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Broker Duty of Care

Two recent court decisions shed additional light on when a "special relationship" is considered to have been formed by an insurance broker in his or her dealings with an insured. The difference between the ordinary standard of care that is due and a "special relationship" is critical to understanding the liability to which a broker may be exposed.

The standard in New York was articulated by the New York State Court of Appeals, the highest state court in New York, more than twenty years ago in the **Murphy v. Kuhn** decision. Citing prior rulings, the court began by stating, "Generally, the law is reasonably settled on initial principles that insurance agents have a common-law duty to obtain requested coverage for their clients within a reasonable time or inform the client of the inability to do so; however, they have no continuing duty to advise, guide or direct a client to obtain additional coverage." Unless one of three exceptional circumstances is found which leads a court to conclude that a special relationship has been formed, this is the duty of care that applies.

What conduct may create a special relationship and therefore an elevated duty of care? The court in Murphy cited three different types: (1) the producer receives compensation for consultation apart from payment of the premiums, (2) there was some interaction regarding a question of coverage, with the insured relying on the expertise of the producer, or (3) there is a course of dealing over an extended period of time which would have put objectively reasonable insurance producers on notice that their advice was being sought and specially relied on. If any of these situations exist, a special relationship may have been created, giving rise to an elevated duty of care on the part of the producer. It is important to note that in these circumstances, insureds bear the burden of proving that a special relationship exists; **the presumption is that a special relationship does not exist**.

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The court in *Murphy* ruled that as a matter of law, no special relationship had been formed because none of the three scenarios outlined above existed under the facts of the case. However, following *Murphy* the New York State Court of Appeals considered a different set of circumstances in **Voss v. Netherlands Insurance Company**. Unlike in Murphy, the court found that specific facts were present that could give rise to a special relationship, although the court did not make that judgment one way or the other. The

court denied a motion for summary judgment based on a finding that the broker failed to refute the facts alleged by the plaintiff that could give rise to a finding that one or more of the three criteria for creation of a special relationship existed. By declaring that the existence of a special relationship is a question of fact, the court made the determination an issue for a jury as opposed to a question of law, which is a judicial determination.

Following *Murphy* but prior to *Voss*, the New York State Court of Appeals issued an important ruling in **American Building Supply Corp v. Petrocelli Group, Inc.** The court found that an insured that had failed to read its insurance policy could still claim that a broker owed and breached a special duty of care. The court stated, "The facts as alleged here, that plaintiff requested specific coverage and upon receipt of the policy did not read it and lodged no complaint, should not bar plaintiff from pursuing this action. While it is certainly the better practice for an insured to read its policy, an insured should have a right to 'look to the expertise of its broker with respect to insurance matters.'" The majority view resulted in Judge William Pigott opening his dissent by stating, "It seems to me elementary that before you can complain about the contents of any contract, you should at least have read it."

This past January, the U.S. District Court for the Southern District of New York put some more meat on the bones of these earlier cases in a pair of decisions. In **Holborn Corp v. Mut. Ins. Co.**, which involved a reinsurance placement, the court found that based on other precedents, an insured must make a "specific request about the feature of the proposed insurance in the subsequent suit." In short, a special relationship will not exist if the insured never raised the particular issue at hand (in the ***Holborn*** case, top and drop reinsurance). It is not enough to contend that the producer should have realized that certain coverage or limits were advisable. However, it is unclear what constitutes raising a particular issue. In the *Holborn* case, the court considered the insured's argument that its broker should have recommended top and drop reinsurance and ultimately rejected the claim based on the topic never having been discussed between the insured and the broker prior to the loss that gave rise to the lawsuit.

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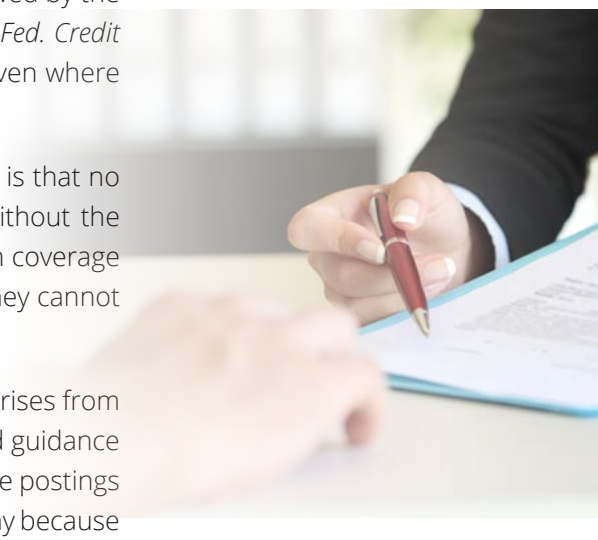
In **Hudson Heritage Fed. Credit Union v. CUMIS Ins. Society Inc.**, the court found that the plaintiff's claim that it had a "multi-faceted, decades spanning business relationship" with the defendant, an insurance company, may, if proven, give rise to a special relationship. The court based its opinion on the plaintiff's further statements that based on the long-term relationship, it relied on the defendant to provide guidance, risk analysis and coverage recommendations, and that the defendant engaged in periodic risk assessment meetings with the plaintiff over the course of their relationship. While the court made no determination regarding the accuracy of the plaintiff's claims, it did find that the statements gave rise to a plausible claim of a special relationship. This decision appears to extend the potential for the formation of a special relationship to insurers.

The *Hudson Heritage Fed. Credit Union* decision raises a perplexing question for insurers. The court found that the policy did not provide coverage for the plaintiff's insurance claim based on the clear and unambiguous language of the insurance policy. However, the court went on to find that the lack of such coverage may have been the insurer's responsibility based on the potential existence of a special relationship. In such a

situation which takes precedence, the policy language or a finding that the insurer owed a special duty to the insured? Although the court in *Hudson Heritage Fed. Credit Union* did not cite *American Building Supply Corp.*, does the latter's finding that an insured's failure to read its insurance policy may not bar a conclusion that a special duty was owed by the insurer to the insured, coupled with the court's finding in the *Hudson Heritage Fed. Credit Union* case, mean that an insurer can be held liable based on a special duty even where the policy itself is clear and unambiguous in denying coverage?



So what are the key takeaways for excess line brokers? First, the presumption is that no special relationship exists and therefore no elevated duty of care applies. Without the existence of a demonstrable special relationship, brokers have a duty to obtain coverage for their clients within a reasonable timeframe or to inform their clients that they cannot do so. There is no duty to advise or guide the client.

What may give rise to a special relationship and the elevated duty of care that arises from it, including potential additional liability? In short, broker recommendations and guidance may be seen as raising the level of care owed. Statements, advertising or website postings such as, "this policy will meet all of your insurance needs," or "go with this company because they are the best at paying claims quickly," or "you need the following limits based on my analysis of your business risks" will likely augur in favor of a special relationship finding. Brokers presenting facts and information so that insureds can make their own judgments and decisions, as opposed to opinions and subjective statements, will be more likely to avoid forming a special relationship. In addition, brokers would do well to understand their history of dealings with a client and to understand how the client may, based on that history, reasonably view the relationship.

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Excess line brokers may be able to avoid the formation of unintended special relationships in several ways:

1. If fees are not for risk management services or coverage advice, a broker may wish to footnote its total cost form that it files with ELANY to specifically indicate what the fees are for, and disclaim what they are not for. The advantage of using the total cost form is that it breaks out fees charged to the insured and the insured must sign the form.

2. From early on in the insurance procurement process, a broker can provide the insured with artfully worded communications disclaiming any special relationship.

3. Brokers can ask insureds to sign a statement agreeing to the services to be provided, stating that any additional services will be provided by separate written agreement, and explicitly agreeing that the broker's work on behalf of the insured does not give rise to a special relationship. It is generally permissible in New York to affirmatively waive fiduciary duties and we are unaware of anything in law or regulation that addresses this question. Special relationships are not created by statute, but by judicial standards. The court rulings are based on what a reasonable insured might infer from various actions. It therefore stands to reason that a clear and carefully worded waiver that is agreed to in writing by the insured would be effective. Brokers must decide if this is feasible from a client relations standpoint.

4. Brokers can avoid statements on websites, advertising or in-person that promise services or results that may lead to a finding that a special relationship has been established.

5. Brokers can urge insureds, in writing, to read the policy and confirm that the content is satisfactory.

Insurers may seek to limit their liability as well but based on the *American Building Supply Corp.* case that was discussed earlier, it is questionable whether a disclaimer placed in the insurance policy itself will be effective. The court in *American Building Supply Corp.* found that an elevated duty of care may be determined to apply even where a policyholder fails to read the insurance policy. Given that finding, it follows that a court may determine that a disclaimer contained in the policy form itself is inadequate.