk for which it sought coverage. The insured relied heavily on its broker to evaluate its options and to procure a policy providing the broadest possible coverage. The broker advised the insured to purchase a policy offered by National Union Fire Insurance Company of Pittsburgh, P.A. (the "National Union Policy"). Based on this advice, the insured purchased the National Union Policy. After the policy was issued, the insured asked the broker to confirm that it was as broad as requested. The broker assured the insured that it was. *Id.*

Consistent with other examples where the broker failed to procure the proper coverage, the broker in *Sempra Energy* breached its duties to the insured. After the broker provided assurances of coverage, the Argentine government modified the regulatory regime as feared, and the insured's investment declined in value by more than \$77 million. The insured filed a claim under the National Union Policy, which ultimately was resolved through arbitration. Nevertheless, throughout the arbitration, the broker continued to assure the insured that the National Union Policy would cover its claim. However, the arbitration panel ultimately denied the insured's claim for coverage. Following the arbitration determination, the insured brought suit against the broker. *Id.* The insured's claim ultimately resulted in a \$48 million jury verdict against the broker. *Id.* See also, e.g., *Aden v. Fortsh*, 776 A.2d 792, 801 (N.J. 2001) (holding that "[a] broker" who agrees to procure a specific insurance policy for another but fails to do so may be liable for damages resulting from such negligence" and affirming verdict against broker in claim by insured for broker's failure to procure coverage insured expected); *Desai v. Farmers Ins. Exch.*, 55 Cal. Rptr. 2d 276, 281 (Cal. Ct. App. 1996) ("A broker's failure to obtain the type of insurance requested by an insured may constitute actionable negligence and the proximate cause of injury.").²⁶

3. New York Workers Compensation Pool Claims

Another set of circumstances for these type of claims has recently arisen in New York related to certain insurance pools. In the late 1990s, agents in New York, in an attempt to circumvent high premiums charged by the New York State Workers' Compensation Fund, searched for alternatives for their insureds seeking coverage. A third party administrator, catering to New York small businesses, started soliciting agents to place their insureds in pools—essentially similarly-situated, business-specific, trusts funded by the insureds and administered by this

²⁵See also, e.g., *Aden v. Fortsh*, 776 A.2d 792, 801 (N.J. 2001) (holding that "[a] broker" who agrees to procure a specific insurance policy for another but fails to do so may be liable for damages resulting from such negligence" and affirming verdict against broker in claim by insured for broker's failure to procure coverage insured expected); *Desai v. Farmers Ins. Exch.*, 55 Cal. Rptr. 2d 276, 281 (Cal. Ct. App. 1996) ("A broker's failure to obtain the type of insurance requested by an insured may constitute actionable negligence and the proximate cause of injury.").

²⁶See also generally BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 1804[b][1] (12th ed. 2004) (citing cases involving a broker's failure to procure insurance).

particular company. The upside was that the buy-ins for the various trusts were significantly less expensive than the premiums offered through the Workers' Compensation Fund. Recognizing the savings, agents started placing their insureds into the pools at a rapid pace and for several years the insureds were quite satisfied. The downside, though, which never was fully investigated, is that the insureds would be held jointly and severally liable for any increase in losses. All insureds signed statements acknowledging their joint and several liability.

Similar to other types of funds operated at the time, the compensation pools were underfunded, and by 2006 a number of pools were insolvent. As a result, the State's Workers' Compensation Board faced a large shortfall in the pools. To make up the shortfall, and based on the joint and several statements signed by the insureds, the Workers' Compensation Board began invoicing the insureds for additional premium, sometimes in the millions of dollars, under the threat of penalties and lawsuits. *See, e.g., Held v. State of New York Workers' Comp. Bd.*, 921 N.Y.S.2d 674, (N.Y. App. Div. 2011) (reversing trial court's partial grant of summary judgment for plaintiff pool members and entering summary judgment for defendant Workers' Compensation Board).

In response, insureds began filing lawsuits against the agents that placed them in the pools, arguing, among other things, that they failed to provide sufficient information about the program and that the insureds were therefore unaware of the far-reaching implications of the joint and several liability provisions. To date, however, these lawsuits have made little headway. This largely is due to the fact that the insureds had expressly acknowledged the joint and several liability provisions when they joined the pools. *See, e.g., State of New York Workers' Comp. Bd. v. 26-28 Maple Avenue, Inc.*, 915 N.Y.S.2d 744, 746-47 (N.Y. App. Div. 2011) (reversing trial court and dismissing insured's claim against brokers for deceptive practices based in part upon the fact that upon joining the pool, the insured's officers "executed participation agreements acknowledging . . . that [the insured] would be jointly and severally liable for all participants' workers' compensation obligations . . . and that it might be required to pay additional amounts to meet these obligations"). Thus, absent further evidence of broker omissions, it appears that the insureds' own obligation to read and understand their policies may shield the agents/brokers from liability.

What appears significant in these Workers Compensation claims is that the insured received the same information about the pools as the agent. So long as that remains the case, New York law may not support a conclusion that the agents or brokers breached any duty owed to the insureds. *See, e.g., Murphy*, 660 N.Y.S.2d at 375 ("Insurance agents or brokers are not personal financial counselors and risk managers, approaching guarantor status."); *Bruckmann*, 885 N.Y.S.2d at 278. However, the recent decision in *American Building Supply Corp.*, 2012 N.Y. Lexis 3476, at **3-4 (N.Y. 2012), in which the broker was unable to rely on the insured's duty to read as a defense, may result in a change for these cases.²⁷

C. Failure to Properly Advise Insureds Regarding, or Failure to Properly Handle, Claims Against Them

As discussed above, an insurance broker's obligations to an insured typically end after it has assisted the insured in securing coverage. As also discussed above, though, where there is a special relationship between the broker and insured, the broker's obligations may extend beyond the mere procurement of insurance—e.g., to advising the insured as to coverage types and amounts. Another area into which the broker's obligations may extend is the handling of claims made against the insured. This particularly is the case when a broker has expressly agreed to take

²⁷ This case and issue are addressed further in Section III.C.3. above and Section IV.D.1. below.

on additional responsibilities with respect to claims, or where the parties' past course of conduct demonstrates that the insured was reasonable in relying on the broker with respect to a claim.

A common source of potential broker liability in this context is the reporting of such claims to the insureds' carrier(s). When a claim is made against an insured, the insured may provide notice of that claim to its broker, but not directly to its insurer(s), with the expectation that the broker will forward the notice on to the appropriate insurer(s). If the broker fails to do so in a timely fashion, this may result in the insurer denying coverage for the claim based on late notice. *See, e.g., Farm Bureau Life Ins. Co. v. Chubb Custom Ins. Co.*, 780 N.W.2d 735, 739–42 (Iowa 2010) (upholding denial of coverage based on late notice); *Martini v. Lafayette Studios Corp.*, 676 N.Y.S.2d 808, 811–12 (N.Y. App. Div. 1998) (same).

A denial based on late notice may, in turn, give rise to a claim by the insured against the broker. Such was the case in the *Farm Bureau* matter discussed above. Following the Iowa Supreme Court's decision upholding the insurer's denial of coverage based on late notice, Farm Bureau pursued a claim against its broker alleging that the broker was responsible for providing notice to the insurer and that its failure to do so rendered it liable to the insured. The trial court granted summary judgment in favor of the broker on the grounds that, due to two exclusionary provisions in the policy at issue, it would not have provided coverage even if the insurer had received timely notice of the claim.²⁸ *Farm Bureau Life Ins. Co. v. Holmes Murphy & Assoc., Inc.*, Case No. LACL-102118 (Iowa Dist. Ct., Polk Cnty. Dec. 29, 2011). Farm Bureau appealed the trial court's decision to the Iowa Supreme Court, where this matter remains pending. *Farm Bureau Life Ins. Co. v. Holmes Murphy & Assocs., Inc.*, Case No. 12-0650 (Iowa); *see also, e.g., Ben Heller, Inc. v. St. Paul Fire & Marine Ins. Co.*, 435 N.Y.S.2d 669, 670–71 (N.Y. App. Div. 1981) (insured pursued claim against broker based on broker's alleged failure to provide timely notice of underlying claim to insurer); *Stevenson Ins. Assocs., Inc. v. Cohen*, 228 So. 2d 118, 120 (Fla. Dist. Ct. App. 1969) (same).²⁹

D. Damages Potentially Recoverable From Broker

When an insured lacks coverage for a loss due to the conduct of its broker—whether due to the broker's failure to obtain insurance for the insured, failure to advise, failure to properly handle a claim made against the insured, or otherwise—and proves that it is entitled to recover damages, courts generally measure those damages in terms of the benefits to which the insured would have been entitled but for the broker's wrongdoing. *See, e.g., Carpenter v. Scherer Mountain Ins. Agency*, 733 N.E.2d 1196, 1203 (Ohio Ct. App. 2000) (“In an action based upon an agent's failure to secure proper insurance, the proper measure of damages is the amount that would have been due to the insured under the policy had the correct insurance been obtained.”); *see also generally* OSTRAGER & NEWMAN, *supra* § 1804[b] (citing additional cases addressing damages recoverable by insureds in claims against brokers).

In some situations, courts may award damages to an insured in an amount other than and above the amount of coverage which the insured should have received but for the broker's misconduct.

²⁸ The parties agreed that this potentially dispositive issue would be addressed before the questions of whether the broker had a duty to provide notice to the insurer and/or whether it satisfied that duty. *Farm Bureau Life Ins. Co. v. Holmes Murphy & Assocs., Inc.*, Case No. LACL-102118 (Iowa Dist. Ct., Polk Cnty. March 9, 2011).

²⁹ A broker also may face liability to an insured if the broker advises the insured not to report a claim to its insurer based on both the broker's erroneous determination that the insured's policy provides no coverage for it or a belief, ultimately proven to be incorrect, that the insured's potential liability is minimal, as well as the broker's improper act of making a coverage determination, which falls uniquely within the insurer's purview.

For example, in *Third Eye Blind, Inc. v. Near North Entertainment Insurance Services, LLC*, 26 Cal. Rptr. 3d 452 (Cal. Ct. App. 2005), the court held that a broker could be held liable to its insured notwithstanding the fact that the trial court found that the insurance carrier's denial of the underlying claim for which the insured sought coverage was erroneous. *Id.* at 457–64. Specifically, the court found that the broker potentially could be liable to the insured for the costs the insured incurred litigating the issue of coverage with the insurer. *Id.* at 463–64; *see also generally* OSTRAGER & NEWMAN, *supra* § 1804[b] (“An insured may also recover consequential damages in addition to the amount of coverage that would have been in effect but for the error of the broker.” (citing cases)).

E. Potential Defenses to Broker Liability

Brokers are not without defenses to liability when confronted with claims by insureds. The defenses available to brokers vary depending on the nature of the claims against them and their alleged wrongdoing. In circumstances in which an insured is accused of failing to procure adequate insurance for an insured, one defense potentially available to the broker is to argue that the insured had a duty to read the policy obtained in order to determine whether it was sufficient.³⁰ Another defense potentially available to a broker in such circumstances is to argue that insurance was not available in the marketplace to cover the claim brought against the insured. Still another defense, where an insured alleges that it was denied coverage under a policy due to the broker's mishandling of a claim made against it, is the argument that the policy would have provided no coverage for the subject claim even absent the broker's alleged wrongdoing.

1. Insured's Duty to Read Policy

In response to an insured's claim that is premised on a broker's failure to procure the requested insurance and/or insurance appropriate for the insured's potential risks, the broker may seek to defend those claims by citing the insured's own “duty to read” its insurance policies. And in some states and circumstances, the duty to read may, in fact, protect a broker from an alleged failure-to-procure claim. For example, in *Zaremba Equipment, Inc. v. Harco National Insurance Co.*, 761 N.W.2d 151 (Mich. Ct. App. 2008), the court held that an insured's failure to read the policy that the broker procured potentially constituted comparative negligence, offsetting the broker's negligence in undervaluing the insured's property, which resulted in insufficient coverage when that property was destroyed by fire. *Id.* at 155, 158–63. Further, although the court found that a special relationship existed between the broker and insured, such that the broker had a duty to provide advice as to the adequacy of limits, that special relationship and related duty did not eliminate the insured's “duty to read its insurance documents.” *Id.* at 159–60. Therefore, the court concluded, the broker's “decision to undertake additional responsibilities on behalf of an insured” does not “immunize[] the insured from the consequences of its own negligence” because “[t]he negligence of one party does not eliminate the legal requirement that an opposing party use ordinary care.” *Id.* at 160; *see also, e.g., Leonard v. Nationwide Mut. Ins. Co.*, 499 F.3d 419, 439 (5th Cir. 2007) (holding that, in Mississippi, “[t]he insured has an affirmative duty to read the policy”).

³⁰ Of course, such a defense is potentially available only when there is an alleged deficiency in a policy actually obtained, including a provision that should have been modified by endorsement, an inadequate limit of liability, etc. Similarly, it is limited in that the defense may not be available when insured's allegations are that the broker fails entirely to procure a particular type of coverage that the insured either requested or that the broker should have recommended to it.

Other courts have discussed the “duty to read” defense in a more nuanced manner. For example, in *Canales v. Wilson Southland Insurance Agency*, 583 S.E.2d 203 (Ga. Ct. App. 2003), the court determined that an insured’s duty to read its policy potentially was a defense to a failure-to-procure claim against its broker only if no special relationship existed between the insured and broker. *Id.* at 204. There, the trial court granted summary judgment to a broker in an action brought by an insured on the basis that “[the insured’s] failure to read the policy [at issue] barred recovery.” *Id.* In *Canalas*, the insured’s van was destroyed by fire in Mexico. *Id.* He sought coverage for the loss, which was denied on the basis that the policy covering the van applied only to loss occurring in the United States or Canada. *Id.* The Georgia Court of Appeals affirmed the trial court’s ruling. *Id.* In doing so, the court noted that “[g]enerally, an insured is obligated to examine an insurance policy and to reject it if it does not furnish the desired coverage.” *Id.* However:

[t]his rule does not apply when (1) the agent has held himself out as an expert and the insured has reasonably relied on the agent’s expertise to identify and procure the correct type or amount of insurance or (2) “the evidence reflects a special relationship of trust or other unusual circumstances which would have prevented or excused [the insured] of his duty to exercise ordinary diligence.”

Id. Because the court concluded that “[n]either exception applie[d],” the court concluded that the insured’s failure to read the policy precluded his claim against the broker and that the broker was, therefore, entitled to summary judgment. *Id.* at 204–05. Further, in addressing the insured’s argument that the broker fraudulently misrepresented to him that the policy would provide coverage for the van in Mexico, the court concluded that this alleged misrepresentation “did not prevent [the insured] from reading the policy” *Id.* at 206. Therefore, “[b]ecause [the insured] had a duty to read his insurance policy, his reliance on [the broker’s] alleged misrepresentation about its contents was not reasonable.” *Id.*

The recent *American Building Supply Corp.* decision from New York, discussed in Section III.C.3 above, also indicates that an insured’s duty to read its policy is not always a defense to potential broker liability, specifically when an insured makes a “specific request” for coverage to a broker and relies on the broker to procure that coverage. 2012 N.Y. Lexis 3476, at **3-4. The insured there retained a broker to obtain insurance for a building it leased. *Id.* at *2–3. The insured specifically requested that the policy provide “general liability coverage for its employees in case of injury.” *Id.* However, the policy obtained by the broker contained an exclusion for such claims. *Id.* at *3. Neither the broker nor the insured read the policy upon receipt. *Id.* Thereafter, one of the insured’s employees was injured. *Id.* The insurer denied coverage based on the exclusion. *Id.* at *3–4. The insured brought suit against the broker for failure to procure the coverage it requested, alleging both negligence and breach of contract. *Id.* at *4. The trial court denied the broker’s motion for summary judgment on the basis of the insured’s testimony “that it informed defendant it required coverage if any employee injured himself or herself” and its determination that “a jury could rationally conclude that [the insured] made a specific request for such coverage to [the broker].” *Id.* The Appellate Division Reversed, “holding that although issues of fact may exist as to [the insured’s] request for specific coverage, [the insured’s] failure to read and understand the policy precludes recovery” *Id.* at *4–5.

In reversing the lower appellate court, the Court of Appeals specifically addressed the broker’s argument that the insured’s claim “[was] barred by its receipt of the insurance policy without complaint.” *Id.* at **5-6. The court acknowledged a split in authority on the issue of whether an insured’s duty to read its policy precludes a failure-to-procure claim against its broker, noting that “[v]arious appellate courts have held that once an insured has received his or her policy, he or she is presumed to have read and understood it and cannot rely on the broker’s word that the policy covers what is requested.” *Id.* at *7 (citing cases). It also noted, though, that “other appellate

courts have been more forgiving and have held that receipt and presumed reading of the policy does not bar an action for negligence against the broker.” *Id.* (citing cases). In then discussing the issue further, the court stated that “[w]hile it is certainly the better practice for an insured to read its policy, an insured should have a right to ‘look to the expertise of its broker with respect to insurance matters’” such that “[t]he failure to read the policy, at most, may give rise to a defense of comparative negligence but should not bar, altogether, an action against a broker.” *Id.* at *7–8.³¹

2. Coverage Unavailable

When an insured pursues a claim against a broker based on the broker’s alleged failure to procure the requested or appropriate insurance to provide coverage for the risks the insured faces, the broker may defend by arguing that the coverage the insurer sought was not available in the marketplace and/or that coverage could not have been obtained to protect against the risk that ultimately resulted in liability to the insured. For example, in *United Fire & Casualty Co. v. Northwind Developers, L.L.C.*, No. 01-1945, 2003 WL 21069502 (table at 666 N.W.2d 620) (Iowa Ct. App. May 14, 2003), an insured brought suit against its broker for negligence, negligent misrepresentation, and breach of contract alleging that the broker failed to obtain adequate insurance for the insured. *Id.* at *1. The trial court granted a directed verdict in favor of the broker. *Id.* at *2. In affirming the trial court’s decision, the Iowa Court of Appeals found it “significant [that] there was testimony that no insurance policy even existed which would have covered [the insured’s loss].” *Id.* at *5 Thus, there was no “substantial evidence [the broker] breached any duty in procuring coverage [for the insured]. The coverage that would have applied to [the insured’s] loss simply was not available.” *Id.*; see also, e.g., *Roger H. Proulx & Co. v. Crest-Liners, Inc.*, 119 Cal. Rptr. 2d 442, 450 (Cal. Ct. App. 2002) (holding that insured could pursue claim against broker only if coverage would have been available to the insured absent broker’s alleged wrongdoing).

3. No Coverage Even Absent Broker’s Alleged Failing

When an insured pursues a claim against a broker based on the broker’s alleged failings with respect to an underlying claim against the insured—such as failing to provide notice of a claim to the insured’s insurance carrier(s) or advising the insured not to provide notice—one defense potentially available to the broker is an argument that, even if the broker failed to satisfy a duty owed to the insured, the insured suffered no harm as a result because its policy would have provided no coverage for the underlying claim even absent the broker’s alleged wrongdoing. This is one argument made by the broker in the *Farm Bureau* case discussed above (see section IV.C. above), although the broker also disputed the insured’s contention that it had a duty to

³¹ See also, e.g., *Aden v. Fortsh*, 776 A.2d 792, 802 (N.J. 2001) (holding that “an insured . . . is entitled to assume that a broker has performed his or her fiduciary duty” and that “that duty is not diminished when a policyholder fails to detect the broker’s breach of that duty,” noting that “[a]uthoritative commentators on insurance law, leading jurisprudence encyclopedias, and other jurisdictions [cited by the court] are in accord,” and that, therefore, “[the insured’s] failure to read the insurance policy [at issue] cannot be asserted as comparative negligence in an action against the broker for negligent failure to procure insurance”); ALAN D. WINDT, *INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES AND INSUREDS* § 6:44 (5th ed. 2007) (“It should not ordinarily be a defense to a claim against the broker that the insured failed to read his or her policy and recognize that the coverage sought was missing. Although . . . an insured has, in general, a duty to read the policy, a failure to read a policy does not constitute negligence when the insured has no reason to suspect that the broker failed to procure the coverage that the broker promised to procure.”).

provide notice of a claim to the insured's insurer and/or that it breached any such duty. The basis for the broker's argument involved two exclusions in the insured's policy that would have applied to exclude coverage for the underlying claim against the insured even if the insurer had received timely notice of the claim. *Farm Bureau Life Ins. Co. v. Holmes Murphy & Assoc., Inc.*, Case No. LACL-102118 (Iowa Dist. Ct., Polk Cnty. Dec. 29, 2011). As noted above, the trial court granted the broker's motion for summary judgment on this issue, *id.*, and the insured has appealed that decision to the Iowa Supreme Court. Case No. 12-0650 (Iowa S. Ct.). The insured's appeal remains pending.

Although a defense such as this potentially is very strong, caution is warranted in asserting it. That is because successfully asserting this defense may lead directly to an alternative claim by the insured accusing the broker of failing to procure insurance for the insured that would have provided coverage for the underlying claim against it. In fact, the insured in the *Farm Bureau* matter asserted such an alternative claim against the broker, though it ultimately dismissed that claim with prejudice. Case No. LACL-102118 (Iowa Dist. Ct., Polk Cnty., Apr. 9, 2012).

V. E&O Coverage Issues Arising Out of Broker Liability Claims

Once an insured notifies its broker that it may have claims against it, the broker must determine whether to seek coverage for these claims from its own E&O insurer. In doing so, the broker likely will consider whether the insured has brought, or is likely to bring, suit against the broker, the nature of the claims against the broker and the broker's alleged misconduct, and the potential value of those claims. If the broker does seek coverage from its E&O insurer, it will be necessary for both the broker and insurer to assess the operation of the E&O policy with respect to the claim. And, as with all claims made by insureds, the operation of that policy may influence the broker's and insurer's response to the insured's claims, including the possible resolution of those claims.

A. Broker E&O Policies

Insurance broker E&O policies typically encompass the most common types of claims brokers may face in connection with the professional services they provide to their clients. As with all insurance policies, though, they do contain limitations on the coverage they provide and do not provide coverage for all claims that a broker may face.³²

1. The Insuring Agreement

Although the specific language used varies among insurers, and some E&O policies provide additional coverages, the basic coverage provided by various insurance broker E&O policies is similar—i.e., coverage for claims first made against the broker during the policy's policy period for wrongful acts committed or allegedly committed by the broker in its performance of professional services for its clients.

³² The operation of a specific insurance policy with respect to a particular claim is governed by that policy's terms, conditions, and exclusions and the facts of the claim. Nothing contained in this paper should be deemed to constitute an interpretation or assessment by any of its authors or their respective employers concerning the operation of the sample policy provisions discussed herein, or broker E&O policies generally, with respect to any specific claim or type of claim.

By way of example, an insurance agents and brokers professional liability policy issued by one insurer (referred to herein as “Insurer A”) provides coverage as follows:

We will pay on behalf of the insured those sums which the **insured** becomes legally obligated to pay as damages because of a negligent act, error or omission in the performance of the **insured’s professional services**. . . .

Insurer A’s policy defines **professional services**, in part, as:

the operation, management and work performed by you or on your behalf in the conduct of the business named in the Declarations as a(n):

- a. insurance agent; [or]
- b. insurance broker . . .

Only when engaged in the following insurance related activities:

- (1) appraising real or personal property for the purpose of purchasing insurance;
- (2) claims adjusting and claims administration, including third party administration (T.P.A.);

* * *

- (4) insurance consulting; [or]

* * *

- (6) placing and selling of insurance products, including reinsurance placements or products . . .

A similar policy issued by “Insurer B” provides coverage, in pertinent part, as follows:

The **Insurer** will pay on behalf of the **Insured** . . . **Loss** in excess of the Retention . . . which the **Insured** shall become legally obligated to pay because of **Claims** . . . provided always that:

* * *

- 2. such **Claim** arises out of a **Wrongful Act** or **Personal Injury** committed on or after the Retroactive Date in Item 7 of the Declarations

Insurer B’s policy defines **Wrongful Act** as “any actual or alleged negligent act, error or omission of an **Insured** arising solely from the **Insured’s** rendering or failing to render

Professional Services,” which it defines, in turn, as “insurance services performed for others for a fee or a commission as an insurance agent [or] insurance broker”³³

Yet another example of an insurance agents and brokers E&O policy, this one issued by “Insurer C,” provides coverage as follows:

[T]he Company hereby agrees as follows: . . . [t]o pay on behalf of the **Insured** all sums which the **Insured** shall become legally obligated to pay as damages resulting from any claim . . . for any **Wrongful Act** of the **Insured** . . . solely in the rendering or failing to render professional services for others for a fee in the **Insured’s** capacity as an Insurance Agent [or] Insurance Broker . . .

Unlike the Insurer A and Insurer B policies, the Insurer C policy does not define the term professional services. However, it uses the term “professional services” in much the same way that Insurer B’s policy uses the term “insurance services.” The Insurer B policy provides coverage for claims arising out of any actual or alleged negligent act, error or omission arising from the insured’s rendering or failing to render *insurance services* performed for others for a fee or a commission as an insurance agent or broker. The Insurer C policy provides coverage for claims for any negligent act, error or omission of the insured solely in the rendering or failing to render *professional services* for others for a fee in the insured’s capacity as an insurance agent or broker. Thus, the terms “professional services” and “insurance services” are interchangeable as used in these policies. It is only Insurer A’s policy that provides a detailed, multi-part definition of what constitutes professional services under the policy. However, notwithstanding the differences between the insuring agreements in these three sample policies, each would encompass the types of claims most often faced by insurance brokers, as discussed above.

2. Coverage Limitations

Like all professional liability policies, insurance broker E&O policies contain limitations on the coverage they provide, and those limitations can vary greatly from one policy to another. That variation in coverage and policy provisions is evident from the three sample policies discussed above. The Insurer A policy contains six exclusionary provisions, the Insurer C policy contains fourteen, and the Insurer B policy contains twenty-four exclusions. However, there are certain exclusions that are fairly uniform among broker E&O policies. For example, each policy discussed above contains an exclusion for fraud/dishonesty claims, employment practices/discrimination claims, ERISA claims, insured vs. insured claims, and fines, penalties, or taxes an insured may be required to pay. Additional exclusions contained in some broker E&O policies include, *inter alia*, exclusions for claims arising from the commingling of, or inability or failure to pay, collect, safeguard or return money, claims seeking non-monetary relief, claims

³³ In addition to providing coverage for claims arising out of the insured’s professional services, Insurer B’s policy also provides coverage for claims arising out of **Personal Injury**, which it defines as:

1. wrongful entry or eviction or other invasion of private occupancy;
2. false arrest, detention or imprisonment; and
3. the publication or utterance of a libel or slander or other defamatory or disparaging material, or a publication or an utterance in violation of an individual’s right of privacy.

This is an example of the additional coverages provided by some E&O policies.

arising from the insolvency of an insurer with which a broker has placed coverage, and claims arising from a breach of contract by the broker.³⁴

B. Coverage Issues

There are potentially two sets of coverage issues to consider when a claim is made against an insurance broker. Most obviously, the broker, its E&O insurer, and their respective counsel must analyze the terms of the E&O policy at issue in order to determine whether it provides, or potentially provides, coverage for the claim against the broker. If it does, then depending on the nature of the claim, it may also be necessary to review the terms of the policy the broker procured for its client to determine whether that policy would have provided coverage for the claim against the client absent the broker's alleged wrongdoing.

1. Coverage Under the Broker's E&O Policy

Disputes seldom are litigated concerning coverage under E&O policies for the types of claims insurance brokers most often face, including related to an insured's allegations concerning the failure to procure adequate insurance for its client or the failure of broker duties with respect to the handling of claims brought against the insured. Among other things, this largely is due to the fact that these types of claims are among those that insurance broker E&O policies are designed to cover. That is not to say, though, that disputes as to coverage under broker E&O policies are nonexistent or that circumstances do not arise in which a denial of coverage is warranted.

When coverage issues do arise, they commonly fall into one of the following categories. First are matters in which the broker's alleged wrongdoing was not committed in its insured capacity. For example, in a recent decision from the U.S. District Court for the District of Oregon, *Walston v. National Union Fire Insurance Company of Pittsburgh, Pa.*, Nos. 3:09-CV-112-AC, 3:10-CV-579-AC, 3:10-CV-6126-AC, 2012 WL 2049451 (June 6, 2012), disgruntled investors brought claims against a State Farm agent in connection with financial advice she provided regarding investments in a real estate development company founded by her brother. The agent sought coverage under an Insurance Agents' Professional Liability Policy issued by National Union to State Farm under which she was an insured. National Union denied coverage on the grounds that the agent was acting in a non-insured capacity with respect to the work she performed on behalf of the development company. The court agreed and held that the National Union policy provided no coverage for the investors' claims against her.

Second are matters in which a claim against a broker does not arise out of the broker's performance of or failure to perform professional services, a circumstance recently addressed by the U.S. District Court for the Eastern District of Michigan in *Matthew T. Szura & Co. v. General Insurance Co. of America*, No. 12-11593, 2102 WL 5328662 (Oct. 26, 2012). There, the broker was accused by a competitor of wrongdoing in its hiring of one of the competitor's former agents. The broker sought coverage for the competitor's claim from its E&O insurer. The insurer denied coverage, and the court upheld the denial on the basis that the claim did not allege a wrongful act arising out of the broker's performance of or failure to perform professional services.

³⁴ Regarding the latter, the Insurer B policy provides no coverage for claims arising out of "any liability assumed by the **Insured** under contract, unless the **Insured** would have been legally liable in the absence of such contract." An exclusion such as this would be particularly pertinent, and potentially problematic for an insured broker, in a state that does not allow negligence or breach of fiduciary claims by a client against a broker and in which a client's claim is based solely on an alleged breach of a contract between the client and the broker.

Another recent example of this type of claim involved allegations of wrongdoing by an insured real estate developer against the agent who placed surety bonds for it.³⁵ The agent had been placing bonds and procuring other insurance on behalf of the insured for several years, and they had developed a good working relationship.

In addition to working as an insurance producer, the agent also was on the Board of Directors and part owner of a local bank. Issues arose concerning loans related to an undeveloped property the bank wanted to sell. With knowledge of its business, the agent approached the insured to see if it had any interest in purchasing the loans. The insured agreed to purchase the loans and simultaneously requested that the agent secure a surety bond for the project. Due to factors that prohibited the agent from placing the bond, the agent introduced the insured to another agent who could place the bond. The insureds made payment directly to the second agent. However, the bond was never placed, and the second agent absconded with the insured's money.

The insured made claims against the agent, both for facilitating the relationship between the insureds and the rouge agent and arising from his role as an owner of the bank. The insured argued that the agent represented the value of the property to the insureds to entice them to purchase the loans. The agent, in turn, sought coverage for the claims from its E&O insurer. Although coverage may be available under the policy for claims related to the agent's involvement in the attempted placement of the bond, subject to all of the terms, conditions, and exclusions in the policy, coverage would not be available for claims related to the agent's ownership of the bank. Such claims do not arise out of the agent's performance of or failure to perform professional services.

Third are matters in which there is a question as to whether the claim asserted against the broker was first made during the policy period of the E&O policy at issue and/or whether notice of the claim was timely provided to the insurer. Also included in this category are matters in which there is a question as to when the wrongful acts at issue occurred, whether the broker had knowledge of a claim or potential claim prior to the inception of the E&O policy at issue, and/or whether the broker provided notice of a claim or potential claim under a prior policy. *See, e.g., Am. Auto. Ins. Co. v. Murray*, 658 F.3d 311 (3d Cir. 2011) (determining that the policy at issue did not provide coverage because alleged wrongful acts did not occur "wholly after" the policy's retroactive date as required for the policy to provide coverage). These issues are not unique to broker E&O policies, of course. They can, and often do, arise under any claims-made policies.³⁶

Although disputes are infrequent with respect coverage under E&O policies for claims made against insured brokers, it is incumbent on the insurer, the broker, and their respective counsel when confronted with a claim against a broker to carefully review the terms of the policy at issue in order to determine whether it does, in fact, provide coverage for that claim.

2. Coverage Under the Insured's Underlying Policy

If the broker's E&O policy provides, or potentially provides, coverage for a claim made by an insured client against its broker, the E&O carrier may need to analyze the terms of the insured client's underlying policy to determine whether it would have provided coverage for the claim against the insured absent the broker's alleged misconduct. Whether this is necessary depends on the nature of the broker's alleged wrongdoing. If, for example, the broker is accused of breaching

³⁵ Ms. Kauffman provided information concerning this claim from her experience.

³⁶ Another policy provision with respect to which E&O insurers often reserve rights is the fraud/dishonesty exclusion. Because of the final adjudication and severability language frequently attached to such exclusions, though, they do not often provide a basis on which to deny coverage for a claim in its entirety.

a duty owed to its client in connection with the handling of a claim, such as by failing to provide notice of the claim to its client's insurer, determining whether the insured client's policy would have provided coverage had the broker not breached its duty bears directly on the broker's potential liability. As discussed above, if the client's policy would not have provided coverage even in the absence of the broker's alleged error, this fact provides a defense to the insured client's claim against the broker. It is therefore necessary in such circumstances to analyze the underlying claim and the potentially applicable policy to determine whether it would or would not have provided coverage absent the broker's alleged wrongdoing. There is, of course, a potentially significant pitfall that can arise from asserting as a defense that a client's policy would not have provided coverage even if the broker had not breached its duty to its client. Successfully asserting this defense can walk the broker directly into an alternative claim that it failed to procure adequate insurance coverage for its client.

C. "Dropping Down"

If a broker's E&O insurer determines that its policy likely provides coverage for a claim by one of the broker's clients, and if it appears that the broker is facing a high likelihood of liability, the E&O insurer may opt to "drop down" and essentially provide the broker's client with the coverage to which it would have been entitled but for the broker's wrongdoing. When an E&O insurer drops down in this way, it essentially steps into the shoes of the client's insurer.

There are important caveats to this general characterization, though. First, the E&O insurer will not provide coverage for the underlying action in excess of the limit of liability of the broker's E&O policy. Thus, if the limit of liability of the broker's policy is less than the limit of liability of its client's underlying policy, the potential remains for the broker's client to face an "uninsured" liability that would have been covered but for the broker's misconduct. Assuming the broker is liable, it is the broker that will be responsible for any such uninsured liability.³⁷ Likewise, the broker's E&O insurer will not provide coverage until the client satisfies any retention that would have been applicable had its policy provided coverage and the broker satisfies the retention under its E&O policy.

Second, even though the E&O insurer drops down and provides coverage to the broker's client, the E&O insurer owes a duty of good faith and fair dealing to the broker and not to the insured client. Therefore, if the interests of the broker and insured client conflict, the E&O insurer must favor the broker's interests over those of the client. However, if favoring the broker's interests over those of its client results in harm or damage to the client, the broker, and its E&O insurer, may ultimately be held responsible for that harm. As such, it is necessary to carefully analyze apparent divergence between the interests of the broker and its client. While there may appear to be a facial conflict between them, it may be the case that, in the long term, their interests are, in fact, the same.

An assessment of all of the potential conflicts and issues that can arise when a broker's E&O insurer drops down to provide coverage for a claim against the broker's client is beyond the scope of this paper. Needless to say, though, such situations potentially are fraught with peril and must be carefully navigated by all parties involved. The best advice for doing so is to establish clear lines of communication among the interested parties and, whenever possible, to reach consensus regarding the defense and resolution of the underlying claim.

³⁷ This assumes that the broker does not have excess E&O insurance. If it does, it is the excess E&O insurer that likely would be responsible for liability incurred by the insured client in excess of the primary E&O insurer's limit of liability, up to excess policy's limit of liability. However, it is the broker who must cover any exposure in excess of all available insurance.

A recent example of a drop down claim involved an insured hedge fund administrator that began operations as a privately held company in 1999.³⁸ The insured's agent obtained various lines of coverage for the insured beginning at that time, including professional liability coverage. The agent obtained professional liability coverage under a policy providing "claims made" coverage based on a triple trigger. The triple trigger required that the Wrongful Act, the assertion of the claim, and notice to the insurer all take place within the policy period. There was no prior acts coverage because, as a startup company, the insured had no need for such coverage. Each subsequent year, though, the policy was renewed using the same form, resulting in a sequence of policies that did not provide prior acts coverage.

In 2007, as a result of significant claims activity, the agent moved the coverage to a new insurer. The new insurer agreed to use the expiring policy's form, and, as a result, its policy also provided claims made coverage based on the triple trigger with no prior acts coverage. In 2008, during the second renewal of the new policy, the wholesale broker recognized that there was no prior acts coverage. The wholesaler advised the agent, and the insurer reluctantly agreed to provide coverage retroactively to the inception of the policy placed in 2007. Despite being notified of the issue, the agent failed to discuss the issue with the insured or seek alternative coverage for the coverage gap created by the error. In April of 2009, three claims were filed against the insured. While the suits were timely reported to the insurer, the insurer denied coverage based entirely on the lack of prior acts coverage because the alleged wrongful acts took place prior to 2006. As the excess policies followed form, there was no excess coverage available to the insured either.

Based on the foregoing circumstances, a drop down agreement was put in place that essentially provided coverage for the insured through the agent's E&O policy, following the provisions of the insured's underlying, but unavailable, professional liability policy. Notably, the agent's E&O excess insurers refused to participate in the drop down agreement. Consequently, there exists the possibility of dispute among the primary and excess E&O insurers, the agent, and the insured in the event that the insured's liability, which would have been covered under its professional liability policy but for the agent's error, exceeds the limit of liability of the agent's primary E&O policy.

VI. CONCLUSION

Insurance brokers and insureds should be aware of potential liability that brokers may face for their conduct related to procuring insurance for clients. Similarly, the parties should be aware of insureds' own duties with regard to reading policies and determining their own insurance coverage needs. By keeping these issues in mind, both parties may be more careful and thorough in how they establish and carry out their relationships and deal with potential issues from the outset.

Brokers may face claims from their insured clients in a number of circumstances. Almost always, though, such claims arise when the insured learns that a loss it expected to incur or has incurred, and which it believes insurance should cover, is not covered as a result of an alleged act or omission on the part of the broker. Whether these acts will support claims against the broker depends upon the duty or duties that the broker owes the insured. Those duties range from the basic duty to procure insurance requested by the insured to a duty to advise clients concerning the adequacy or limits of their insurance coverage, or even to duties regarding claims made against their clients or other continuing duties. However, a broker typically is obligated only to fulfill a duty to procure unless the insured can establish the existence of a "special relationship" with the broker. Similarly, while brokers should be diligent with respect to an underlying claim an insured

³⁸ Ms. Kauffman provided information concerning this claim from her experience.

reports—e.g., by failing to transmit notice of that claim to the insured’s carrier in a timely fashion, which might result in the carrier denying coverage for late notice—the insured must be able to show a special relationship with the broker to state a claim based on a broker’s alleged mishandling of a claim.

Insureds that bring suit against brokers typically rely primarily on causes of action for negligence or breach of contract. Additionally, and depending upon the nature of the broker duties and the specific facts or circumstances, insureds also may bring claims for, among other things, breach of fiduciary, negligent or intentional misrepresentation, or even fraud. When a broker is faced with a claim by an insured, it is not without potential defenses. First, though by no means the case in all states or circumstances, a broker may be able to defend a failure-to-procure claim by alleging that the insured’s own failure to read its policy or determine its own coverage limits was the reason a claim or loss was not covered, not any alleged wrongdoing by the broker. Notably, New York may have reduced the utility of that defense by precluding the broker in *American Building Supply* from relying on it. However, one decision alone does not diminish the fact that courts often look to whether the insured read its policy and took responsibility for understanding and controlling its own insurance program. Second, a broker also may be able to defend a failure-to-procure claim on the basis that coverage for the loss suffered by the insured was not available, such that the broker could not have procured coverage for the insured. Third, a broker may be able to defend itself by arguing that the claim would not have been covered or would have been excluded under the insured’s policy without any wrongdoing by the broker.

Should a court find a broker liable to an insured, it likely will measure the damages recoverable by the insured in terms of the benefits to which it would have been entitled but for the broker’s wrongdoing—whether that was coverage, limits of coverage, or otherwise. In certain limited circumstances, however, an insured also may be able to recover consequential damages in certain circumstances even if the insured ultimately is able to establish that its claim or loss is covered—e.g., costs such as those the insured incurs in establishing coverage under its insurance policy or policies.

In turn, after an insured files any claims against its broker, the broker may choose to file its own claim with its E&O insurer for coverage of that claim. Although broker E&O policies typically provide coverage for the types of claims most commonly made against brokers, they do contain limitations that, in certain circumstances, may be significant. For example, E&O policies usually cover only those claims that arise out of the broker’s performance of, or failure to perform, professional services. Similarly, E&O policies typically require that the broker’s alleged wrongful acts were committed in an insured capacity. If the broker’s E&O policy does provide coverage, or potentially provides coverage, for a broker’s claim or claims, it may be necessary to analyze whether the insured would have been entitled to coverage absent the broker’s alleged wrongdoing. If not, as noted above, the E&O carrier may use this fact as a defense to liability for the broker.

Finally, with regards to a broker’s E&O coverage for insured vs. broker claims, if the broker shows that the insured would have been entitled to coverage under its policy absent the broker’s alleged wrongdoing, and if the broker’s liability is fairly apparent, the broker’s E&O insurer may opt to “drop down” and provide the insured with the coverage to which it would have been entitled. In assessing this possible course of action by its E&O insurer, a broker must be aware that a carrier that does “drop down” will not provide coverage in excess of the limit of liability of the broker’s E&O policy. Moreover, as the broker’s and client’s interests may diverge or conflict, the E&O insurer will favor the broker’s interests. If the insurer is later harmed as a result, the broker may be liable for that harm.