Agents E&O Standard of Care Project

Minnesota 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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LANDMARK CASES IN MINNESOTA:
THE STANDARD OF CARE APPLICABLE TO AN INSURANCE AGENT

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1. *Osendorf v. American Family Insurance Company* 318 N.W.2d 237 (Minn. 1982)

Osendorf employed Daniels, a 15-year old, as a part-time farmhand. Daniels was hurt while he was working on Osendorf's farm. Osendorf did not have workers' compensation insurance. American Family provided the general liability coverage but denied coverage for a work related injury.

The original American Family agent sold Osendorf a farm general liability policy in 1961. This original American Family agent did not explain the coverages to Osendorf.

Two years later in 1963, Osendorf called the American Family agent and asked whether or not coverage was in place for part-time help. The American Family agent said there was coverage for part-time help but not full-time help.

That same year, Baltes replaced the original American Family agent and assumed the account. Baltes visited Osendorf at Osendorf's farm annually from 1963 to 1973. They did not discuss liability coverages during any of these visits.

Osendorf sued Baltes and the case was tried to a jury. The jury concluded that Baltes was negligent.

The Minnesota Supreme Court let the negligence finding stand against Baltes. The court found it significant that Osendorf did not complete school beyond the eighth grade and was unable to read an insurance policy.

The court did not explicitly describe an insurance agent's standard of care. Osendorf's functional illiteracy set the stage for a formulation of the standard of care in subsequent cases.

2. *Johnson v. Farmers and Merchants State Bank of Balaton*

320 N.W.2d 892 (Minn. 1982)

Warren Johnson was a farmer. He died when his tractor turned over. His widow, Agnes Johnson, sued the agency, Balaton, alleging that Balaton did not sell Warren Johnson a sufficient amount of credit life insurance on his life.

Warren Johnson purchased $40,000 of credit life insurance from Balaton. As time went by, he owed more money to the bank and thus when he died, the $40,000 was insufficient to pay for the amount of money that he owed the bank. Hence the claim by his widow the agency sold an insufficient amount of credit life insurance.

We see in *Farmers and Merchants* the court is continuing to formulate the standard of care applicable to an insurance agent. The court was disinclined to impose a duty on the part of Balaton, the insurance agency, to review the insurance coverage on a regular basis to ascertain whether or not the amount of credit life insurance was sufficient, and the court stated: "An insurance agent has the duty to exercise the standard of skill and care that a reasonably prudent person engaged in the insurance business will use under similar circumstances." (320 N.W.2d 898) More on this in later cases.

3. *Atwater Creamery Company v. Western National Mutual Insurance Company* 366 N.W.2d 271 (Minn. 1985)

Atwater Creamery Company bought a property policy from Western National Mutual Insurance Company. Atwater Creamery experienced a burglary loss. Western National denied coverage because there was no physical evidence, such as scratch marks on a door, of the burglary. The policy required physical evidence of the burglary.

Atwater Creamery sued its insurance agent in the alternative, that is, if Western National is correct in its coverage position, then the agent must have been at fault in not explaining the coverage to Atwater Creamery.

Atwater Creamery and the agent had a 17-year business relationship.

The court addressed the question of whether the agent had an affirmative duty to check the insurance policy and notify the insured, Atwater Creamery, of potential gaps in coverage.

Atwater Creamery hints at a special relationship standard of care because of the longstanding business relationship between Atwater Creamery and the agent. *Atwater Creamery* is also significant because the court required expert testimony about the standard of care when the question about the standard of care goes beyond what the agent should do when the agent is clearly requested to perform a task. For instance, if the insured alleges the

insurance agent did not procure the coverage the insured instructed the agent to procure, *Atwater Creamery* does not require expert testimony to establish the standard of care. But when the standard of care dispute goes to the broader issue of whether the agent has affirmative duties to advise, then expert testimony is a required part of the case against the insurance agent. Without expert testimony, a jury is simply speculating about what an insurance agent should have done in the particular circumstances presented in the lawsuit.

4. *Gabrielson v. Warnemunde*
443 N.W.2d 540 (Minn. 1989)

Gabrielson is the landmark case in Minnesota.

In 1978, LaCanne purchased a homeowner policy from the insurance agent. LaCanne purchased his automobile insurance from a different agent. The homeowner policy excluded boats with a motor greater than 25 horsepower. The agent did not specifically tell LaCanne about the exclusion.

The homeowner policy renewed for several years. In 1982, LaCanne purchased a boat with 60 horsepower motor. LaCanne did not inform his agent. The policy renewed one month later.

Tim Gabrielson was injured in a boat accident a few months after the policy renewed. Gabrielson sued LaCanne, the owner and driver of the boat.

LaCanne's homeowner insurer denied coverage because the policy contained an exclusion for boats with motors exceeding 60 horsepower.

The Minnesota Supreme Court articulated the standard of care expected of an insurance agent. The court ruled unless there are special circumstances existing between the insurance agent and the insurance customer, the insurance agent is not obligated to inquire about any changes that might have occurred between renewals.

The court looked to *Farmers and Merchants* for the general notion that the insurance agent is obligated to exercise the skill and care that a reasonably prudent person engaged in the insurance business would use under similar circumstances. The court added this nuance: "An insurance agent's duty is ordinarily limited to the duties imposed in any agency relationship, to act in good faith and follow instructions…Absent an agreement to the contrary, an agent has no duty beyond what he or she has specifically undertaken to perform for the client." The court looked to *Farmers and Merchants* and said the agent is under no affirmative duty to take other actions if the typical principal-agent relationship exists. If special circumstances are present, the insurance agent might be under an obligation to take some sort of affirmative action, such as advise the insurance client.

The *Gabrielson* standard of care draws on the earlier cases and strengthens the idea that unless there are special circumstances giving rise to a special relationship, the insurance agent is only obligated to follow the instructions of the insured and act in good faith. Good faith means that the agent is to be honest and aboveboard with the insurance customer and the insurance company.

The court reiterated that once an insurance policy has been issued, the insurance agent is generally not obligated to update the insurance policy by ferreting out at regular intervals information which would be pertinent to the policy's provisions. The insurance customer, not the insurance agent, bears the responsibility to inform the agent about change circumstances which might in turn affect the coverage.

It is the *Gabrielson* standard of care that is the most potent argument in the defense of an insurance agent case.

5. *Beauty Craft Supply & Equipment Company v. State Farm Fire and Cas. Ins. Co.* 479 N.W.2d 99 (Minn. App., 1992)

In *Beauty Craft,* the court added some guidance to the idea of special circumstances giving rise to a special relationship and thus a duty to advise the insured. It also addressed the issue of an insured allegedly ordering "full" or "complete" coverage.

Beauty Craft was a wholesaler selling to beauty salons. Wexler was in charge of getting insurance.

Beauty Craft was insured with Transamerica Insurance. When the Transamerica policy came up for renewal, Wexler asked several insurance agents, including Michael Nelson, for bids.

Nelson asked to meet with Wexler but was rebuffed. The agents were simply to submit a written proposal. Wexler and Nelson did have a brief telephone conversation and Wexler claimed he told Nelson: "I want a policy that doesn't have any formulas. I want complete coverage. I want a no questions asked policy."

Nelson got the successful bid for the insurance coverage and it essentially matched the Transamerica insurance coverage.

Beauty Craft experienced employee theft and made a claim for $50,000. The policy Nelson sold to Beauty Craft did not include employee dishonesty coverage. Employee dishonesty coverage was available for $350 premium.

The court decided there were no special circumstances giving rise to a special relationship between Beauty Craft and Nelson. Nelson was therefore under no duty to advise Beauty Craft.

The court in *Beauty Craft* ruled that a special circumstance can include an agent's knowledge the insured is "unsophisticated in insurance matters," that the insured is relying on the agent to provide appropriate coverage, and the insured needs the protection in dispute.

The court rejected the idea that Wexler's request for "full coverage" created a special relationship. Beauty Craft asked for bids matching Transamerica's coverage and Beauty Craft received what it requested.

The idea of a special circumstances giving rise to a special relationship is not resolved with any one particular factor. In *Osendorf,* the farmer had a limited ability to read. It is a good example of a special circumstance giving rise to a special relationship. The court of appeals in *Beauty Craft* said that special circumstances may arise when the insured delegates to the insurance agent decision making authority. The agent becomes an insurance consultant. Functional illiteracy can cause that shift of decision making from the insurance customer to the insurance agent.

A plaintiff in an errors and omissions case often argues the insurance customer is unsophisticated about insurance. The usual flaw in this argument is that the plaintiff's lawyer is attempting to compare the insurance customer's degree of sophistication to the insurance agent's degree of sophistication. It logically cannot be the test by comparing the insurance customer to the insurance agent. The insurance agent will usually be more sophisticated about 99% of the insuring public. The test for sophistication or lack thereof, has to be how this insurance customer compares to the rest of the insuring public. The farmer in *Osendorf* was truly unsophisticated by reason of his functional illiteracy.

6. ***Graff v. Robert M. Swendra Agency, Inc.*** **800 N.W.2d 112 (Minn. 2011)**

This is the most recent iteration of the standard of care in Minnesota. The Supreme Court of Minnesota explicitly held that an insurance agent may be held independently liable for negligent procurement of insurance coverage.

It is not a particularly significant opinion. It makes explicit what was implicit in *Gabrielson* and the cases leading up to *Gabrielson.* The standard of care is now an amalgam of what the *Gabrielson* court and the *Graff* court say the standard of care is: Unless there is a special relationship, an insurance agent is obligated to use reasonable care following the instructions of the insured and to act in good faith.

7. *Louwagie v. State Farm Fire and Cas. Co.*
397 N.W.2d 567 (Minn. App., 1986)

Louwagie is included in this discussion because it discusses the obligation of the insured. *Louwagie*, like *Osendorf,* arises out of a work related injury to a farmhand. The farmer did not have workers' compensation insurance. The insurance agent was sued. The significance of *Louwagie* is: "Generally, an insurance consumer is responsible to educate himself concerning matters of insurance coverage." Simply put, the insurance customer should not be a passive participant in the procurement of insurance. When an insurance agent negligence case is tried, the relative fault of the insurance customer is very much at issue. The jury assigns a percentage of fault to the plaintiff/insurance customer. The plaintiff's percentage of fault reduces the recovery of money from the insurance agent. For example, if the jury finds that the insurance customer is 25% at fault but awards $100,000 and finds the insurance agent is negligent, the insurance agent is obligated to pay $75,000 to the plaintiff/insurance customer.

CASE STUDIES – STANDARD OF CARE APPLICABLE TO AN INSURANCE AGENT

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Case Study #1

A. Line of coverage involved: A commercial package policy containing business interruption/extra expense coverage.

B. Position of person in the agency involved**:** Producer.

C. Personal or Commercial Lines**:** Commercial.

D. Type of coverage involved: Business interruption/extra expense.

E. Procedural or knowledge-based error: Procedural.

F. Claimant allegation: A wood cabinet manufacturer alleged the insurance agent did not recommend an increase in the business interruption/extra expense coverage. The wood cabinet manufacturer sustained a fire and sustained a total business interruption and extra expense losses of $328,534.

G. Settlement or trial: Arbitration.

H. Description of alleged error: The wood cabinet manufacturer alleged the agent did not recommend increased business interruption/extra expense coverage.

I. Tip to avoid claim: Document communications with the insurance customer, particularly when the customer declines increased coverage.

J. Summary of case: The plaintiff is a wood cabinet manufacturer ("Wood Cabinet Manufacturing"). Wood Cabinet Manufacturing was insured under a commercial package policy. The insurance policy included business interruption/extra expense coverage of $100,000.

Wood Cabinet Manufacturing's business was destroyed by fire. Wood Cabinet Manufacturing alleged a total business interruption and an extra expense loss of $328,534. Wood Cabinet Manufacturing was underinsured for this loss because it had $100,000 of coverage and thus it claimed $228,534 in damages against the insurance agent.

Wood Cabinet Manufacturing alleged there were special circumstances giving rise to a special relationship, in part because of the social relationship between the insurance agent and the owners of Wood Cabinet Manufacturing. A special relationship means that the insurance agent is, in certain circumstances, obligated to advise the insurance customer about appropriate coverage.

The insurance agent met with the owners of Wood Cabinet Manufacturing over lunch at a restaurant. The insurance agent testified he specifically recommended that Wood Cabinet Manufacturing increase its business interruption/extra expense coverage. The insurance agent used a business income loss worksheet, but he could not recall whether he actually gave the owners of Wood Cabinet Manufacturing a copy of the worksheet.

The case was arbitrated rather than tried to a jury.

The insurance agent expert who testified on behalf of Wood Cabinet Manufacturing criticized the defendant insurance agent for not documenting his file adequately. The expert asserted the insurance agent did not meet the standard of care because he did not adequately explain the process by which Wood Cabinet Manufacturing should evaluate its need for business interruption/extra expense coverage.

The expert also asserted the business income worksheets used by the defendant insurance agent were inadequate in that they were insufficient to guide Wood Cabinet Manufacturing to ascertain the proper amount of coverage.

The defense expert who testified on behalf of the insurance agent asserted that the defendant insurance agent met the standard of care in these particular circumstances. The insurance agent recognized the business income/extra expense coverage was insufficient and brought it to the attention of Wood Cabinet Manufacturing. The defense expert also thought the business income worksheets the insurance agent used were adequate.

Forensic CPAs testified for both parties.

The arbitrator decided the business interruption coverage had not been sufficiently explained and offered to Wood Cabinet Manufacturing. The arbitrator awarded a

gross damage award of $217,564. The insurer paid $100,000 and thus the net amount owing to Wood Cabinet Manufacturing was $117,564.

Had the *Gabrielson* standard of care been applied by the arbitrator, it is likely Wood Cabinet Manufacturing would have lost its case against the insurance agent.

The paramount lesson to take away from this case is the importance of documentation. The insurance agent did not document his file adequately.

Case Study #2

A. Line of coverage involved: Business personal property.

B. Position of person in the agency involved**:** Producer/principal.

C. Personal or Commercial Lines**:** Commercial.

D. Type of coverage involved: Business owner policy.

E. Procedural or knowledge-based error: Allegation of procedural error.

F. Claimant allegation: The insurance customer alleged the agent did not ask about a second location.

G. Settlement or trial: The insurance customer's lawsuit was dismissed by the court and thus there was no trial.

H. Description of alleged error: The insurance customer alleged that the insurance agent did not ask sufficient questions about the possibility of a second business location.

I. Tip to avoid claim: Inquire whether or not the insured has more than one location for its business.

J. Summary of case: John Smith became the agent of record on August 29, 2007 for the Hartford business owners' policy ("BOP") insuring Business Promotions. It sells specialty products to its customers. For example, SuperValu, a chain of grocery stores, is a customer of Business Promotions that buys golf shirts with the SuperValu logo.

The Hartford policy was initially sold by a different insurance agent than Smith. Smith sold Business Promotions a D&O policy in 2005 in response to Business Promotions' request. In 2007, Peter Jones, Business Promotions' CFO, decided to

switch the Hartford BOP to Smith. The agent of record letter was therefore executed August 29, 2007.

Jones and Smith toured the Business Promotions site and its adjacent warehouse in Chanhassen, MN during the summer of 2007. Jones said nothing to Smith about a second warehouse site during their tour of the Chanhassen warehouse.

The Hartford BOP renewed October 23, 2007. Smith met with Jones on October 24, 2007. They reviewed an insurance summary that identified Business Promotions' only location in Chanhassen, MN. Again, Jones did not say anything about a second warehouse located elsewhere.

It turned out that Business Promotions, unbeknownst to Jones, stored a substantial amount of its inventory at a warehouse named Shamrock Storage in Green Isle, MN.

The Hartford BOP renewed on October 23, 2007. On June 19, 2008, Jones sent Smith an e-mail: "I just thought I should share with you our current inventory levels we have on hand. Right now we have over $2.8 million, so I suggest that we increase this level to $3 million." Smith instructed his account executive to increase the business personal property to $3,000,000.

The Shamrock Storage facility was destroyed by fire on July 2, 2008. Business Promotions submitted a claim to Hartford for $1,200,000 because of destroyed inventory at the Shamrock Storage facility. Hartford denied Business Promotions' claim because the Shamrock Storage facility was not named as an insured location.

Business Promotions claimed that Smith should have asked Jones before the October 23, 2007 renewal whether or not Business Promotions had another storage facility. Business Promotions did not claim that Jones' June 19, 2008 e-mail was a red flag to Smith which should have prompted him to ask Jones about a potential second location.

Business Promotions sued Smith alleging negligence and breach of contract.

The trial court dismissed the case. The trial court reasoned that there was no special relationship between Business Promotions and Smith which invokes the *Gabrielson* standard of care. Smith was obligated to follow the instructions of Business Promotions, use reasonable care following the instructions of Business Promotions, and to act in good faith. The trial court reasoned that this standard of care was met and there was nothing for a jury to decide.

The Minnesota Court of Appeals agreed.

Had the court decided that there was a special relationship between Smith and Business Promotions, the case would probably not have been dismissed by the court. The case probably would have gone to trial or settled.

Case Study #3

A. Line of coverage involved: Fire insurance.

B. Position of person in the agency involved**:** Producer.

C. Personal or Commercial Lines**:** Commercial.

D. Type of coverage involved: Business owner policy.

E. Procedural or knowledge-based error: Claimed procedural error.

F. Claimant allegation: River House Restaurant ("River House") alleged two things: (1) the insurance agent sold ACV coverage on the restaurant instead of RCV; and (2) the agent sold business interruption/extra expense coverage that did not respond to the fire loss River House ultimately sustained.

G. Settlement or trial: The trial court dismissed the lawsuit against Acme Agency.

H. Description of alleged error: River House alleged that the insurance agent should have recommended RCV coverage for the restaurant. River House also alleged that the insurance agent should have sold BI coverage which would have paid insurance proceeds even in an instant where River House was losing money when it was operating at a loss before the fire.

I. Tip to avoid claim: The case is a good demonstration of how documentation made it possible for the court to dismiss the lawsuit.

J. Summary of case: The insurance agent at Acme Agency made a cold call on River House Restaurant. River House decided to purchase insurance through Acme Agency. The insurance agent sold River House a business owners' policy ("BOP") with Integrity Mutual Insurance Company ("Integrity Mutual").

A fire destroyed River House. Integrity Mutual paid the ACV limit. Integrity Mutual did not pay River House any BI monies because Integrity Mutual concluded River House was operating at a loss before the fire. The BI coverage, which is an ISO form, requires that the business operate at a profit in order to invoke BI payments after the loss.

River House sued Acme Agency and Integrity Mutual. River House alleged Acme Agency was negligent in its procurement of insurance.

The trial court decided that special circumstances did not exist and thus there was no special relationship between Acme Agency and River House which would invoke a duty on the part of the insurance agent to advise River House about its insurance needs. The insurance agent solicited River House through a cold call and met the owners of River House in person to discuss their insurance needs. The court reasoned that if this type of activity was enough to establish special circumstances, then nearly every insurance agent errors and omissions claim would require a special relationship standard of care. In a word, a special relationship would not be special.

Acme Agency provided evidence to the court that the BI/EE provision in the Integrity Mutual policy was standard for the industry. Acme Agency also provided evidence to the court that the type of BI/EE coverage River House claimed should have been offered was probably unavailable in the insurance market, or would have been very difficult to procure. The court decided that without evidence from River House that another insurance policy was available in the insurance market that would have covered River House's business income claim, River House could not establish its case against Acme Agency.

The evidence demonstrated the insurance agent periodically informed River House that it was underinsured on the structure and that replacement cost value coverage would offer more protection than actual cash value coverage. The insurance agent was concerned River House did not select RCV coverage. The insurance agent had River House sign a form acknowledging that it was purchasing ACV coverage rather than RCV coverage.

The trial court noted that River House ignored this information or indicated it was satisfied with its existing level of coverage and declined to purchase RCV coverage.

The insurance agent also had River House sign coverage checklists indicating the amounts and types of coverage the agent sold to River House.

The trial court stated: "Often, greater coverage comes with higher premiums – thus the selection of insurance is a balancing act between low-cost but consistent monthly premiums versus the risk of a higher but relatively unlikely catastrophic loss."

In this instance, the insurance agent was proactive in getting the insured to acknowledge it did not select RCV coverage.

Case Study #4

A. Line of coverage involved: Homeowners.

B. Position of person in the agency involved**:** Producer/principal.

C. Personal or Commercial Lines**:** Personal.

D. Type of coverage involved: Homeowners insurance.

E. Procedural or knowledge-based error: Procedural error.

F. Claimant allegation: The claimant alleged the insurance agent, Bob Sorenson, should have sold a home movers insurance policy in addition to the homeowners policy Sorenson sold to Amy Miller.

G. Settlement or trial: Trial.

H. Description of alleged error: Miller alleged Sorenson knew Miller was planning to move his recently purchased house to another location. Miller alleges Sorenson should have known the homeowner's policy he sold to her would not provide first-party coverage to her while the house was being moved.

I. Tip to avoid claim: The tip here is not about avoiding the claim. The lesson to learn here is to be thoroughly prepared for a deposition during the litigation period.

J. Summary of case: Amy Miller asked Bob Sorenson, the insurance agent, to sell her homeowner's insurance for a house she was about to purchase with her husband. The closing was scheduled for July 29, 2009. She had previously purchased car insurance from Sorenson.

Miller's first meeting with Sorenson was July 22, 2009. Sorenson visited the home. He took photographs of the exterior.

The homeowner's policy was placed with Wild River Mutual Insurance Company ("Wild River").

The Wild River homeowner's policy incepted July 29, 2009. On November 28, 2009, the Millers hired Mark Holmes to move the house. Amy Miller asked Holmes if he had insurance. Holmes represented he had insurance.

On December 23, 2009, Holmes moved the house. During the move, the house tipped and was extensively damaged.

The Millers submitted a claim to Wild River but Wild River denied the claim because

of a policy condition which excludes coverage for a loss that occurs when the hazard is increased by the insured.

Amy Miller insisted she informed Sorenson about her plan to move the house from its foundation. She acknowledged she did not specifically request insurance to insure the house while it was being moved.

Sorenson, on the other hand, insisted that Amy Miller did not inform him about the possibility the house would be moved. There was no indication in his file that Miller informed him about her intention to move the house.

The case proceeded to trial. Insurance agent experts testified for both the Millers and Sorenson. The insurance agent experts agreed that if Amy Miller informed Sorenson she intended to move the house, Sorenson should have informed her that the homeowner's policy would not have provided first-party coverage to the house while it was being moved.

Bob Sorenson agreed when he testified.

First, the case is a good example of a he-said/she-said dispute. The focus is then on the circumstances of the case, such as the plausibility that an insurance agent would not say anything to his customer when something extraordinary was going to happen to the risk involved.

Second, the case is a good example of why the amount of the premium is significant. The insurance agent who testified on behalf of Sorenson did a market survey and concluded it would have cost $10,000 or more for the Millers, a young couple, to reimburse Holmes, the home mover, for a special policy of insurance insuring the liability of Holmes in the event that the house was damaged during the move.

Third, the case is instructive because it exemplifies why it is important for an insurance agent to be prepared thoroughly before he testifies at his deposition. A deposition is almost always taken of the defendant insurance agent. In this instance, the lawyer who was initially retained to represent Bob Sorenson informed him not to review his file before he testified. The agent's testimony at his deposition was ill-informed and imprecise. For example, Sorenson acknowledged he "did not remember" Amy Miller informing him she planned to move the house. At trial, Sorenson affirmatively stated she did not inform him she planned to move the house. Sorenson was subject to a vigorous cross-examination. The jury nevertheless believed Sorenson, but in retrospect he received incorrect advice from his first lawyer. The lesson: prepare thoroughly for your deposition.