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## Broker Responsibility Extends Beyond Procuring Coverage

Focus Column

By **Kirk A. Pasich**

Insurance brokers play a significant role in the procurement and negotiation of policies. They also play a role in coverage disputes. Frequently, insurance brokers attempt to assist insureds in explaining why an insurance carrier's coverage position may be wrong. However, they also play another role in coverage disputes—when a dispute arises as to whether proper coverage was obtained, or whether the terms of the insurance policy match the insured's expectations. In many of these instances, insurance carriers say, in essence, "if you didn't get the coverage you thought you were buying, you should talk to your insurance broker, not us. After all, they are professionals, they are your agent, and if anyone made a mistake, it's them."

However, the law does not actually conform with what insurance carriers often say. California law is clear that an insurance broker can represent both an insured and a carrier at the same time. See *Kotlar v. Hartford Fire Ins. Co.*, 83 Cal. App. 4th 1116, 1123 (2000) ("A dual agency can exist where a broker represents both the insured and the insurer. For example, an insurance broker acts as an agent for the insured in procuring insurance for the insured, but the broker may also be the agent of the insurer in respect to the policy."). In fact, most brokers appear to act as an insurance carrier's agent in at least one respect—the collection of the premium payment from the insured. A broker frequently collects the premium, subtracts its fee or commission (which the carrier is obligated to pay), and transfers the balance to the carrier.

Other courts have recognized that a broker can be an agent of the carrier. For example, in *Fraser-Yamor Agency, Inc. v. County of Del Norte*, 68 Cal. App. 3d 201, 213 (1977), the court observed that a broker "may become the agent of the insurer as well as for the insured." It explained that an agency relationship between a broker and a carrier can be established based upon compensation paid to the broker by the insurer:

In the present case, in view of the manner in which the insurance business of the county was handled it appears that the agency acted both as the agent of the county (i.e., as an insurance broker) and as an agent of the respective insurance companies (i.e., as an insurance agent). Insofar as the agency's compensation is concerned that compensation came from the insurance company by way of commissions which the agency was authorized to deduct from the premiums paid by the county to the insurance companies.

This led the court to conclude that there was a conflict of interest because a principal of the insurance firm involved was a member of the board of supervisors of the county, which was an insured under the policies procured by the firm. The court noted that “volume of business procured and placed by the [principal’s] agency is an important consideration in the agency’s relationship with the insurance companies. If the volume of business produced by the agency is profitable the insurance companies pay an amount to the agency on a basis of profit-sharing over and above the ordinary commissions.”

In light of this decision and the revelations of sometimes "secret" contingent commission arrangements between insurance brokers and insurance carriers, an insured might justifiably question whose agent a broker is. For example, there has been substantial attention paid to the claims filed by Elliott Spitzer, the Attorney General of the State of New York, alleges in an October 14, 2004, complaint against Marsh, that Marsh was paid hundreds of millions of dollars in contingent commissions by among others AIG (National Union’s parent company). Through this relationship, Marsh is alleged to have acted for the benefit of and in concert with AIG to make certain that AIG’s policies were chosen by insureds over other insurers’ policies. This action was settled by Marsh’s agreement to pay \$850,000,000, coupled with a public apology in which Marsh admitted that “certain Marsh employees unlawfully deceived their customers” and that the “wrongful conduct was shameful.”

Various insurance carriers were named in the allegations in the lawsuit, and certain employees of Marsh and certain AIG companies pled guilty in criminal proceedings. Additionally, the Spitzer complaint alleges that another insurance group, Chubb & Son, offered to enter into a “Profit Sharing Agreement” for 2002, with Marsh in which Marsh would enforce a “no shopping” policy for its Chubb-related accounts. And, in another complaint filed against Marsh this year, a Chubb Executive Vice President is alleged to have stated to a Marsh employee, “Our definition of ‘incentive’ is that you are financially motivated to act in Chubb’s best interests.”

If proven, these allegations suggest that at least certain insurance brokers may have been acting as agents for, or perhaps to some degree in the interest of, insurance carriers, not insureds. Thus, even though brokers may be dual agents for various purposes in "normal" insurance transactions, there may be more compelling agency arguments in circumstances involving alleged undisclosed secret compensation or other undisclosed arrangements between carriers and brokers. Thus, the carrier defense that the “broker did it” may not prevail.

However, insurance brokers may, in fact, have liability to their insureds in a number of situations. Some of these situations have been addressed recently by California courts. For example, in *Business to Business Markets, Inc. v. Zurich Specialties*, 135 Cal. App. 4th 165 (2005), the insured hired an Indian software company to write a computer program. The contract required the Indian company to carry errors and omissions insurance. The insured contacted a retail insurance broker and advised it of the Indian company’s needs. That broker, in turn, contacted a surplus

lines insurance broker to place the insurance policy. Thereafter, the Indian company failed to deliver useable software to the insured, which filed suit against the Indian company. The errors and omissions insurance carrier refused to cover the Indian company, citing an exclusion for claims arising from work performed in India. The insured then sued the surplus lines broker for negligence. It responded by claiming that it owed no duty to the insured because it had no direct dealings or contact with the insured. The court of appeal held that the insured could proceed with its claim against the surplus lines broker. It stated: "An intended beneficiary of insurance . . . is one who intentionally receives the benefit of the insurance. However, this person does not need to be specifically named, as long as he is in the class of members that the insurance is intended to benefit." The court noted, "Just because other parties, such as [the] retail insurance broker . . . , may have closer connections to [the insured] does not mean [the wholesale broker's] connection was legally inadequate." The court also explained that, "imposing a duty of care to third parties who are not clients does not involve a reworking of any accepted legal principles, particularly when, as here [the surplus lines broker] was a professional entity rendering specialized services."

California courts also have recognized that even when an insurance broker obtains the coverage that is promised, it still may be liable if the carrier denies coverage and the insured incurs costs or fees in dealing with that denial. In *Third Eye Blind Inc. v. Near North Entertainment Insurance Services LLC*, 127 Cal.App.4th 1311 (2005), the court of appeal addressed an insured's claim against its insurance broker for negligence and breach of contract. The insured rock band had been sued by one of its former members. It notified its insurance carrier. The carrier denied coverage, pointing to a policy exclusion.

Ultimately, the insured settled with the carrier after obtaining a favorable summary judgment ruling. Thereafter, the broker contended that it could not be liable because the trial court had found that the policy provided coverage.

The court disagreed. It held that the broker should have warned the insured of the possibility of a gap in its coverage—or at least that the carrier might dispute coverage: "The point is that [the broker] failed to alert [the insured] that the [exclusion] would give [the carrier] a viable basis for refusing coverage under some circumstances and, consequently, failed to recommend that [the insured] purchase errors and omissions insurance to ensure complete, uncontestable coverage."

The court also noted that even if policy turned out to afford the desired coverage, the broker could still be liable for the insured's fees and costs incurred in the coverage dispute. This was because "the law recognizes that there may be multiple causes of a plaintiff's injury." The court emphasized that although the carrier "may have been wrong to deny coverage, ... the complaint alleges this was a foreseeable harm that could have been avoided if [the broker] had competently advised [the insured]." Thus, a broker can be liable not only when it fails to procure coverage that it should have procured, but also when it does not take required steps to avoid, or at least warn the insured of the possibility of, a coverage dispute.

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