Agents E&O Standard of Care Project

California 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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STANDARD OF CARE APPLICABLE TO INSURANCE AGENTS AND BROKERS IN CALIFORNIA

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1. Summary of Standard of Care in California

In California, the terms "agent" and "broker" are defined by statute. California Insurance Code sections 31 and 33, respectively, provide that an insurance agent acts on behalf of an insurer, while an insurance broker transacts insurance with, but not on behalf of, the insurer. Thus, the duty of the insurance agent/broker may in the first instance depend on whether the agent/broker is an "agent" or "broker" or both. An agent for whom a notice of appointment has been filed with the California Department of Insurance will generally be considered an "agent" rather than a broker. Conversely, where no agency contract exists and no notice of appointment has been filed, the agency will generally be considered a "broker." A broker in securing a policy for a client generally acts only as agent for the insured[1] though a broker may have actual or ostensible authority to act on behalf of the insurer for some purposes. An insurance broker may, for example, act in a dual capacity, in which he serves as the insured's broker in procuring insurance but also acts as the insurer's agent by collecting the premium and delivering the policy to the insured.[2]

The duty of an insurance broker towards its client is to use reasonable care, diligence, and judgment in procuring the requested insurance.[3] Generally, no duty exists to do more unless: (a) the broker misrepresents the nature, extent or scope of the coverage being offered or provided, (b) the client requests or inquires about a particular type or extent of coverage, or (c) the broker assumes an additional duty by either express agreement or by "holding himself out" as having expertise in a given field of insurance being sought by the insured.[4] Discussed below are cases in California which illustrate the scope of a broker's duties.

(a) *Jones v. Grewe* (1971) 189 Cal. App. 3d 950 – The Duty of a Broker is to Exercise Reasonable Care, Diligence and Judgment in Procuring the Insurance Requested by the Client.

The seminal case in California concerning the duty of an insurance broker is *Jones v. Grewe* (1971) 189 Cal. App. 3d 950. The Court of Appeal held that an insurance broker's

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[1] *Maloney v. Rhode Island Ins. Co.* (1953) 115 Cal. App. 2d 238, 244.
[2] California Ins. Code, § 1732; *Maloney v. Rhode Island Ins. Co., supra.*
[3] *Jones v. Grewe,* (1971) 189 Cal. App. 3d 950, 954.
[4] *Fitzpatrick v. Hayes*, (1997) 57 Cal.App.4th 916, 927; *Pacific Rim Mechanical Contractors, Inc. v. Aon Risk Ins. Services West, Inc.*, (2012) 203 Cal.App.4th 1278, 1283.

standard of care was no greater than the duty to use reasonable care, diligence and judgment in procuring the insurance requested by the client, and that the mere existence of the agency relationship between the broker and the insured did not impose a duty on the broker to advise the insured on specific insurance matters. The court further held that a broker has no obligation to point out the advantages of additional coverage, or to ferret out additional facts applicable to such additional coverage.

In *Jones* the broker was accused of not obtaining liability policy limits high enough to cover a particular loss, and protect the insured's assets. The Court held that this was not the broker's responsibility. Rather the insured is the one responsible for determining how much liability insurance to purchase because the insured is better positioned than the insurance broker to know how much protection the insured wants and/or needs, and what they can afford, or would be willing, to pay. Whether framed as a negligence question or contract question, the broker's duty is to use reasonable care in procuring the insurance requested.[5]

(b) *Fitzpatrick v. Hayes*, (1997) 57 Cal.App.4th 916, 927 -- The Broker Has No Duty to Advise the Insured of the Availability of Additional or Extended Coverage.

In *Fitzpatrick*, the California Court of Appeal held that an insurance broker has no duty to point out to the insured the advantages of additional coverage unless that duty is assumed by the broker by express agreement or by holding him or herself out to be an expert in the insurance matter at issue. The insureds in *Fitzpatrick* sued for professional negligence, alleging that the broker should have advised them of the availability of personal umbrella coverage to supplement the maximum UM/UIM limits of their auto liability policy. The court found that no such duty was owed because the insureds never asked for additional coverage and the broker did not agree to undertake the task of searching out additional coverage. *Fitzpatrick* is often cited for the exceptions to the general rule as set forth in the *Jones* case. These exceptions include:

1. The broker represents the nature, extent, or scope of the coverage being offered or provided;

2. The client requests or inquires about a specific type of coverage;

3. The broker assumes an additional duty by either express agreement or by "holding himself out" as having expertise in a given field of insurance.[6]

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[5] *Hydro-Mill Co., Inc. v. Hayward, Tilton & Rolapp Ins. Associates, Inc.* (2004) 115 Cal.App.4th 1145, 1156. Occasionally, the insured contends a broker has an implied contractual duty to investigate an insured's needs. Rejecting such an argument, the Court in *San Diego Assemblers v. Work Comp for Less Insurance Services, Inc.* (2013) 220 Cal.App.4th 1363 held there is no implied contractual duty to do so.

[6] No case has yet fully examined the scope and impact of the language that a broker holding itself out as an expert has an enhanced duty. In one case, *Kurtz, Richards, Wilson & Co. v. Insurance Communications Marketing Corp.* (1993) 12 Cal.App.4th 1249, the court found an enhanced duty when the broker urged a customer to sign a certificate attesting to the fact that a special type of group health plan was not subject to Medicare. In fact, the insured was subject to Medicare and when the insurer sought to rescind coverage, the court permitted the action to go forward against the broker because the broker represented it was an expert in the particular type of health plan

(c) *Pacific Rim Mechanical Contractors, Inc. v. AON Risk Insurance Services West, Inc.*, (2012) 203 Cal.App.4th 1278 – a Broker Has No Duty to Notify an Insured of an Insurer's Post-Issuance Insolvency.

In *Pacific Rim Mechanical Contractors, Inc. v. AON Risk Insurance Services West, Inc.* the California Court of Appeal was presented with the issue of whether a broker had a duty to notify an insured of an insurer's post policy-issuance insolvency. Citing with approval the cases of *Jones v. Grewe,* (1971) 189 Cal. App. 3d 950 and *Fitzpatrick v. Hayes*, (1997) 57 Cal.App.4th 916, the Court refused to find any such duty and reiterated the principles that a broker's duty is to use reasonable care, diligence, and judgment in procuring the insurance requested by its client, and the broker does not have greater duties unless assumed by express agreement or by holding out that the broker has expertise on a particular insurance matter. *See also*, *Wilson v. All Services Ins. Corp.* (1979) 91 Cal.App.3d 793, 798 (broker has no duty to investigate the financial condition of insurer authorized to conduct business when policy issued.); *Kotlar v. Hartford Fire Ins. Co.* (2000) 83 Cal.App.4th 1116 (broker owes no duty to notify the insured that the policy was being cancelled); and *Brandwein v. Butler*, (2013) 218 Cal. App. 4th 1485 (broker had no duty to independently verify the information in a marine insurance policy regarding the value of a yacht).

(d) *Mark Tanner Construction, Inc. v. HUB International Insurance Services, Inc.* (2014) 224 Cal.App.4th 574 – No Duty by Broker to Investigate the Financial Soundness of a Self-Insured Workers Compensation Program.

Consistent with prior California decisions, the California Court of Appeal in the recent case of *Mark Tanner Construction, Inc. v. HUB International Insurance Services, Inc.* (2014) 224 Cal.App.4th 574 refused to expand the scope of a broker's duties beyond those articulated in *Jones v. Grewe*. In *Tanner*, the broker placed workers compensation insurance coverage for Mark Tanner Construction, Inc. with a self-insured worker's compensation program administered by the California Department of Industrial Relations. The program became insolvent after the insurance was placed. Tanner sued HUB, claiming that it owed Tanner a fiduciary duty to have investigated the financial condition of the SIR program. The trial court rejected the insured's assertion and granted summary judgment in favor of HUB. Tanner unsuccessfully appealed.

The Court of Appeal found that the broker had no duty to investigate the financial condition of the insurer before placing the insurance and that the broker's duty was fulfilled once it placed insurance with an insurer that was properly conducting business. Neither did the Court find that the broker had a duty to monitor the financial health of the self-insured workers

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sought by plaintiff. Compare that to a common situation where, for example, most commercial brokers will hold themselves out as having expertise in matters such as general liability policies, or property policies. Does that make them liable for any failure of the policy to provide coverage for a given loss? We believe the Court's holding means that if the broker has in fact given advice on a specific matter in a specialized area in which the broker claims expertise, the broker has a duty to ensure that such advice was proper. An insured should be entitled to rely on such affirmative advice, if the broker claims to have expertise on a particular issue.

compensation program as that program was under the administration of the California Department of Industrial Relations, not the broker.

(e) Do Brokers Owe a Fiduciary Duty to Their Clients?

Often, in pleading their case, a plaintiff insured will include, in addition to the typical causes of action for negligence and breach of contract, a cause of action for breach of fiduciary duty. By doing so, the plaintiff insured seeks to hold the broker to the more stringent test and standards of a fiduciary, and to arguably obtain a longer statute of limitations.[7]

California courts have not ruled definitively on whether a fiduciary relationship normally exists between an insurance broker and an insured.[8] One reason for this reluctance is that under some circumstances a broker may have a fiduciary duty. One situation in which such a duty exists is when a broker receives and holds premiums or premium refunds. In that instance the broker owes the insured a fiduciary duty in handling such money.[9] The below succession of cases, however, suggests that, a broker does *not* generally owe the insured a fiduciary duty:

1998: In *Eddy v. Sharp* (1988) 199 Cal.App.3d 858 the court noted in dicta that under the circumstances of that case the broker owed the insured a fiduciary duty to be truthful when making representations of coverage. In *Eddy*, the broker prepared a proposal for insurance that stated coverage was "All Risk," but failed to disclose that it provided no coverage for sewer backups. The trial court granted summary judgment in favor of the broker, but the Court of Appeal reversed, finding a triable issue of whether the broker had misrepresented the terms of the policy. Although not necessary to the holding in the case, the court opined that under agency principles, the broker had "not only a fiduciary duty but an obligation to use due care." *Id.* at p. 865; *see Westrec Marina Management, Inc. v. Jardine Ins. Brokers Orange County, Inc.* (2000) 85 Cal.App.4th 1042, 1045. The *Eddy* case stands alone in describing brokers as generally having a fiduciary duty to an insured. It bears noting that *Eddy* has often been cited but is usually distinguished and has never been acknowledged as stating a commonly accepted rule of law.

2000: In *Kotlar v. Hartford Fire Ins. Co.*, (2000) 83 Cal. App. 4th 1116, the insured asserted that an insurance broker had a legal duty to notify an insured of the cancellation of an insurance policy and argued that the relationship between a broker and an insured gave rise to a fiduciary duty comparable to the duty owed by an attorney to a client. The Court of Appeal disagreed, because a broker is required to exercise *reasonable* care in procuring insurance whereas an attorney must represent the client *zealously within the bounds of the law*. The duties were not comparable and the court refused to find a fiduciary duty between a broker and an insured.

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[7] Generally, a claim against a broker must be filed within two years of an insured incurring damage. CCP §339. Breach of Fiduciary Duty is governed by the four year statute. CCP §343.

[8] *Hydro-Mill Co., Inc. v. Hayward, Tilton & Rolapp Ins. Associates, Inc.*, (2004) 115 Cal.App.4th 1145, 1156

[9] California Insurance Code §1733.

2004: In *Hydro-Mill Co., Inc. v. Hayward, Tilton & Rolapp Ins. Associates, Inc.* (2004) 115 Cal.App.4th 1145, 1156, the California Court of Appeal found unclear whether a fiduciary relationship existed between an insurance broker and an insured, but ultimately concluded that if an insurer is not considered a fiduciary to its insured, then neither was a broker a fiduciary to the insured.

2014: In *Mark Tanner Constr. v. HUB Internat. Ins. Servs.*, (2014) 224 Cal. App. 4th 574, the California Court of Appeal concluded that except when handling the insured's money, a broker's duty, whether or not phrased as a fiduciary duty, was no greater than the duty to use reasonable care and diligence in procuring the insurance. *Tanner* suggests that a broker's duty, however characterized, extends only to the use of reasonable care and diligence in procuring insurance, and does not require more.

In 2011, in the short-lead case of *Workmen's Auto Ins. Co. v. Guy Carpenter & Co., Inc.*, (2011) 194 Cal. App. 4th 1468, the Court of Appeal *expressly* held that even if an insurance broker might have certain fiduciary-like duties, a broker could *not* be sued for breach of fiduciary duty. A month after this opinion was published the court granted rehearing and the opinion was *depublished.*

In summary, California courts resist suggestions that a broker is a fiduciary to an insured, but stop short of ruling out the possible existence of such duty.

THE AUTHORS

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CASE STUDIES

1. (a) Line Of Coverage Involved

Professional liability.

(b) Position Of Person And The Agency Involved

Principal in Commercial lines agency.

(c) Personal Or Commercial Lines

Commercial lines.

(d) Type Of Coverage Involved

E & O for actuary.

(e) Procedural Or Knowledge-Based Error

Knowledge based error.

(f) Claimant Allegation

Plaintiff County asserted that ACORD certificate of insurance and endorsement it received from broker misrepresented nature and extent of coverage afforded to insured actuary in that County's contract required actuary to maintain an occurrence based policy while policy obtained was a claims-made policy. County claimed actuary's mistake caused County to sustain in excess of $25 million in damages when it obtained judgment against actuary for which actuary's insurer denied coverage based on a claim not having been timely made.

(g) Settlement Or Trial

Settled for nuisance value.

(h) Description Of Alleged Error

Failure to understand terms of underlying contract between insured (actuary) and insured's client (County); improper description in ACORD or that coverage was occurrence based on rather than claims-made.

(i) Tip To Avoid Claim

If insured requests coverage to satisfy underlying contractual requirements, require insured to specify these requirements rather than making independent assessment. If broker undertakes duty of determining contractual requirements, carefully review

document and then ask insured client to confirm understandings. Prepare ACORD forms, including Certificate, accurately. Consider sending policy, in addition to Certificate to third party, and requesting third party to confirm that coverage is acceptable based on their review.

(j) Summary Of Case

Broker was asked to obtain E&O coverage for actuary. Actuary had lengthy contract with County that detailed type and limits of coverage that actuary was required to maintain. Broker sent Certificate to County which arguably described obtained coverage inaccurately.

2. (a) Line Of Coverage Involved

General liability and Professional liability.

(b) Position Of Person And The Agency Involved

Commercial Broker/Agent.

(c) Personal Or Commercial Lines

Commercial.

(d) Type Of Coverage Involved

GGL and E&O.

(e) Procedural Or Knowledge-Based Error

Procedural.

(f) Claimant Allegation

Claimant was a general contractor sued for alleged construction defects. Contractor gave notice to broker and asked that all insurers be notified. Broker placed insurers that issued CGL policies on notice and advised insured contractor that all insurers had been placed on notice. Contractor had a professional liability policy for work as a "construction manager."

(g) Settlement Or Trial

Settled.

(h) Description Of Alleged Error

Broker failed to put professional liability carrier for general contractor on notice of claim. When CGL carriers later denied coverage, professional liability carrier was then placed on notice but denied on basis that claim was not made and reported timely.

(i) Tip To Avoid Claim

When advised of a claim, review nature of all coverage in place, and review nature of claim with client. Place all carriers possibly having coverage on notice after reviewing with client, and obtaining consent from client.

(j) Summary Of Case

Broker had placed both CGL and E&O coverage for client, a general contractor. When general contractor was sued in construction defect case, broker placed all CGL carriers on notice but failed to place E&O carrier on notice, believing it was not an E&O claim.

3. (a) Line Of Coverage Involved

Fire.

(b) Position Of Person And The Agency Involved

Personal Lines Agency.

(c) Personal Or Commercial Lines

Personal.

(d) Type Of Coverage Involved

Fire and Difference in Conditions.

(e) Procedural Or Knowledge-Based Error

Procedural.

(f) Claimant Allegation

Homeowner alleged that broker failed to obtain appropriate limits in California Fair Plan policy and had knowledge of inadequacy because of separate Difference in Condition policy which broker had obtained.

(g) Settlement Or Trial

Settled for nuisance value.

(h) Description Of Alleged Error

Broker procured a Fair Plan policy providing a basic form of fire protection for insured Homeowner. Broker also procured a Difference in Condition policy from different insurer providing enhanced supplemental coverage. At the time of fire loss, the DIC policy showed a dwelling value in excess of $500,000 while the Fair Plan fire policy still had limits of less than $140,000, the same limits that had been obtained more than 15 years before the fire destroyed the home. Plaintiff insured contended that broker knew dwelling was valued in excess of $500,000, held itself out as expert in personal lines, and should have recommended higher limits on the basic fire policy.

(i) Tip To Avoid Claim

Broker was able to avoid serious exposure in case by pointing to annual letters it sent to client, asking client to review the limits on policies and to contact broker to raise limits. Form letter contained language that insured "may be underinsured."

(j) Summary Of Case

Homeowner purchased basic fire policy and a Difference in Condition policy many years prior to a fire. Although the DIC policy annually adjusted the limits upward, the limits on the fire policy remained the same, and at the time of the fire, the home was seriously underinsured. Broker was able to defend claim on basis that insured homeowner annually received a form letter requesting insured to review limits and contact the broker to discuss adequacy of the limits.

4. (a) Line Of Coverage Involved

EPLI.

(b) Position Of Person And The Agency Involved

Commercial Agency.

(c) Personal Or Commercial Lines

Commercial Lines.

(d) Type Of Coverage Involved

EPLI.

(e) Procedural Or Knowledge-Based Error

Procedural.

(f) Claimant Allegation

Claimant business alleged that broker, in moving business from one insurer to another, failed to discuss ramifications of move, including whether to place earlier insurer on notice of possible or potential claims based on earlier termination of employees.

(g) Settlement Or Trial

Settled for nominal amount.

(h) Description Of Alleged Error

Claimant business contended that broker switched insurers for its own reasons and failed to discuss with claimant business whether earlier terminations would be considered potential claims. When a claim was later made, new insurer denied on basis of prior knowledge of circumstances.

(i) Tip To Avoid Claim

When a change is made from one insurer to another, notify client, discuss ramifications with client, understand differences, if any, between prior and renewal form. When dealing with claims-made and reported forms discuss with client whether any claim has been made, and most importantly, document and confirm discussion with client.

(j) Summary Of Case

Broker that had placed EPLI coverage changed insurers allegedly without instruction of client. Business contended that it was aware of a number of terminations and that broker should have discussed changeover, and should have given notice of potential claims to expiring insurer.