

Agent-Broker Malpractice



BY MICHAEL SEAN QUINN

The district court observed "it is standard practice for an insurance broker to notify an insured of a reduction in coverage."

In specifying, arranging for and renewing insurance policies, it is customary in the industry for agents to use a kind of shorthand. It is also customary for agents to rely upon manuals provided to them by insurers. A case decided last year in federal district court in Delaware illustrates how these trade customs can lead to problems for agents. The case was *Polly Drummond Thriftway, Inc. vs. W.S. Borden Company*. In this case, an insured sued the agency and an insurer for not providing the right coverage, and the agency cross-claimed against the insurer.

Here's the story

Polly Drummond Thriftway ("Thriftway") was a grocery store. It had been purchasing insurance through Edward Hannon for a good number of years. Hannon worked for a succession of agencies, but ended up with Borden, the target defendant in the case.

Hannon specialized in insurance for supermarkets. One of the things supermarkets

need is coverage for food spoilage. For years, Thriftway had been insuring against food spoilage resulting from off-premises power interruptions. Often, this kind of coverage is to be found in boiler and machinery policies.

Thriftway passed through a number of different carriers over the years. The store's placements appeared to be largely discretionary with Hannon. At one point, Hannon switched to Commercial Union. According to the Agent's Guide published by Commercial Union, its *Nameplate* brand boiler and machinery policy, one of several options, provided coverage to retail stores for food spoilage resulting from off-premises power interruptions.

On the basis of the representations contained in the Agent's Guide, Hannon applied to CU for boiler and machinery insurance, obtained it, and then renewed the coverage for a second year. On the application Hannon wrote, "boiler plate" rather than "Nameplate", and under the column labeled Spoilage, Hannon wrote, "actual loss sustained." CU issued coverage. Neither Hannon nor Thriftway officials reviewed the CU policy. Unfortunately, that policy did not cover food spoilage losses resulting from off-premises power outages. In fact, it didn't cover spoilage at all.

Hannon assumed it did and so failed to notify Thriftway that it actually did not. As the district court observed, "[i]t is standard practice for an insurance broker to notify an insured of a reduction in coverage." To be sure, the "lack of off-premises power interruption coverage constituted a reduction in coverage from" the previous policies Thriftway had.

Moreover, not even the Nameplate policy Hannon thought he had ordered—the one he tried to order—would have covered food spoilage losses resulting from any or all off-premises power outages. It would have covered spoilage losses only if the power outage was caused by an accident to covered equipment "located on or within 500 feet" of the insured's business.

Naturally, there was an off-premises power failure. Of course, it caused some spoilage in the Thriftway inventory. Indeed, the loss was in excess of \$275,000. The amount of the loss was never in dispute.

Law for agents

Under Delaware law—the state law applied here—insurance agents—brokers have a

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tort-based duty to exercise reasonable care, skill and diligence in the exercising of the responsibilities of brokerage. This means that they must exercise that degree of care reasonably prudent businesspeople in the brokerage field would exercise in a similar circumstance.

If an agent-broker breaches this duty and causes a loss to his customer, he is liable for that loss, "unless the customer has also been negligent in taking care of his own affairs." The Borden agency suggested that Thriftway was guilty of superceding negligence, which caused its own loss because it didn't read the policy once it was delivered. Borden's position was

not fool-hearty. There is plenty of old-time, unrealistic, ill-considered law around the country stating that policyholders are expected to read and understand their own policy.

Nevertheless, the district court did not hold Thriftway responsible for its own loss. Apparently, the court realized that hardly anyone ever reads his own insurance policies. Perhaps the court recognized that many who read are mystified. Perhaps the court also thought that, in commercial contexts, policy holders can properly delegate this responsibility to their insurance agents.

In any case, the court held the Borden

agency liable. Naturally, Borden had brought a cross-action against CU seeking contribution (i.e. part payment for the loss) or (i.e. full reimbursement) indemnity. The court rejected the agency's position.

First, the agency agreement upon which Borden relied appointed Borden CU's agent for the Trenton, New Jersey vicinity only. It did not appoint Borden an agent for Delaware.

Second, even supposing that the insurer-agency agreement applied, the court refused to hold CU liable. After all, said the court, Hannon, the agent, had not actually requested the Nameplate policy. Even though that contract may have been ambiguously (mis)described in the Agent's Manual, CU did not issue the wrong policy with the wrong coverage. It issued exactly what Hannon requested—plain vanilla boiler machinery coverage.

The fact that when Hannon filled out the form he specified "actual loss sustained" in the spoilage column, left the court unpersuaded. According to the judge, the agent simply did not ask for the right policy. When the agent wrote down "boiler & machinery" instead of "Nameplate," he failed correctly to specify what he wanted.

Observations

The Polly Drummond opinion will stand as what lawyers call "persuasive precedent." There is no chance it will be reversed. The case has been settled, so the decision of the district court will not be appealed.

Unfortunately, as logically elegant as the district judge's reasoning appears, the decision is defective.

First, the judge does not seem to understand how abbreviated communications are between agents and insurers. Everyone expects very brief notations to be written, and there are unwritten conventional understandings as to what such things mean.

Thus, when Hannon wrote "actual loss sustained" in the Spoilage column, he was—in effect—asking for insurance that would cover food spoilage. This notation should have put the insurance company on notice that there were imperfections in the application. That should have put CU on notice that it needed to make further inquiry. Consequently, CU was involved in the error that led to Thriftway getting the wrong insurance.

Second, CU was causally responsible for Hannon's error, at least to some degree. If the Agent's Guide was as the district judge portrayed it, it is poor prose indeed. It leaves even an experienced agent ill informed. ■

Quinn is an Austin shareholder in the law firm of Sheinfeld, Maley & Kay. He litigates and testifies on insurance related problems and is currently the chair of the Insurance Section of the State Bar of Texas.

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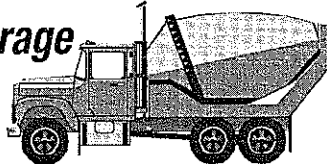
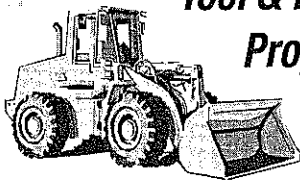
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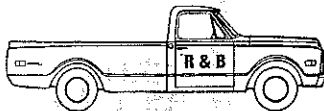
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