

Ponzied Insurance Premiums



BY MICHAEL SEAN QUINN

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This is the tale of what the Court of Appeals of Maryland—the state's highest court—called a modified insurance “Ponzi scheme.” The case, decided earlier this year, is *Insurance Company of North America v. Miller*. It is important to note that an individual, not a corporation, was the defendant in this case. An insurance agent designed the scheme, and it appears that he will pay dearly.

I.

The facts are as follows: a Texas-based insurance agency did a fair amount of business in Maryland servicing the funeral industry, among other commercial accounts. The agency created a scheme to utilize cash available from misused premium financing proceeds. This insurance agency was a corporation. The defendant in the lawsuit was an individual who was a senior officer of the corporation. The scheme appears to have gone something like this.

The agency set up an installment payment plan with an insured. (Often commercial insureds pay premiums on a quarterly or monthly basis, or even borrow the money to pay their premiums. Lenders which specialize in this trade are called premium financing companies.) After setting up an installment plan with an insured, the agency would then obtain financing for the same premium through a premium financing company. In general, the premium financing company would pay the full amount of the premium to the agency. It expected that, as is routine, the agency would pay the full amount of the loan directly to the insurance company.

That is exactly what the agency would not do, however. Instead, it deposited the loan amount in its own operating account and paid the insurance company only the installment the agency had pre-arranged for the insured. The installment payments from the insured would then be used to repay the premium financing company as loan amounts came due. No one except the agency was aware of this scheme: not the insureds, not the premium finance company and not the insurer.

Of course, as is true of all Ponzi schemes, this one collapsed in the end. INA ended up not being paid for quite a number of business insurance policies, some of which had premiums in excess for \$1 million a year.

The local agency had entered into a “CIGNA Agency Company Agreement” with INA. That agreement declared that the insurance agency was INA’s trustee with respect to

all premiums it received. The agreement required the agency to keep these amounts in separate accounts. The agency was explicitly designated the legal agent of the insurer for the purpose of premium collection.

The law of agency in Maryland is pretty much the same as the law of agency in Texas. An agent is the fiduciary of its principal. It is obligated to act on behalf of the principal and subject to its control. The corporate insurance agency here was unquestionably the legal agent of INA. Nobody disputed that. However, the Court of Appeals went a step further, holding that the president of the agency, who signed the agency agreement and who was active in managing the business, was also an agent of the insurer.

The court went on to hold that the president of the agency was not merely a person confusingly called an “insurance agent.” It held that he was the administrator of premiums, that he was the legal agent of the insurer with respect to those premiums, and that he had a legal obligation to make sure that those premiums were forwarded to INA.

At the same time, the Court of Appeals presupposed that no one is a fiduciary of another for all purposes. Every fiduciary relationship is a focus and has limits. One person is the agent of another for a particular purpose or for specific purposes, and not for every conceivable purpose. Every agency has a scope.

If one person is the agent of another, the agent has a duty of utmost loyalty and fidelity to the interests of the principal. An agent may never let the interests of another person diminish his responsibilities to his principal. These include the interests of a third-party, not to mention his own interests. In other words, an agent must subordinate his own interests to those of his principal.

What is interesting about the Miller case was that the court held that a corporate executive could be responsible for the torts of the corporation if he knew about and participated in them. It held that when a corporation is a fiduciary of a principal, leading officers of the corporation may also be fiduciaries of that principal. This will particularly be true when the corporate officer is involved in some sort nefarious or unlawful plot. This rule may apply with special force to entities such as insurance agencies where the

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people in the corporation must themselves have licenses.

The Maryland Court of Appeals has held that when a fiduciary relationship is involved, it will sometimes pierce the corporate veil, reach out, and hold actively misbehaving corporate officers liable. However, the instant opinion goes even further, holding that if a corporate officer should have known about the corporation's breaches of its fiduciary duty, the corporate officer can be held liable as a principal for negligence. This rule likely is restricted to senior executive office types and probably does not apply to lower-level corporate employees. Perhaps it is restricted to senior executives who have licenses.

II.

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involved in defrauding everyone in sight. Nevertheless, there are several enterprising features of this decision. First, the tort of negligence is usually restricted to situations in which there is bodily injury or property damage. As a rule, mere financial loss is not actionable as negligence. There are exceptions, of course. Malpractice is actionable as negligence. This includes both lawyers and insurance intermediaries. At the same time, this case was not exactly a malpractice case.

Second, this case exemplifies a profound paradox in the law of agency. Agents are required to subordinate their own interests to those of their principals. At the same time, agents are business people. Consequently, they are expected to pursue their own self-interest. Thus, there is a fundamental contradiction between the context in which legal agents-including insurance agents-operate and the precise legal rules governing what it is to be an agent.

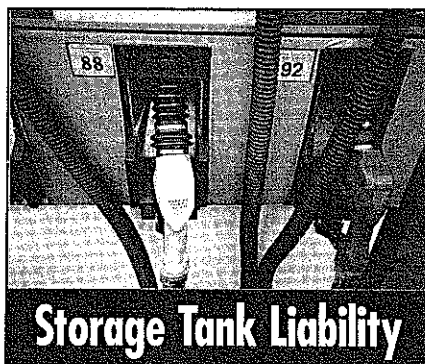
Third, under the right circumstances, an insurance intermediary can have two principals. This situation is commonly referred to as dual agency and may be easily described. For instance, the agent may be the agent for the company, and simultaneously the agent for the insured or prospective insured, as well. If every agent is always required to place the

interest of her principal above the interest of everyone else, it becomes logically impossible for any person to be the legitimate legal agent of two opposing parties in the same transaction. But this situation arises all the time. Sometimes, the problem can be avoided by saying that someone is an agent of Principal One with respect to one thing and an agent of Principal Two with respect to another.

Sections 21.02 and 21.04 of the Texas Insurance Code complicate and confuse matters. A superficial reading

of these two statutes suggests that every insurance intermediary is always at least the legal agent for the carrier which ultimately issues coverage. This simplistic reading is faulty and dangerous. But that is a story better told another time. ■

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