Agents E&O Standard of Care Project

South Dakota 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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WHAT BUSINESS PRACTICES WILL HELP ME AVOID LIABILITY? THE STANDARD OF CARE GOVERNING INSURANCE AGENTS IN SOUTH DAKOTA

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As an insurance agent, you are providing professional services to your clients when selling them insurance products. As such, you have a duty to act reasonably in providing those services. Failing to act as a "reasonable" insurance agent is negligent conduct, which will expose you to liability if the conduct causes any harm to your client. But, what do you need to do to be a "reasonable" insurance agent? In the law, this is known as the "standard of care." This short article strives to educate insurance agents about the law governing the standard of care (i.e., what the agent must do to avoid liability) by describing some of the applicable decisions by the South Dakota Supreme Court. This article also indicates steps that the agent does **not** need to take. Finally, the article provides a couple practical pointers based upon the authors' experience in representing insurance agents in South Dakota.

STANDARD OF CARE FOR PROCURING INSURANCE IN SOUTH DAKOTA

Typically, insurance agents are sued for negligent procurement, which is the legal label for failing to purchase the correct type or level of insurance or coverage for the client. Under South Dakota law, "[a]n insurance agent has a duty to a potential insured to 'procure insurance of the kind and with the provisions specified by the insured.'" *Cole v. Wellmark of S.D., Inc.*, 2009 S.D. 108, ¶ 34, 776 N.W.2d 240, 251 (quoting *City of Colton v. Schwebach*, 1997 S.D. 4, ¶ 10, 557 N.W.2d 769, 771). "The duty owed to a potential insured by an insurance agent asked to procure a particular type of insurance by the insured is to use reasonable diligence to get the insurance specified, or to seasonably notify the potential insured of the agent's inability to do so." *Id.* (citing *Feldmeyer v. Engelhart*, 54 S.D. 81, 222 N.W. 598, 599 (1928)). "The same duty to procure arises when the potential insured asks an agent to conduct a review of coverage

and makes a recommendation." *Id.* (citing *Schwebach*, 1997 S.D. 4, ¶¶ 10-11, 557 N.W.2d at 771). "In such instances, the agent has a duty to procure the coverage [that she] recommended after conducting the review." *Id.* The key is that, in South Dakota, the insurance agent's obligation is to purchase the type and amount of insurance requested by the client.

As an insurance agent, the general rule is that if you purchase the coverage requested, then you are likely not liable if the coverage requested by the client does not adequately cover a later loss. The South Dakota Supreme Court applied this general rule in *City of Colton v. Schwebach*, 1997 S.D. 4, 557 N.W.2d 769. In *Colton*, City's long-time insurer decided that it could no longer provide coverage because City owned and operated a swimming pool with a diving board. The mayor therefore contacted his insurance agent to request a quote for an insurance policy identical to the one that City previously had in place. After reviewing the existing policy, the insurance agent provided a quote. City accepted the quote, and a policy was issued. Neither the mayor, city counsel, or any other officer or employee of City read the prior or proposed insurance policies, requested a further review or coverage, or sought any recommendations on coverage. Later, City's finance officer embezzled more than $60,000. City asserted a claim under an employee dishonesty provision in the liability insurance policy. The insurer denied coverage on the basis of two exclusions in the policy. City sued the insurance agent, arguing that she was negligent by failing to obtain coverage for the city finance officer's dishonesty. Because City had merely sought coverage identical to the policy previously in place – which also did not provide coverage for the city finance officer's dishonesty – the insurance agent was not negligent. Thus, there was no liability.

Importantly, an insurance agent does not have a duty to suggest higher policy limits or additional insurance coverage than the client requests. The South Dakota Supreme Court addressed this issue in *Trammel v. Prairie States Insurance Company*, 473 N.W.2d 460 (S.D. 1991). In *Trammel*, parents were covered under a supplemental accidental death policy as

named insureds under the policy. Their teenage daughter, however, was only identified on the policy as an additional driver and was therefore not covered under the supplemental accidental death policy. Although the parents requested that their daughter be added to the policy when she received her driver's permit, the agent and the parents did not discuss whether the daughter should be listed as a named insured or merely as an additional driver, and there was no discussion whether the daughter would be covered under the supplemental death policy. When the daughter was later killed in a one-car rollover, the insurer refused to pay the supplemental death benefit, and the parents sued their insurance agent for negligent procurement. The agent had no duty to recommend additional coverage for the daughter. Because the parents had not asked the insurance agent to explain and recommend available coverage or to make certain that their daughter would be covered under the supplemental accidental death policy, and because the insurance agent had no affirmative duty to go beyond what parents requested to recommend additional coverage for their daughter, the insurance agent was not negligent.

Thus, in sum, the general rule is that the standard of care requires you to purchase the coverage requested by the client. There are several important exceptions to this rule, however.

Exception No. 1: *The client requests a review of his policy or coverage.*

Keep in mind, however, that the rule from *Trammel* only applies if the client does not ask the agent to recommend the proper level of insurance. Once an agent is asked to provide advice, he or she must provide a reasonable recommendation of insurance coverage and procure the recommended insurance. *See Trammell*, 473 N.W.2d at 462; *see also Cole*, 2009 S.D. 108, ¶ 34, 776 N.W.2d at 251. An agent cannot review the policy, make recommendations of coverage, and then fail to procure the coverage requested unless the client specifically rejects the insurance agent's recommended coverage.

Exception No. 2: *You take it upon yourself to review the client's coverage without the request of the client*.

If an agent decides to unilaterally review the client's coverage to determine adequacy and whether proper coverage is obtained, then he or she may assume a duty to recommend the correct coverage. *See Fleming v. Torrey*, 273 N.W.2d 169 (S.D. 1978) (recognizing that a special relationship in which agent assumes a legal duty to volunteer advice may be created through a prior course of conduct by agent toward the insured). In that case, an agent must then give a reasonable recommendation and procure the recommended insurance. *See id. See also Aesoph v. Kusser*, 498 N.W.2d 654, 656 (S.D. 1993) ("[T]he insurance agent [has] a duty to exercise care when giving information.") (citing *Moore v. Kluthe & Lane Ins. Agency, Inc.*, 89 S.D. 419, 234 N.W.2d 260 (1975)). Essentially, once the agent decides to review the policy or coverage, the standard of care is the same as if the customer asked you to review the policy or coverage.

Exception No. 3. *You learn unique facts about the client that indicate a particular insurance need.*

Although generally the agent only has a duty to purchase the insurance requested, if during his work with the client, the agent learns something unique about their situation that indicates that the client lacks adequate insurance coverage, then he or she may have an obligation to recommend additional coverage. For instance, in *Rumpza v. Larsen*, 1996 S.D. 87, 551 N.W.2d 810, the client traded real estate he owned in Waubay for property near South Shore. The client contacted his insurance agent and told him of the property trade. He indicated that "there was a house on that location, and the people were still residing in there and would be moving out of that home, and they were going to be making some repairs to that property and put it up for rent and also possibly for sale." Importantly, the client specifically told the agent that there would be periods of time that the house would likely be vacant. After closing, the client contacted his insurance agent to bind coverage on the new property. After some discussion, the client and his insurance agent determined that $50,000 was the appropriate coverage amount and

placed the coverage by adding it to an existing farm policy that contained an endorsement for vacant property. The vacancy endorsement, however, provided that it would not pay coverage for property vacant more than 30 days. Ultimately, the house burned. Although the property was rented, it had been vacant for more than 30 days because the renter had not taken possession when the fire occurred. The carrier initially denied coverage (although eventually paid 60% of the loss). The client sued the agent. The court concluded that the agent's standard of care in *Rumpza* required the agent to obtain the coverage requested, namely $50,000 in coverage that would cover the home while vacant for extended periods of time. The agent breached that standard of care by selecting the policy that did not provide coverage for the house as it was foreseeable that the house would be empty for more than 30 days.

There are two key lessons from *Rumpza*. First, when it comes to complicated policy language (i.e., the limitations on the endorsement for how long the place is vacant), the agent may have to do more. The agent in this case should have explained to the client that if the house is vacant for more than 30 days, no coverage exists. This is particularly important because the agent knew that the property may be vacant. Second, the agent needs to document what information is provided to them from the customer. In *Rumpza*, there was a clear dispute about what the client told the agent about the vacancy of the property. The agent's potential liability is substantially diminished if the agent documents what he or she is told and has told the client.

Exception No. 4. *If you have recommended specific coverage or limits in the past, then you may need to recommend coverage and limits even when not requested to do so by the client unless you make clear that you are not reviewing the coverage or making coverage and limit recommendations.*

If the client and agent have developed a custom and practice in which the agent reviews and recommends coverage or limits, then the agent may have a duty in South Dakota to recommend coverage even if not requested by the client on a specific policy. In *Fleming v.*

Torrey, 273 N.W.2d 169, the South Dakota Supreme Court discussed whether an agent had a duty to recommend higher limits for a farm truck, which the agent knew was being driven by the rancher's eighteen-year old son for commercial purposes. The rancher claimed that his insurance agent held himself out as an expert in insurance, that he relied on his insurance agent's expertise, and that he would have purchased additional liability insurance if his insurance agent had told him to do so. The South Dakota Supreme Court held the agent was not liable as a matter of law because he purchased the insurance requested by the rancher. In reaching this decision, however, the Court emphasized that the insurance agent and rancher did not have a past practice or custom of the agent or prior dealings with the agent, indicating that the rancher had in the past (and thus could assume to be asking for the truck policy) requested that the agent evaluate the policy and provide coverage limit recommendations.

The lesson from *Fleming* is that an agent must be cognizant of his or her past dealings with the client. If in the past the client has asked you to review his or her coverage, or if you have done so in the past, but if you are not going to review the client's coverage on a specific policy procured, then you must communicate to the client that you are not reviewing the coverage when purchasing the policy. This communication should be in writing before the policy is obtained.

Exception No. 5. *You owe your clients a fiduciary duty.*

A fiduciary has a duty to act primarily for the benefit of the other. *Ward v. Lange*, 553 N.W.2d 246, 250 (S.D. 1996). To create a fiduciary relationship, one must have, in addition to "'confidence of the one in the other,'" the existence of "a certain inequality, dependence, weakness of age, of mental strength, business intelligence, knowledge of the facts involved, or other conditions, *giving to one advantage over the other*.'" *Cole*, 2009 S.D. 108, ¶ 46, 776 N.W.2d at 253 (quoting *Garrett v. BankWest, Inc.*, 459 N.W.2d 833, 838 (S.D. 1990)) (emphasis in original). If a fiduciary relationship is deemed to exist, then a separate legal cause of action

may be brought for a breach of the fiduciary duty. This possibility is significant as punitive damages, which punish the wrongdoer rather than compensate the victim, are recoverable in a lawsuit for a breach of a fiduciary duty. *Chem-Age Indus., Inc. v. Glover*, 2002 S.D. 122, ¶ 19 n. 5, 652 N.W.2d 756, 766 n. 5 (citing *Grynberg v. Citation Oil & Gas Corp.*, 1997 S.D. 121, ¶ 18, 573 N.W.2d 493, 500).

In South Dakota, most commercial or business relationships do not rise to the level of a fiduciary relationship when the parties are dealing over an arms-length transaction. *High Plains Genetic Research, Inc. v. JK Mill-Iron Ranch*, 535 N.W.2d 839, 842 (S.D. 1995) (citing *Taggart v. Ford Motor Credit Co.*, 462 N.W.2d 493, 500 (S.D. 1990)). Thus, an insurance agent generally does not owe his or her client a fiduciary duty. *See Cole*, 2009 S.D. 108, ¶ 47, 776 N.W.2d at 254. However, in the one case to consider the issue in South Dakota, the court relied heavily on the facts of that case, leaving open the possibility that a fiduciary duty may be deemed to exist if the relationship between the insurance agent and client could be characterized by inequality and dependence. *See id.* For example, it is possible that a fiduciary relationship could be deemed to exist when the agent has held himself or herself out as an expert in insurance matters and has undertaken a duty to review coverage and recommend specific coverage or limits to a particularly unsophisticated client.

Exception No. 6. *You misstate or misrepresent insurance coverage.*

This exception is the most important exception discussed in this article. Although an insurance agent has a duty to only purchase the insurance requested, the insurance agent also has special insurance knowledge that the client is typically relying upon in making policy purchase decisions. Indeed, from the client's perspective, that is the whole point of having an insurance agent. Thus, any misstatements about the coverage provided by a requested or procured policy may subject the agent to liability for negligent misrepresentation.

Under South Dakota law, a negligent misrepresentation occurs "when one party makes (1) a misrepresentation; (2) without reasonable grounds for believing the statement to be true; (3) with the intent to induce a particular action by the other party; and the other party (4) changes position with actual and justifiable reliance on the statement and (5) suffers damages as a result." *Am. Family Ins. Grp. v. Robnik*, 2010 S.D. 69, ¶ 9 n. 4, 787 N.W.2d 768, 771 n. 4 (quoting *Ehresmann v. Muth*, 2008 S.D. 103, ¶ 21, 757 N.W.2d 402, 406). Negligent misrepresentation claims only occur if the relationship of the parties, arising out of the contract or otherwise, is such that the one party has a right to rely upon the information and the other party has an obligation to exercise good care in providing the information. *Meyer v. Santema*, 1997 S.D. 21, ¶ 9, 559 N.W.2d 251, 254 (quoting *Rumpza v. Larsen*, 1996 S.D. 87, ¶ 19, 551 N.W.2d 810, 814) (additional citations omitted). A relationship between an insurance agent and client are just such a relationship. *Aesoph*, 498 N.W.2d at 656. Clients have the right to rely on the superior knowledge of the insurance agent. *Id.*

It is critical that agents be accurate in all information they provide to a client, and in particular, any statements about the coverage provided under a specific insurance policy or certain policy language. False statements, even if accidentally made, may subject the agency to liability. Equally important, the agent should document, in writing, what information is communicated to the clients so that there is written evidence that no misrepresentation occurred.

The agent's potential liability for negligent misrepresentation is not limited to clients who actually purchase insurance from the agency. Instead, a false statement to someone considering the purchase of insurance could subject the agency to liability. For instance, in *Aesoph v. Kusser*, 498 N.W.2d 654, a farmer contacted his insurance agent about procuring federal crop insurance. The agent incorrectly told the farmer that the farmer did not qualify for federal crop insurance. Based on this statement, the farmer did not procure crop insurance. When the farmer suffered a total crop loss, the farmer sued his insurance agent based on the misinformation he

received. The court stated that while the insurance agent had no affirmative duty to answer the farmer's questions about his eligibility for federal crop insurance, when he did provide an answer, he changed the relationship and assumed a duty to exercise care in providing the answer. After all, clients have a right to rely on the superior knowledge of the agent on insurance matters, especially detailed information that a lay person would ordinarily rely upon an insurance agent to understand. The insurance agent could be held liable when he provided incorrect information.

In sum, it is imperative that you exercise care to make sure every communication you have with a client or potential client about insurance products is true and accurate.

PRACTICAL POINTERS FOR DECREASING LIABILITY EXPOSURE

So, the take away from the South Dakota Supreme Court is that insurance agents, despite having superior insurance knowledge, should only buy what their clients ask them to purchase. At the same time, the authors recognize that this may not be the most practical business advice for insurance agents. Clients hire insurance agents because they trust them with their insurance needs, and insurance agents are not mere cashiers at a fast food restaurant serving the requested policies. Thus, what can agents do to minimize exposure while still serving their client's needs? The authors attempt to provide some practical pointers and tips based on both the South Dakota law discussed above and the authors' experience in defending insurance agents.

1. Document, Document, Document. It is very important that you clearly document, in writing, all interactions and communications with your clients. This documentation provides the best evidence of what the client said, what instructions the client provided, and what the agent told the client. For example, in one of the authors' recent cases, the agent had extremely detailed notes in her file relating to every conversation with the insured. Notably, there was no documentation of an alleged call in which the client allegedly told the agent he was starting to custom pasture other parties' cattle (which required different insurance coverage than the existing farm policy). The detailed nature of the existing notes substantially

aided the defense and made the insurer's claim that this phone call occurred much less believable.

2. If you did not review the client's policy or coverage, make sure your remind them of that fact. As a practical matter, the duty to take steps beyond purchasing the requested coverage generally arises because of the client's expectation that, as the insurance agent, you are evaluating the client's coverage. If you are only purchasing what the client asked you to purchase without evaluating their coverage, makes sure that is communicated to the client. Ideally, this communication should be in the form of letter or email.

The letter can be friendly and serve other purposes. For instance, you could send a short communication to the client confirming the purchase of the policy. In the communication, you could remind the client to read the policy upon receiving it. This is an opportune time to remind the client that you purchased the policy they wanted you to purchase, that they have not asked you to review their coverage and made further recommendations, and that you have therefore not done so.

3. Be accurate at all times. False statements, even mistaken false statements, almost always create potential liability. Thus, when answering client questions, be sure about the information communicated before giving the answer. If you do not know, the answer must be, "I do not know." Of course, you can tell the client that you will find the answer and get back to them. Do not ever guess or speculate. Be sure about your answer. If you later realize you made a mistake, then correct it as soon as possible so that the client does not continue to rely on the information.

4. Remember, while you are the insurance coverage expert, the client is the expert regarding his or her property or business and the corresponding risks facing that property and business. Again, the key here is communication. You should inform your clients, preferably in writing, that even when you are reviewing the client's coverage, you are relying on

the information they have provided regarding their property or business. If a questionnaire or checklist is used, then there should be a statement on the checklist (in bold print) that you are relying on this information from the client in selecting the client's policy.

Also, if you are awaiting information from the client, make sure that there is a writing documenting when you communicated the request to the client and what it is that you are waiting for. This is particularly important when updates are made to coverage, such as listed personal property on a farm or commercial blanket. For example, one of the authors' recent cases involved disputes whether personal property should have been listed on a farm blanket. The policy was reissued each year. The personal property blanket was not necessarily revised each year, however. It would have been helpful if, in conjunction with the renewal of the policy, a letter had been sent to the client that no coverage would exist for personal property that was not listed on the blanket, and that the client therefore needed to review the personal property blanket carefully.

5. Remind the client to advise you of changes to their property or business.

This is a corollary to the client being the expert regarding his or her property or business. As an insurance agent, you know that changes in the property or business may affect coverage. Clients, however, may not realize this. Thus, prudence suggests informing the client, in writing, that changes to the property may change their coverage, and that the agent needs to be advised of these changes. Then, of course, document changes communicated in the file.

CONCLUSION

In South Dakota, the general rule is that if you purchase the coverage requested, you are likely not liable if the coverage requested by the client does not adequately cover a later loss. However, as with any rule, exceptions exist. To manage the risk of liability, it is vital that you develop appropriate business practices with both the general rule and its exceptions in mind. Consistent business practices that allow for effective communication with clients and thorough

documentation of those communications will go a long way toward achieving the goal of avoiding liability.