

AGENTS BEWARE WITH YOUR COMMERCIAL CLIENTS

By

Richard M. Mitchell, Esq., CPCU
Maddin, Hauser, Wartell, Roth & Heller, P.C.

INTRODUCTION

You have known your client for years. You work together, maybe even socialize. You know your client's business, or so you think. You know the risks your client faces and you take pride in your ability to provide protection from them.

Another client is new to you, but you have studied the business. You will land the account by impressing the client with your knowledge of its operations. Still, you will have to rely on that client to answer some unknowns when it comes to completing the insurance application.

Depending on what state you are in, your liability for any lack of coverage for a loss may vary. The National Association of Insurance Commissioners has attempted to bring some uniformity to laws applying to agents and brokers through the Producer Licensing Model Act. Not all states, however, have adopted this Act, and the laws vary from state to state. The agent may protest that he or she did nothing wrong when a summons shows up at the doorstep. While that may be true, the litigation itself can be costly. The "American rule" holds that each party pays its own attorney fees, whether or not it prevails. In some circumstances, those fees can be recovered, but an incredibly high standard applies. Sometimes taking a few extra minutes today can save a great deal of time and energy tomorrow. What follows is not meant to be an exhaustive list of potential problems, but actual issues that have brought trouble to the doors of agents and brokers with otherwise sterling reputations.

- **Coverage Gaps for “Prior Acts” When Switching Carriers**

This is a particular concern with claims made policies. Your client may have been insured by a particular insurer for several years, but the premiums have gone through the roof. There is a tremendous cost savings with moving to a competitor, but the threat of coverage gaps looms. There is always some level of risk associated with switching carriers. The new carrier will likely not cover a claim if the insured knew the circumstances prior to the policy inception date. The old carrier may not cover the claim if it was not reported in accordance with the applicable notice provisions prior to the end of its policy period.

It is critical that the insured carefully review the possibility of a claim before switching carriers. The insured may look to its agent or broker if a claim falls into a gap. A company wide e-mail or other inquiry regarding any knowledge any employee may have of any circumstances that may give rise to a claim is essential.

If the agent or broker learns about such circumstances, but no claim has yet been made, particular caution must be used before making the switch. Most policies define a claim as a written demand for money by a third party. That does not need to be a lawsuit. One possible solution when contemplating switching carriers is actually approach the potential claimant and request such a written demand, which can then be tendered to the carrier prior to the end of the policy period. Doing so will likely satisfy the reporting requirements of most policies.

- **Joint Ventures/Partnerships**

When your client is undertaking a business venture, it is important to accurately identify the proper party involved. This is particularly true when a broker or agent has a longstanding relationship with the insured and knows that it has parents or subsidiaries. Two parties may enter into a joint venture or partnership. Each party on its own is insured. The joint venture or

partnership, however, is a new entity that is not an insured, unless it is properly designated as such. The general liability policy of an insured will likely not cover its acts as part of a joint venture when that joint venture is named as a defendant in litigation. It is necessary that the joint venture itself be named on the policy if coverage is to be available for the acts of that joint venture. Additionally, even where the joint venture or partnership is properly named, a standard insurance policy usually provides that the members or partners will typically also be insureds, “but only with respect to the conduct of your business.”

- **Policies Designed to Cover Liability Assumed in Specific Contracts**

As most agents and brokers know, contractual liability claims are not covered under most policies. This is subject to exception where an indemnification obligation would exist independent of any contractual obligations. What if the insured has entered into a contract where it has assumed certain additional liabilities? An example might be a tenant in a shopping center that has agreed to assume a percentage of liability for accidents that occur in common areas in accordance with a master agreement. The insured will seek the assistance of the agent or broker in obtaining this coverage. The agent or broker, in turn, may work with the underwriter to create an endorsement, particularly if the insured is paying substantial premiums and has some bargaining power.

Yes, what if the language of the endorsement conflicts with the language of the contract? In the above example, have you read not only the insured’s lease, but the insurance provision in the master agreement? What if the master agreement has even broader insurance requirements? If there is a loss, the most likely result is that a court will find the insurance policy to be ambiguous, which in most cases would then be construed against the insurer. In our example,

however, the insured has had some input into the language of the endorsement, so the ambiguity may not be entirely construed against the insurer.

The point is that the insured will claim it relied on its agent to obtain the appropriate coverage. Reading each contract may be going above and beyond the legal duties of the agent, but it is prudent practice. Again, preventing a lack of coverage may require some extra work, but the resultant lawsuit when there is no coverage will be more work and will use time and effort that the agent or broker could better spend elsewhere.

- **Waiver of Subrogation Issues**

A related issue may arise when the insured has entered into a contract with a waiver of subrogation provision. This is the clause that gives the insurer the right to seek collection of any sums paid to the insured as a result of a loss from a third party tortfeasor who actually caused the loss. The subrogation clause is also, generally, a condition precedent of coverage. If that condition is not met, an insured may be without coverage in the event of a loss.

Sometimes contracts, such as leases of real property, will contain a “waiver of subrogation” clause. Executing a contract containing such language may limit the rights of the insurer which, in turn, may result in a denial of coverage if there is a loss. While this is not necessarily the fault of the agent or broker, the insured will not see it that way when it gets the denial of coverage letter from the insurer. In certain circumstances, such as one involving a lease transaction, the short time it takes to ask about the contract may be more than the agent has a duty to expend, but it may painlessly avoid a myriad of future problems.

- **Claim Notification**

This one may seem obvious, but it is surprising how often agents and brokers get themselves into trouble by not timely tendering a claim to an insurance carrier once they receive

notice from the insured. The best way to avoid this problem is through closely followed internal office procedures.

Once the insured tenders notice of a claim or potential claim, the agent or broker should treat it as a “hot potato.” The agent may be an agent of the insured or the insurer. Either way, significant liability exposures arise the second the claim comes through the door. Generally, an independent agent is the agent of the insured. If the agent fails to notify the carrier of the claim immediately, he or she faces potential exposure to the insured if the insurer denies the claim because of a late notice. This situation may arise particularly when the insured is at the end of a policy period. In some states, particularly with claims made policies, an insurer must show that it was prejudiced by notice not being made timely. In others, it must only show that the notice was outside the policy period, regardless of whether or not this caused it any prejudice. In these instances, the insured may come after the agent or broker in litigation.

Perhaps the agent has a contract with the insurer, making it the agent of that insurer. If so, litigation exposures arise from the other side. Notice to the agent or broker constitutes notice to the insurer. A duty to defend the insured likely arises immediately. Even if the insured is already being defended, such as by its own corporate counsel, the insurer still has a right to associate in that defense. The failure of the agent or broker to provide immediate notice deprives the insurer of that ability and will land the agent or broker in a courtroom.

Again, providing notice of a claim to a carrier once an agent receives it should be an almost reflexive response. Depending on the size of the agency or brokerage, however, it probably receives notices of claims fairly regularly. All it takes is for one of those notices to fall through the cracks one time and the litigation is about to start.

- **Notices of Cancellation**

It is up to the insured to pay its premiums when they are due. Of course, that does not always happen and, when it does not, the insurer will send a notice of intent to cancel to the first named insured on the policy. The agent or broker is likely to be copied on that notice even if it is sent directly to the insured. What should the agent do?

Doing nothing is the surest way to invite a lawsuit. If the policy lapses and the insured suffers a loss that is not covered, it will look to the agent, whether right or wrong. It may claim that it did not receive the cancellation notice, but the agent certainly did. Maybe it has moved its corporate offices. Maybe it will simply assert that the notice must have gotten lost in the mail. Either way, the agent is on notice of a problem. This may particularly be a concern if the insured typically makes its premium payments to the insurer through the agent. When the payment does not come through the door, the agent is definitely on notice that the policy is about to lapse, if it has not already done so.

Depending on the state, the agent may or may not have a duty to do anything when it receives notice that an insurer intends to cancel a policy. Regardless, the best course of action is to cut the problem off at the pass. Contact the insured. Make sure the payment is made. Most importantly, document this effort. Whether the agent has actual liability for not contacting the insured when it gets a copy of a notice of intent to cancel, making that contact requires virtually no effort. Making sure the contract does not lapse may be beyond the duty of the agent, but it is the surest way to avoid an uncovered loss- and expensive litigation. Even if the policy lapses, the documentation in the agent's file showing an effort to prevent that result will be tremendously helpful.

- **Certificates of Insurance**

Often a contract requires one party to prove to another that it has insurance for a particular purpose. This is often accomplished by providing a certificate of insurance. While this certificate shows that a policy issued by a certain insurer for a certain time period is in place, it does not convey much other useful information.

What if the party your insured has contracted with contacts you directly to ask for a certificate of insurance? Do you now owe a duty to that person, as well as to the insured? What if the person tells you the nature of the project that gave rise to the contract, but the coverage necessary is outside the scope of the insurance policy? Armed with information about why the coverage is needed, have you misrepresented the nature and scope of the coverage if it does not provide what the contract requires? You had better believe that the certificate holder will argue as much if a loss occurs for which there is no coverage. Again, this investigation may be beyond the scope of the agent's duty, but it is prudent risk management.

- **Protected Information Under Privacy Laws**

Privacy is one of the hottest issues of the day. The federal government has passed various pieces of legislation designed to protect social security numbers, financial information and health information. For example, the Health Insurance Portability and Accountability Act of 1996 places certain privacy requirements and regulations on healthcare information. Among other requirements, HIPAA imposes strict security standards protecting the confidentiality and integrity of "individually identifiable health information." Many other states have passed their own legislation, many of which impose a standard of virtual strict liability. Many businesses possess confidential information about their clients and customers. Accounting firms or law firms, for example, store the social security numbers and financial information of their clients

electronically. A gifted “hacker” may be able to access that information and completely destroy the credit of the client. These laws place substantial penalties on companies that do not adequately safeguard that information.

A client may approach an agent seeking protection for this type of information. It is incumbent upon the agent to know what type of coverage is available. Coverage for these risks remains somewhat limited, although more carriers are in the marketplace than there were just five years ago. Certain types of stand alone policies are available, although coverage for hackers obtaining private information is often available through policy endorsements. Either way, the point is that an agent or broker in today’s business climate must be aware not only of the risks a client faces when it deals in confidential information, but how to protect against those risks.

- **Conclusion**

This article is not meant to suggest that agents or brokers voluntarily assume duties that they would not otherwise have. It is, however, meant to remind agents and brokers that they can become parties to litigation even when they do nothing wrong. Depending on the circumstances, knowledge about specific risks of a client, particularly one that is long-standing, might be imputed. It is impossible to place coverage for every risk a client might face and exclusions will apply to specific facts. Nonetheless, the best way to avoid litigation over a gap in coverage is to spend a few extra minutes trying to prevent it. When you make those efforts, you **MUST** do one other thing to protect yourself – document them.

Richard M. Mitchell is a shareholder in the law firm of Maddin, Hauser, Wartell, Roth & Heller, P.C., in Southfield, Michigan. He focuses his practice on insurance coverage disputes, professional liability defense and complex commercial litigation. He is a member of the

Chartered Property Casualty Underwriter Society (CPCU) and is the past president of the Greater Detroit Chapter.