Agents E&O Standard of Care Project

Texas Survey

To gain a deeper understanding of the differing agent duties and standard of care by state, the Big "I" Professional Liability Program and Swiss Re Corporate Solutions surveyed their panel counsel attorneys. Each attorney was asked to draft a brief synopsis outlining the agents' standard of care in their state. They were also asked to identify and include a short summary of the landmark cases. In addition, many of the summaries include sample case studies emphasizing how legal duties and issues with standard of care effected the outcome. Finally, recent trends in errors in the state may also be included.

This risk management information is a value-added service of the Big "I" Professional Liability Program and Swiss Re Corporate Solutions. For more risk management information and tools visit www.iiaba.net/EOHappens. On the specific topic of agents' standard of care check out this article from the Hassett Law firm, our E&O seminar module, and this risk management webinar.

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Insurance Agent Duties in Texas - A Discussion of the Law Governing Insurance Agent Obligations to their Customers under Texas Law

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"Basic Duties of an Insurance Agent in Texas"

I. Introduction

Most insureds have a general understanding of the duties and obligations of their insurance company. Whether an insured expects the insurance company to provide them a defense against a claim, or whether the insured expects the insurance company to repair and/or replace their property in the event of a loss, are well within the understanding of your typical insurance consumer. Under Texas Law, matters between the insured and their insurance company, revolve around very clear duties on the part of the insurance company and typically favor the insured.

Oftentimes, the relationship between an independent insurance agent and the insured, however, is not well understood by the typical insurance consumer. With respect to issues between the insured and the insurance agent, however, the law in Texas is generally favorable to an insurance agent. Many people do not distringuish the relationship they have with the insurance company from the relationship they have with their own insurance agent. Understanding the insurance agent's obligations and duties under Texas law can help you to avoid many of the issues that arise between the insurance agent and the insured. This paper addresses the basic duties of an insurance agent under Texas Law, and highlights specific cases to demonstrate how you can minimize successful claims against you or your agency.

II. Insurance Agent Duties in Texas

A. Basic Duty of an Insurance Agent:

The basic duty of an insurance agent under Texas law is simple:

> "It is established in Texas, that an insurance agent who undertakes to procure insurance for another owes a duty to a client to use reasonable diligence in attempting to place the requested insurance and to inform the client promptly if unable to do so." *May v. United Serv. Ass'n of America*, 844 S.W.2d 666 (Tex. 1992).

This duty is limited. *Id.* It is expressly limited to the agent's "client." *Id.* It is limited to procuring the "requested insurance." *Id.* It does not impose any obligations to procure the coverage at all costs, an agent must use "reasonable diligence." *Id.* The agent's inability to procure the coverage requested does not mean the agent has failed to satisfy his duties if he informs the client of his inability to procure the coverage. *Id.*

Insureds commonly file "failure to procure" claims against insurance agents. The foundation of such a claim is traced to the basic duty described above. A case study involving the failure to procure coverage will be discussed below.

B. Other Duties of an Insurance Agent (less common)

In addition to the basic duty outlined above, an insurance agent owes two additional general duties to an insured. These duties are less common in the context of claims against an insurance agent but having an understanding of these duties is important.

First, it is important to note that an insurance agent does not have a duty to explain policy terms to an insured. *Heritage Manor v. Peterson*, 677 S.W.2d 689 (Tex. Civ. App. – Fort Worth 1984, writ ref'd n.r.e.). Under Texas law, an insured has a duty to read the policy, and failing to do so is charged with knowledge of the terms of the policy. *Schindler, et. al., v. Mid Continent Life Ins. Co.*, 768 S.W.2d 331 (Tex. App.–Houston [14th Dist] 1989, no writ). Despite this clear limitation on an agent's duties, one Texas Supreme Court case holds:

> "An insurance agent, who receives commissions from a customer's payment of insurance policy premiums, has a duty of reasonably attempting to keep that customer informed about the customer's insurance policy expiration date when the agent receives information pertaining to the expiration date that is intended for the customer." *Kitching v. Zamora*, 695 S.W.2d 553, 554 (Tex. 1985).

Reconciling the general premise that an agent does not have a duty to explain policy terms to an insured with the *Kitching* case leads to the conclusion that this duty arises in a very narrow fact scenario. This additional duty to inform the insured about the expiration of a policy is triggered when the agent "receives information pertaining to the expiration date that is intended for the customer." *Id.* The emphasis here is to demonstrate that when the insurance agent receives information that is intended for the customer concerning the policy expiration (e.g. the insured's copy of the Notice of Policy Expiration) then the insurance agent has a duty to inform the customer about that information.

Second, depending on the circumstances, an agent may have an obligation to take steps to protect the insured against the insolvency of a carrier:

> "An agent is not liable for an insured's lost claim due to the insurer's insolvency if the insurer is solvent at the time the policy is procured, unless at that time or at a later time when the insured could be protected, the agent knows or by the exercise of reasonable diligence should know, of facts or circumstances which would put a reasonable agent on notice that the insurance presents an unreasonable risk." *Higginbotham & Associates, Inc. v. Greer*, 738 S.W.2d 45 (Tex. App.–Texarkana 1987, writ denied).

The circumstances described in *Higginbotham* are limited to when the agent obtains information about the insolvency of a carrier. *Id.* Given the rarity under which claims arise with respect to these two duties, there is no case studies contained in this paper discussing how these duties may arise in the context of a claim. Nevertheless, it is important to know that these duties

do exist and that in the very limited fact scenarios in which they arise, one should be aware of their potential implications.

C. Commonly asserted "Duties" NOT owed by an insurance agent in Texas

Aside from the general duties that were previously discussed, it is very important to know what duties are not owed by an insurance agent in Texas. Often times an insured's expectations of what an insurance agent should do does not coincide with the actual legal duties of an insurance agent in Texas. Having a solid grasp of insurance agent duties will enable you to take steps to minimize claims being successfully made against you.

Many claims asserted against an insurance agent in Texas by the insured derive from a mistaken belief that an agent owes duties to the insured to advise, recommend, explain and/or extend insurance coverage. As noted above, the duties of an insurance agent in Texas are limited. *See May v. United Serv. Ass'n of America (supra*). There are many cases discussing the "duties" that are not owed by an insurance agent in Texas. The following is a list of commonly pled "duties" which do not generally exist under Texas law.

a. There is no common law or statutory duty to disclose any limitation in insurance coverage. *Moore v. Whitney-Vaky Ins. Agency*, 966 S.W.2d 690 (Tex.App.–San Antonio 1998, no pet.); *see also Choucroun v. Sol L. Wisenberg Ins. Agency-Life & Health Div., Inc.*, 2004 Tex. App. LEXIS 11097 (Tex. App.–Houston [1st Dist.] 2004, no pet)

b. There is no duty to explain provisions of an insurance policy. *Heritage Manor v. Peterson*, 677 S.W.2d 689 (Tex. Civ. App. – Fort Worth 1984, writ ref'd n.r.e.).

c. There is no legal duty which arises on the part of the insurance agent to extend the insurance protection of his customer merely because the agent has knowledge of the need for additional insurance for that customer. *McCall v. Marshall* 398 S.W.2d 106, 109 (Tex. 1965); *see also Critchfield v. Smith*, 151 S.W.3d 225 (Tex. App.–Tyler 2004); *see also Pickens v. Texas Farm Bureau Ins. Companies*, 836 S.W.2d 80 (Tex. App.–Amarillo 1992, no writ).

Although an insurance agent may not owe the duties listed above. Many insurance agents voluntary undertake to perform these duties for their clients thus, creating duties that otherwise do not exist under Texas law. Understanding the duties that do not exist under Texas law can help you to avoid incurring a duty that otherwise does not exist.

One area that is potentially problematic and can often result in an insurance agent voluntarily assuming duties that they do not have, revolve around representations made on the agency's website. Websites are a great marketing tool, but they often make impossible promises. Websites often expand the normal duties owed by an insurance agent. Specific examples seen from various agent websites easily demonstrate how websites can result in an agent voluntarily assuming obligations he or she may not otherwise have. The following were found on various insurance agencies websites:

1. "We start by taking the time to learn your business. We ask the right questions, to uncover your unique requirements and individual concerns. Then we help you to understand your potential for risk, no matter how elusive it may seem."

2. "We address your need for a comprehensive risk management program and can reduce your overall cost, increasing your profitability and productivity."

3. "We'll produce the most complete plan to safeguard your business and help you reduce the frequency, severity and cost of claims."

4. "We dig into the insurance specs to make sure you include all proper coverages on every job you bid."

The effect of statements such as these, is to impose an obligation on the insurance agency that it would not otherwise have. The promises made in these examples from the websites greatly exceed the basic duties of an insurance agent in Texas. In addition, these statements create an impression that the insurance agent is acting in a capacity more than an insurance agent

(i.e. a risk manager). Making such promises and representations on your website can result in you having to live up to standards that may not be achievable. We understand the importance of websites in marketing, however, they can be a considerable point of trouble if not written carefully and if the statements made on the websites expand the duties owed by an insurance agent in Texas.

IV. Case Studies - Failure to Procure Coverage

Case No. 1:

> The insurance agent received premiums from the insured to purchase a windstorm policy through TWIA. The insured needed the policy to be able to close on the purchase of her home. The agent created a document which he called "Proof of Insurance" and sent it to the title company who conducted the closing. The agent did not get the premium to TWIA before an approaching hurricane entered the 80/20 box, and therefore, no coverage could be procured. The damage occurred while the agent was holding the client's funds.

In this case, the most obvious mistake by the insurance agent was to receive client funds for the payment of the premium and fail to forward them to the insurance carrier. Under the particular rules of TWIA, TWIA will not bind coverage when there is a hurricane or a named windstorm in the 80/20 box, with some limited exceptions. Because of TWIA's particular rules, coverage could not be procured in this instance, yet the insurance agent represented to the title company and the insured that the coverage was already in place. The failure to timely send the premium payment to the carrier ultimately resulted in there being no coverage when the hurricane struck and damaged the clients property.

Case No. 2:

> The agency procured windstorm coverage on behalf of their client. The Carrier became concerned that some repairs had perhaps not been made and requested proof that the repairs had been completed. The insured never responded to the Carrier's request. The Carrier sent notice that its 60-day temporary binder was expiring and there would be no

coverage because of the insured's failure to comply with a request for confirmation that the necessary repairs had been made. The agent received similar communications from the Carrier. The insured, of course, denied receiving any communications from the Carrier. When the binder expired, the Carrier refunded the unearned premium to the agency. The agency failed to react and the returned premium remained in the agency's account for nine months before the Plaintiffs' home was damaged by another hurricane.

As a result of the agency's failure to refund the money to the insured, the insured claims to have been unaware of there being no coverage.

The agency's failure to return the premium resulted in a claim against the agency.

Steps to minimize both of the above case examples relate primarily to adhering to agency procedures for ensuring that coverage is obtained advising the customer when coverage is not obtained.

V. Case Studies - Negligent Misrepresentations

Case No. 1.:

In this case, the insured requested coverage with no co-insurance penalty. The insurance agent took steps to negotiate with the Carrier to have the Carrier waive the co-insurance clause contained in the policy. As a result of the insurance agents efforts, the insurance company included the following:

Waiver of Co-Insurance Clause - "It is understood and agreed that notwithstanding anything to the contrary contained in this Policy and its endorsements, the Co-insurance Provisions under this policy are waived."

The insurance agent (incurring an obligation he would not otherwise have), advised the client of the policy terms and conditions and represented that the co-insurance penalties or provisions in the policy had been waived. Unbeknownst to the insurance agent, the policy also contained an "Average Clause" that operated in the same way as a co-insurance provision. This "Average Clause" stated:

"This Policy is subject to the condition of average, that is to say, if the property is covered by this Insurance shall at the time of any loss be of greater value than the Sum Insured hereby, the Assured shall only be entitled to recover hereunder such proportion of the said loss as the Sum Insured by this Policy bears to the total value of the said property."

These two conflicting provisions were actually contained in a manuscripted Lloyd Syndicate Policy. Because the agent represented to his customer that there was no co-insurance provision in the policy, he assumed an additional duty to further advise that there were additional provisions in the policy that acted in a similar manner to a co-insurance provision. To avoid this, the insurance agent should have read the policy and gone back to the broker to have the Average Clause removed. The agent certainly should not have represented that there was no co-insurance policy when another policy provision acted as a co-insurance penalty.

Case No. 2:

> The agent procured a complex policy for their client who owned and operated a large marina. The policy was procured through the London market. The agent delivered the policy without reading it and expressly represented to the client that the policy was the same as prior years with minor changes to the coverages.
>
> Had the agent taken the time to read the policy, he would have discovered that there were numerous aspects of the policy delivered by the London broker which were completely inconsistent with the coverage he requested. Because he assumed that the policy provided was consistent with the application, the agent made numerous express misrepresentations to the insured which proved to be the cause of very significant losses.

In this case, once again the insurance agent incurred a duty to advise his client fully as to the contents and terms of the insurance policy. Not only did the agent not actually know what was in the policy, what he represented was utterly false. The case was tried and a jury awarded a significant amount of damages to the Claimant as a direct result of the insurance agent's misrepresentations.

There are certain steps to help minimize misrepresentation claims.

1. Do no promise what you cannot deliver.

2. Always review the policy.

3. If you are replacing a policy, ensure the new policy matches the old policy, or advise of major changes, and that the insured needs to read the policy.

4. As with the handling of any issue, documenting all actions taken can help minimize claims.

VI. Case Studies - Explaining Policy Provisions

Case No. 1:

> The agent sold a $200,000 windstorm policy to their insured and a $200,000 flood policy for their insured's beach house. The agent explained to the insured that if it was completely destroyed by wind they would receive $200,000. He also explained that if it was completely destroyed by a flood they would receive $200,000. When the house was destroyed by a combination of wind and flood, the insured claimed that the agent had misrepresented to them that in such circumstances, they could stack the policies and receive $400,000.

This case example illustrates the most significant problem with making efforts to explain policy provisions. While it is obvious that the insurance agent's intentions were well intended, the insured was left with the mistaken impression of how the two policies operated together in the event of a loss involving wind and flood damage. When an insurance agent voluntarily explains policy provisions, there are countless scenarios under which there may be or may not be coverage in the event of a loss. If one of these scenarios happens to be one that was not explained by the insurance agent, a claim can be expected.

Summaries of coverage are also at the center of many claims. As expected, summaries of coverage(s) contain partial descriptions of the scope of the policy. As with the previous case example, in the event a loss occurs that is not covered, an insured will often point to the summary of coverage and question why that contingency was not explained. In those scenarios, there will undoubtedly be a claim against an insurance agent as a result of the agent's failure to fully explain the policy provisions in the summary of coverage. It must be considered whether or not

summaries of coverage are even worth it. If summaries are used, it is imperative that the agent obtain a signed acknowledgment from the insured that it is a summary only, and that for a complete description of coverages, the insured understands and acknowledges that they must read the entire policy.

In addition to obtaining signed acknowledgments from the insured, and as with the preceding case studies, there are methods to avoid claims related to explaining policy provisions:

1. Don't promise what you can't deliver.
2. Let the policy speak for itself – Don't Summarize.
3. And as with all others, document the file.

VII. Conclusion

In considering the obligations that an insurance agent owes to its client under Texas law, it should be remembered that Texas law generally favors the insurance agent. As noted, the duties an insurance agent owes to an insured are limited. It is important to note that insureds often believe that the legal duties owed by an insurance agent exceed what the actual duties are under Texas law. Keep in mind that actions taken can expand the obligations an insurance agent may owe to the insured. While all claims cannot be avoided you can certainly take steps to minimize such claims and hopefully be in a position to defend yourself when a claim does arise.