

# INSURANCE LITIGATION™

*Reporter*

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## Liabilities of Intermediaries When Sued by Their Customers (*Part III*)

Susan Scott Hayes & Michael Sean Quinn<sup>1</sup>

The authors are two of the named members of the law firm of Quinn, Hayes, and Quinn in Austin, Texas and Birmingham, Alabama. Both currently spend a substantial amount of time working on various insurance problems, including agent-and-broker cases. Quinn took a Ph.D. from the University of Pittsburgh in 1972 and a law degree from the University of Missouri at Kansas City in 1980. Hayes took her law degree from Southern Methodist University in 1987. Quinn has spent a fair amount of time formally studying insurance: CPCU, AID, ASLI, ASFB, AMIM, & AIS. He often appears as an expert witness, sometimes in cases involving intermediaries. See [www.michaelseanquinn.com](http://www.michaelseanquinn.com). Hayes, in contrast, spends her time actually working. (Hayes currently represents a broker in what may be the longest insurance intermediary case in the history of man.)

This is the final part of a three-part paper regarding insurance intermediaries—brokers and agents, of various sorts—and the legal relationships they have with their customers.<sup>2</sup> Part I of this paper was previously published in this journal<sup>3</sup> and explicitly concerned 7 of 26 independent and sometimes overlapping rules—Rules A through F—governing the conduct of insurance intermediaries. The rules discussed in Part I were entitled as follows, and the area of intermediary obligation is quite clear

Rule A: Procurement

Rule B: Reasonable Money Terms

Rule C: Misrepresentations

Rule D: Reasonable Care

Rule E: Skill and Knowledge

Rule F: Truthful Answers.

Each of these rules concerns the duties and obligations of insurance intermediaries. We listed what we believe to be the central and most frequently used rules first.

In Part II, published in the preceding issue of the Journal,<sup>4</sup> we provided shorter discussions of Rules G-Z, as follows:

Rule G: Providing Information

Rule H: Providing Cancellation Information

Rule I: Inform by Answering Relevant Questions

1. *Index of Abbreviations.* To simplify citations, I will not set up a series of more frequently to be used cites. For those who do not know much about the intermediary sector of the insurance industry, legal encyclopedias are helpful for our topic. The most straightforward is Part IV, entitled "Insurance Agents and Brokers," of the chapter entitled "Insurance" found in 43 AM. JUR.2d §§122-182 (2003), hereinafter cited as "AJ2§ \_\_\_\_." Less helpful are the state legal encyclopedias, such as TEXAS JURISPRUDENCE (THIRD). The appropriate part of those volumes is Chapter IV, entitled "Agents and Brokers," of the Chapter entitled "Insurance Contracts and Coverage" found in 45 TEX. JUR.3d §§ 271-394 (2006), hereinafter cited as "TJ3§ \_\_\_\_." Also very important, as an encyclopedic-level treatise, is Lee R. Russ & Thomas F. Segalla, COUCH ON INSURANCE 3D (2005), hereinafter cited as "C3d§ \_\_\_\_." Another significant textbook is a very thick paperback. Robert H. Jerry II, UNDERSTANDING INSURANCE LAW (1986), hereinafter cited as J-II. We will rely upon Malcolm Clarke, POLICIES AND PERCEPTIONS OF INSURANCE: AN INTRODUCTION TO INSURANCE LAW (Oxford University Press: Clarendon Law Series, 2003), hereinafter cited as "C at \_\_\_\_." This is a high prestige series of legal treatises. Some of them are among the most famous and influential legal treatises of the 20<sup>th</sup> century. Indeed, this book was first published in 1997.

2. The terms "agent" and "broker" have been utilized in the insurance industry for many years. Originally, the generally received understanding was that insurance agents with legal agents of the insurers, while brokers, if they were the legal agents of anyone, were the legal agents of the customers of the brokers. Cornelius Walford, THE INSURANCE CYCLOPEDIA, 39-42 (agent) and 393-94 (broker) (1871). The term "intermediary" is not defined in Walford at all.

3. Michael Sean Quinn & Susan Scott Hayes, *Legal Duties of Insurance Intermediaries (Part I)*, 29 INS. LITIG. RPTR. 53-77 (2007).

4. Michael Sean Quinn & Susan Scott Hayes, *Legal Duties of Insurance Intermediaries (Part II)*, 29 INS. LITIG. RPTR. (2007)

- Rule J: Providing Advice
- Rule K: More Than Reasonable Efforts: Non-Procurement
- Rule L: Explaining Alternatives
- Rule M: Coverage Maintenance
- Rule N: Duty as to Selection
- Rule O: Providing Administrative Information
- Rule P: Use of a Fictional Carrier
- Rule Q: Use of Unqualified Carrier
- Rule R: Unnecessary Insurance Policies
- Rule S: No Stealing from Customers
- Rule T: Use of Certificates of Insurance
- Rule U: Later Undertakings
- Rule V: Developing Rule? Good Faith and Fair Dealing
- Rule W: Fiduciary Duties
- Rule X: Accurate Information to Insurer
- Rule Y: Conspiracy or Assistance
- Rule Z: Duties Regarding Advertising

In this final section, Part III, we discuss some of the substantive fundamentals of litigation involving insureds and intermediaries. Part III is more of a primer given that the subject is neither deep nor complex. As you will see, there is not a large jurisprudential discussion of causes of action available against intermediaries. The same is true for affirmative defenses available to intermediaries and counterclaims.

## I. CAUSES OF ACTION

This subsection is intended to indicate and to discuss part of the potential liabilities of intermediar-

ies when they are sued by their customers, and the customer wins. Liabilities, of course, derive from breaches of duties which cause damages. Causation must be of the right sort, of course, and the damages must be proved in fact and proved by law. Thus, the place to begin discussing liability is with what causes of action can be used. Our discussion will stop with this.

### 1. Negligence

The cause of action seen more than any other is the tort of negligence. Indeed, it is the only one Professor Jerry discusses in his book, *UNDERSTANDING INSURANCE LAW*. According to this treatise-textbook, the foundation of intermediary liability is “a professional duty to the insured or applicant, and the agent can be held liable in tort for breaching this duty.”

[A] person who represent himself as having expertise in insurance is expected to be able to do more than simply fill out an application form.” “[A]n insurance professional who represents that he or she possesses the skill needed to arrange a complex package of coverages for a business will be expected to perform this task in a manner commensurate with the skills represented. [¶] Generally speaking, the principle approved by most courts that have addressed the issue is that the agent, simply by undertaking to function as an agent, assumes a professional duty of care in all of the services he or she provides client. But absent special circumstances, this duty does not include a duty to give advice about what particular coverages the insured should purchase, or to explain a policy’s coverage, or to procure certain kinds of coverage. Special circumstances, however, may cause the agent to acquire additional, more substantial duties, such as a duty to advise the insured about coverages or a duty to procure insurance.<sup>5</sup>

There are three problems with Professor Jerry’s account. First, it may exaggerate the role of the idea of *professionalism* or *professional relatedness* formulating the essence of the law’s image of insurance intermediaries. This may be changing.

Second, Jerry does not discuss the use of breach of contract as a possible cause of action. At least one important national commentator suggests that when filing a suit against an intermediary, an insured should utilize both causes of action in the litigation thought process and then choose one cause of action to pursue.<sup>6</sup> This is a controversial view, as we shall see. Third, he should have made it clear that professional negligence does not require either bodily injury or property damage as common law negligence usually does.

## 2. Breach of Contract

Sometimes courts and lawyers say that no such cause of action exists. There is much to be said for breach of contract. Often, especially in procurement, it is required that the intermediary agree to obtain the coverage.<sup>7</sup> Interestingly, English law conceptualizes “the agent’s duties [as] based concurrently in both contract and tort, and stiffened by an added element of equity. From equity the agent gets duties to the client, called ‘fiduciary’ duties.”<sup>8</sup> Clearly, if the agent has declined or refused to try and procure the coverage there can be no successful cause of action at all for failure to procure. Then again, agreement to procure can be implied, as can declination—although the latter is harder to prove. In addition, causation is probably easier to prove in contract cases than it is in tort cases. In Texas, in contract cases it is only necessary for the plaintiff to prove that his injury and damages “resulted from” the breach of contract by the defendant. In relevant tort cases—negligence and non-professional malpractices cases—it is necessary to prove proximate causation. Recovery in a breach of contract case, of course, authorizes the recovery of

attorney fees.

On the other hand, a breach of contract by the intermediary may provide a foundation for vicarious liability by the insurer. Further, proving the terms of a given contract is much more difficult than proving its existence. Moreover, it is possible to devise a number of complex defenses in contract cases, whereas in a negligence case the defenses often boil down to contributory negligence.

## 3. Misrepresentation

If an intermediary says something false to the applicant about the insurance, the intermediary may be held liable for either negligent misrepresentation or for deliberate misrepresentation, i.e., fraud. Obviously, these causes of action are not for failure to procure cases, and probably not for procure-the-wrong-policy cases. They are probably mostly for bad advice cases and false explanation cases.

## 4. Statutory Causes of Action

Some misrepresentations trigger statutory causes of action. In Texas, there are two of them. The first and more general one is the Texas Deceptive Trade Practices-Consumer Protection Act. It outlaws misrepresentations in several ways. The other is the Unfair Methods of Competition and Unfair or Deceptive Acts or Practices Act,<sup>9</sup> which is §541.003, .008, .051, plus a number of other sections of the new Texas Insurance Code.<sup>10</sup> Both of these acts apply to insurance intermediaries, and both of them provide for treble damages under some circumstances, and both of them provide for the recovery of attorney’s fees.<sup>11</sup> “Chapter 541 [of the Texas Insurance Code] and the DTPA form the basis for almost every suit

5. *Id.* For a similar recent discussion see *Wisniski v. Brown & Brown Ins. Co. of Pa.*, 906 A.2d 571 (Pa. Super, 2006). Jerry’s emphasis on the idea of *professionalism* is extremely important, and may point in the direction of a decades-to-come long change in how the law views insurance intermediaries.

6. C3d § 46.43. “When an agent negligently breaches his or her contract with the insured, the better rule is that the applicant or the insured may sue either for breach of contract or for the negligence involved.” *Id.* at 46-57. It is noted that some states insist upon one, while others require another. In our view, the plaintiff should plead both and keep both alive for as long as possible. The plaintiff might have to choose before trial begins, or before the jury retires. Unlike legal malpractice in Texas, there is no hard and fast rule against using breach of contract.

7. *Avery v. Diedrich*, 2006 WL 154787 (Wis. App. June 7, 2006)

8. C at 47.

9. The DTPA is §§ 17.41-17.63 of the Texas Business & Commerce Code (2006)

10. The predecessor was Art. 21.21 of the old Texas Insurance Code.

11. See *Celtic Life Ins. Co. v. Coats*, 885 S.W.2d 96 (1994) and *Royal Globe Ins. Co. v. Bar Consultants, Inc.*, 577 S.W.2d 688 (1979).

where an agent is sued by a policyholder.”<sup>12</sup>

No doubt there are other possible causes of action; there always are. There may even be more statutes to deploy; there sometimes are. The aforementioned six (6) routes, however, are the most commonly seen, and the second one—breach of contract—is very seldom seen, at least in Texas insurance intermediary cases.<sup>13</sup>

## II. “MUST READ”

The issue of whether an insured must read his or her insurance policy, or the effect of an insured’s failure to read or understand a policy, has been widely litigated and despite some diverse results, general rules have surfaced. Although it is likely recognized that an insured will most often not read his or her insurance policy or is not likely to understand the policy even if he or she reads it, the general rule that an insurance policy will not be construed so as to relieve the insured from a policy exclusion on the mere ground that he or she has failed to read it.<sup>14</sup>

### 1. The Role of Intermediaries

When it comes to intermediaries, the courts have not followed the general rule in most every instance. Although there is some authority holding that a court will not invalidate a clear policy provision where the insured did not read it, even though the insurer’s agent knew or should have known that the insured’s expectations contradicted the policy’s language and the agent’s words or conduct led to those expectations.<sup>15</sup> In some instances, courts have rejected the general rule of construction when an insured claims that he or she failed to read the policy

due to a representation by an insurance agent regarding coverage. In an Arizona Supreme Court case, the court wrote:

There are strong reasons to recognize a rule which allows an insured to raise the issue of estoppel to establish coverage contrary to the limitations in the boiler-plate policy when the insurer’s agent had represented the coverage as greater than the language found in the printed policy. The fact that the insured has not read the insurance policy ‘word for word’ is not, as a matter of law, an absolute bar to his theory of estoppel.<sup>16</sup>

Another fact situation involving an intermediary is where the insured did not read his or her policy, but claims that the agent negligently failed to procure the coverage specified and requested. In one instance, it was noted that where an insurer issues a policy that differs from that requested and paid for, the insurer has a duty to advise the insured of changes, and the insured need not read the policy looking for changes, or worry that the failure to do so is at its peril.<sup>17</sup> Recognizing that few insureds read and understand the policy or application for coverage, these courts reason that the insured is justified in assuming that the policy which is delivered has been faithfully prepared by the insurance company to provide the protection requested.<sup>18</sup> There is authority for the proposition that where the company fails to provide such protection, the agent has an ethical obligation to its customer and as such, can be held legally responsible, along with the company for providing

12. Mark L. Kincaid, *Agents, Agency, and Vicarious Liability* at 5. Presented at the 10<sup>th</sup> Annual Insurance Law Institute (December 8-9, 2005). Of course, insurance intermediaries can also be sued for the types of causes of action mentioned in this section. See K&M§ 6:2 at 6-2ff and §21:2 at 21-3f.

13. For a general discussion of this topic, see Douglas R. Richmond, *Insurance Agent and Broker Liability*, 40 [ABA] TORT TRIAL AND INSURANCE PRACTICE J. 1 (2004).

14. See *Farmers Mut. Hail Ins. Co. of Iowa v. Fox Turkey Farms, Inc.*, 301 F.2d 697 (8<sup>th</sup> Cir. 1962); *Travelers Ins. Co. v. Morrow*, 645 F.2d 41 (10<sup>th</sup> Cir. 1981); *Hallowell v. State Farm Mut. Auto Ins. Co.*, 443 A.2d 925 (Del. 1982) (the court said: “An insured has a duty to read his insurance policy and he is bound by the provisions thereof if they are clear and unequivocal. Given our law as we find it now, we conclude that the Court should not rewrite an insurance policy nor ignore its clear and certain terms.”).

15. See *Allen v. Prudential Property and Cas. Ins. Co.*, 98 F.Supp. 609 (N.D.W.Va. 1951).

16. *Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 140 Ariz. 383, 682 P.2d 388 (1984).

17. *Reliance Ins. Cos. v. Moessner*, 121 F.3d 895 (3<sup>rd</sup> Cir. 1997) quoting *Tonkovic v. State Farm Mut. Auto. Ins. Co.*, 513 Pa. 445, 521 A.2d 920 (1987).

18. See *Fetherston by and Through Featherston v. Allstate Ins. Co.*, 125 Idaho 840, 875 P.2d 937 (1994) and *Fiorentino v. Travelers Ins. Co.*, 448 F.Supp. 1364 (E.D.Pa. 1978).

the correct coverage.<sup>19</sup>

## 2. Contributory Negligence on the Part of the Insured?

In some cases, courts have looked into the possibility that an insured's failure to read his or her policy may constitute contributory negligence. This is particularly true when, in litigation, the insured claims that the agent has been negligent for failing to procure the coverage requested, or making a representation to an insured that led him or her to not read the policy. In *Hilton v. Federated Brokerage Group, Inc.* the court held:

. . . [T]he policy having been received, the insured would be presumed to have read its provisions and even if he contended that his insurance broker was negligent in describing the premises insured, the insured would have to show that he was not contributorily negligent. . . . A client charging his broker with negligence must prove his own freedom from contributory negligence. . . .<sup>20</sup>

The question of whether an insured is contributorily negligent in failing to read his or her policy is generally determined to be a question of fact in which the fact finder must take into account the facts of each case and the precise nature of the relationship between the agent and the insured:

Insureds and insurance policies are not all alike. Insureds range from unsophisticated individuals who know nothing about insurance, to experienced business persons knowledgeable about insurance, to large corporations with batteries of lawyers. The relevant provisions of the policy may be

simple (the address of the insured premises, for example) or complex. A jury should be allowed to consider two questions: Under the relevant circumstances, was it unreasonable in the light of foreseeable risks for the insured not to read the policy? If so, did the insured's unreasonable failure to read the policy contribute to the insured's damages?"<sup>21</sup>

Where an insured knows that the policy issued does not provide the coverage requested or specified clearly has no claim based on the insurance agent's alleged misrepresentation concerning coverage regardless of whether the insured read or failed to read the policy.<sup>22</sup> The conclusion appears to be that if there is no representation as to coverage and nothing upon which an insured may reasonably rely in assuming that the policy provides the coverage requested, and an intermediary has not induced the insured not to read the policy, the insured may not avoid responsibility for reading the policy and take for granted that the policy issued has the coverage requested.<sup>23</sup>

## 3. Special Circumstances

The failure to read an insurance policy, will not, generally speaking, relieve an insured from policy exclusions, limitations or conditions. What if, however, special circumstances exist such as illiteracy or a failure to understand English? A survey of cases reveals that the general rule has been followed where an insured was illiterate,<sup>24</sup> as well as where an insured could not read English.<sup>25</sup> In most cases, courts held that it was the insured's duty to determine the contents of his or her policy and have someone read the policy to him or her. In the case, the insured was more comfortable in speaking and reading his native

19. See, e.g., *Murphy v. Liverpool & London & Globe Ins. Co., Ltd.*, 1922 Ok 275, 89 Okla. 207, 214 P. 695 (1922) and *Journal Co. v. General Acc. Fire & Life Assur. Corp.* 188 Wis. 140, 305 N.W. 800 (1925).

20. 30 Misc. 2d 503, 213 N.Y.S.2d 171 (1961). See also, *Fillinger v. Northwestern Agency, Inc. of Great Falls*, 283 Mont. 71, 938 P.2d 1347 (1997) and *Floral Consultants, Ltd. v. Hanover Ins. Co.*, 470 N.E.2d 527 (Ill. App. - 1<sup>st</sup> Dist., 1984).

21. *Martini v. Beaverton Ins. Agency, Inc.*, 314 Or. 200, 838 P.2d 1061 (1992).

22. See *Small v. King*, 915 P.2d 1192 (Wyo. 1996).

23. See *Martinez v. John Hancock Mut. Life Ins. Co.*, 145 Super. 301, 367 A.2d 904 (App. Div. 1976).

24. *Serdones v. Aetna Life Ins. Co.*, 21 Md. App. 453, 319 A.2d 858 (1974)

25. *American Fidelity Co. v. Schemel*, 103 N.H. 190, 168 A.2d 478 (1961) ("The insured's incapacity to read English would not excuse him from the obligation to ascertain what the provisions of his policy were.")

language, Greek, than English. The Court noted:

Nor would our holding be different if [the insured] were illiterate. Illiteracy would not relieve him of his obligation to inform himself of the content of the [policy] by having it read to him by someone whose interests were not antagonistic to his own before he signed it.<sup>26</sup>

In these special circumstances, following the general rule seems to be the norm, resulting in what may seem to be extreme results.

#### 4. Duty to Read Renewal Policies

Unlike the general rule above, it appears well settled that there is no legal duty on the part of an insured to read a renewal policy:

Some courts have decided, and we agree, that where the policy at issue is a renewal policy, the insured's duty to read it may be less than the insured's duty to read the original policy.<sup>27</sup>

An insured is entitled to assume that the renewal policy provides at least as much protection as the coverage which existed in the policy being replaced.<sup>28</sup> However, this rule does not apply where neither the original policy nor its replacement contain the terms sought by the insured in the replacement policy.<sup>29</sup> The notion of a "renewal" of a policy is that the same coverage will be continued. For this reason, an insurer has a duty to notify the insured of any changes in coverage and the failure to do so will bind the

insurance company to continue the original coverage.<sup>30</sup>

### III. INTERMEDIARIES VS. INSURERS

Scenarios in which an intermediary is a plaintiff against an insurer—most often its principal in an agency relationship—seem unlikely. However, we added this section in light of a recent decision out of the Colorado appellate court in which an agency sued an insurance company.<sup>31</sup>

In that case, an agency sued an insurer for tortious interference with prospective business relations and breach of fiduciary duties. The plaintiff designed and arranged for insurers to issue coverage to ski resorts when the resorts had "lost paid skier days," as a result of insufficient snow. For the first two years, there were no claims. During the third year, the insurer experienced numerous claims and lost a lot of money. The insurer stopped writing the policies and other insurers refused to get into the new business with the broker.

The court of appeals decided in favor of the insurer. According to the court, the broker's tortious interference claim failed because it did not have contracts with any customers and, according to the court, a defendant cannot tortiously interfere with its own contract—or a contract in which it is a party.<sup>32</sup> The fiduciary duty claim of the broker also failed. Generally speaking, according to the court, a principal does not owe a fiduciary duty to an agent as a matter of law.<sup>33</sup>

### CONCLUSION

There is no rigid model governing how the

26. 319 A.2d at 860.

27. *Thomas v. Northwestern Nat. Ins. Co.*, 292 Mont. 357, 973 P.2d 904 (1998) (holding that an insured's failure to read a renewed commercial general liability policy did not bar the insured from bringing a negligence claim against the insurer for failing to notify the insured of a new exclusion, where the new provision was not conspicuous but was buried in the endorsement section of the policy).

28. *Baxman v. Royal Indem. Co.*, 36 N.J. 12, 174 A.2d 585 (1961).

29. *Martinez v. John Hancock Mut. Life Ins. Co.*, 145 N.J. Super. 301, 367 A.2d 904 (App. Div. 1976).

30. *Thomas v. Northwestern Nat. Ins. Co.*, 973 P.2d at 906.

31. *MDM Group Associates, Inc. v. CX Reinsurance Company*, \_\_ P.3d \_\_, 2007 WL 528800 (Colo. App. 2007).

32. *Id.* It is clear to Hayes that brokers do not have contracts with customers, prospective or otherwise. Therefore, this decision makes complete sense. Quinn disagrees. He questions: "Why isn't a business promise to get insurance a contract?" Until another court examines the issue, Quinn's questioning will continue. It might even continue thereafter.

33. *Id.*

intermediary sector of the insurance industry is organized. The language used to describe that business area is not uniform; it is not completely agreed upon; and it is subject to manipulation. Consequently, and perhaps for additional reasons, statutes governing and constituting this area of business life, and subject to extensive and prolonged misinterpretation. Perhaps this should be changed; perhaps not. If it were changed, then—at least in Texas—insurance middlepersons—would be more extensively classified as the legal agents of insurers. Of course, this would be to the advantage of insureds.

There are a number of independent legal duty-

rules which can be invoked to hold intermediaries liable to an insured or those trying to become insureds. It is tempting, of course, for those suing intermediaries to claim to remember discourse, commitment, and advice from intermediaries, which the intermediaries themselves do not remember. Then again, many intermediaries have busy lives and so they may not remember conversations which are one among many. In addition, there is a tension between the ideal of the intermediary industry to be classified as a “profession” and litigation strategy where it is better to be classified as a routine arm’s length business.