CASE IN POINT

Examining the circumstances of cases where clients have sued sheds light on the ways brokers can expose and protect themselves

>> BY SAMANTHA IP

When brokers are involved in the process of negotiating the terms of the policy for insureds and informing potential insureds of what their most suitable coverage options are, they assume certain risks as they owe a duty of care to clients and in some cases to the insurer. Failure to meet that duty of care through negligent acts, errors and omissions during the performance of a broker's professional services can result in civil liability and financial loss.

This article provides an overview of a number of cases on the duties owed by brokers through an examination of factual circumstances, and the potential and actual liabilities and penalties that resulted when those duties were not met.

1. Brokers' Standard of Care

Causal Link: A Federal Court of Canada case from 2007 concerned whether the broker in question met the standard of care of a reasonably prudent marine insurance broker by asking relevant questions about the insured's plans for their boat.

The brokerage firm was aware that the insured planned to use the boat for commercial purposes in the near future, but suggested that the boat could be insured for personal use until such time as the insured was ready to take paying customers on the boat.

The insured obtained a personal insurance policy on the boat that specifically stated the boat would be used solely for private pleasure purposes and would not be "chartered or leased or used for any commercial purpose." This was an absolute warranty and applied to the entire policy period. The policy was renewed on the same coverage terms. The broker did not communicate with the insured about his use of the boat at the time of renewal.

After the renewal, despite failing to obtain commercial insurance, the insured began to use the boat for commercial purposes. The boat was then stolen and the insured tried to claim on their policy. The insurer denied the claim in respect of the theft, citing the use of the boat for commercial purposes in contravention of the policy. In response, the insured argued that the broker failed to properly advise them and failed to meet the standard of care that was necessary.

The court agreed with the insurer—the insured had taken paying customers on the boat without having commercial insurance and knowing that his policy specifically prohibited use for commercial purposes.

With respect to the insured's claim against the broker for failing to advise him fully about the effect of not obtaining commercial insurance, the court held that while the brokerage firm failed to meet the standard of care required of a reasonably prudent marine insurance broker, there was no causal link between the broker's actions and the insured's loss. The insured had not relied on the advice of the brokerage firm and instead had consciously chosen to take paying customers on his boat despite being aware that this would amount to commercial use, contrary to the terms of the policy.

In this case, the broker failed to meet the standard of care required of a reasonably prudent broker. Failure of a broker to meet their standard of care, however, is not sufficient to establish their liability. A causal link must also be found between the broker's failure to meet the standard of care and the insured's loss. Here, the insured did not rely on the broker's bad advice to his detriment; he chose to disregard the broker's advice knowing full well that his insurance coverage could be affected by his actions.

Brokers are required by law to be proactive about the questions they ask to assess the risks to be insured against, and to be accurate about the advice they give to insureds. As we can see from this decision, communication with the underwriter about the scope of coverage is good risk management.

Care by brokers must be given not only at the initial policy application, but also at the time for renewal. Brokers should review the insured's file fully, ask necessary questions to establish the risks and advise on coverage.

Similar to other professional standards of care, perfection is not required by agents and brokers. A potential defence for claims against brokers, even if they have not met the standard of care expected of a reasonably prudent broker, is the lack of a causal link or reliance by the insured on the broker's advice.

Gaps In Coverage: In a 2010 decision from the Ontario Superior Court of

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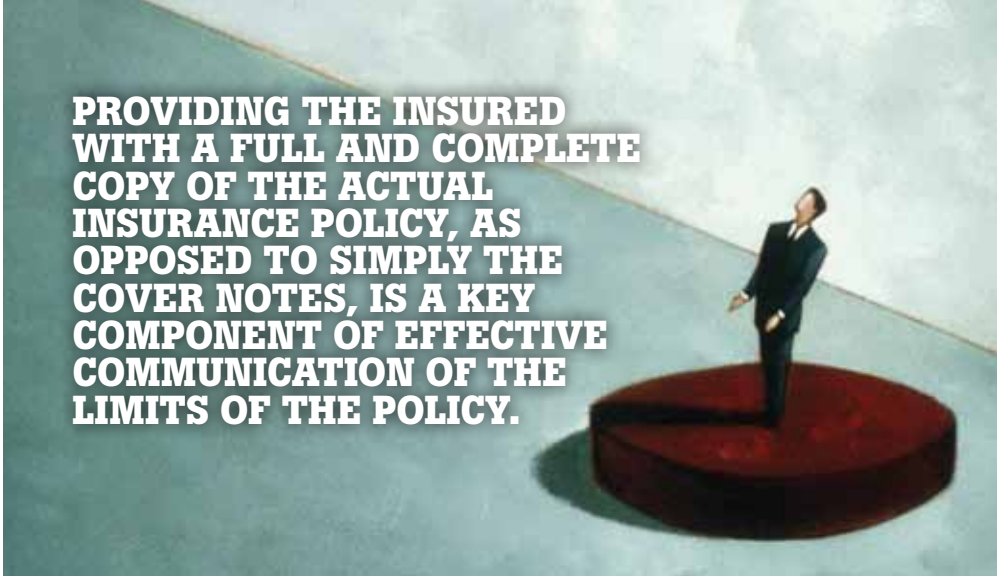

Justice, the plaintiff, a global company that inspected oil refinery coke drums, sued the brokerage firm that arranged for its insurance. The action was brought for damages for negligence, breach of fiduciary duty, and breach of contract. The plaintiff historically carried insurance covering property, liability and office contents. When it came time for renewal, the plaintiff contacted the defendant brokerage firm with a list of its insurance needs based on its prior coverage.

Subsequently, a drill stem operator accidentally caused a sensor to fall to the bottom of a coke drum at a Venezuelan refinery. The plaintiff's claim for insurance proceeds was denied on the basis that the policy issued was for cargo coverage and only covered the sensor while in transit. The policy excluded job site risks. The plaintiff had assumed it had been insured against such risk and blamed the brokerage for the gap in coverage. The plaintiff claimed damages representing the value of the lost equipment, the economic impact of the loss of one of its two sensors, and restructuring costs it incurred following the loss.

The defendant brokerage firm was eventually found liable and ordered to pay $297,500 based on its negligence. The brokerage was found to have failed to provide the insurance coverage requested, and to have failed to communicate the gap in coverage to the plaintiff. The actual policy was never given to the insured by the defendant. Unlike the marine case above, the court in this case found a causal link between the negligence of the defendant and the loss suffered by the plaintiff. This finding was based on the fact that the policy requested by the plaintiff would have covered the loss suffered, and that had the plaintiff been aware of the gap in coverage, it would have sought other coverage or modified its business to reduce exposure to uninsured risk.

This case demonstrates that brokers must carefully review the instructions of insureds to ensure that the policy they provide matches the needs and desires of the insured. Where there are gaps in coverage that pose risks to the insured, those gaps ought to be communicated to the insured by the broker. Providing the insured with a full and complete copy of the actual insurance policy, as opposed to simply the cover notes, is a key component of effective communication of the limits of the policy.

2) Fiduciary Duty of a Broker

In a 2007 decision from the Saskatchewan Court of Queen's Bench, a client brought a successful action against a broker and brokerage firm for breach of fiduciary duty, negligent misstatement and negligence resulting from the broker's failure to advise the insured of a gap in coverage for a crane-on-the-hook policy.

The insured was a crane operator whose services were contracted by the owner of a printing press to transport a printing press from one building to another. The value of the press was estimated at $200,000. The insured was concerned that this was in excess of the rider for "on-the-hook" property covered by their policy. Accordingly, the insured contacted their broker and requested an increase in the coverage for "on-the-hook" property to ensure the press would be insured in case of any damage during the move. The press was damaged during the move and the owner of the press made a claim against the insured for property damage and for loss of profits. In order to settle the claim, the insured contributed $35,000 in excess of the cost required to fix the printing press. It was later discovered that there were no insurers in the marketplace that would insure against "loss of profits" or consequential losses suffered by third parties. The broker was unaware that this type of insurance was not available and therefore did not disclose this fact to the insured.

The insured claimed that the brokerage firm failed in their duty to warn him of a "hole" in the policy and that, but for the brokerage firm's breach of duty, the insured would have had no exposure to loss beyond the amount for which it was insured.

The Court held that the broker breached his fiduciary duty and was negligent in not knowing about the lack of coverage for business interruption and the broker breached his duty when he failed to advise the insured of this fact.

Brokers have a fiduciary duty toward the insured, which requires that they act in the best interest of the insured. This duty includes being aware of the insurance the insured requires, warning the insured of any "holes" in their policy and advising them accordingly. Where there is a causal link between a breach of fiduciary duty by a broker and the loss suffered by an insured, the broker will be held liable for that loss.

3) Brokers and Duties to the Insurer

A case from 2006 from the British Columbia Supreme Court concerned the failure of a broker to ensure warranties were incorporated into a jeweller's interim policy. The issue raised was whether the broker in these circumstances owed a duty to the insurer and if so, what was the scope of that duty.

The owner of a jewelry store purchased a jeweller's block of policy insurance from her local agent. This local agent bought the policy from a jeweller's block broker. The insurer did not require the warranties to be sent out with quotes or binders, and the insurer knew blank-form warranties were not sent out before the policy was issued. The insurer's own procedures never required warranties to be sent out before the policy was issued. The law is clear that a warranty would not be binding on the insured or enforceable by the insurer until the insured had agreed to the warranties.

Shortly after the purchase of insurance, the jewelry store was robbed. The store was closed for the day but exterior doors were not locked. Jewelry had been removed from the display cases and was collected in trays on a trolley in preparation for nighttime storage in the vault. The robbers entered through an unlocked back door and stole jewelry worth $2 million.

The policy contained a warranty that stipulated store closing procedures, which required the owner to lock exterior doors prior to removing jewelry from display cases. This owner had not been provided with a copy of the warranties by the date of the robbery and was unaware that her business practices breached the warranties. As such, these warranties were not enforceable by the insurer against the insured.

The insurer paid the loss and sued the broker for failing to advise the insured of the content of the warranties and failure to obtain the owner's acceptance of the warranties by the time the insurer was bound. The insurer argued that the broker owed a duty of care to act as a prudent professional insurance broker, and breached its duty and was negligent in failing to ensure the warranties were communicated to, and accepted by, the insured.

The broker argued that its obligations were governed by the contract it had with the insurer and that it was never an express or implied term that brokers were obliged to send warranties to the insured in the quotation or within the interim binder.

The issues considered by the court were: does the jeweller's block broker owe the insurer a concurrent duty of care in tort that is broader than its contractual duty? Is the jeweller's block broker liable in tort for failing to do what the insurer did not bother to do itself, knew the broker was not doing and did not rely on the broker to do?

The court held that the broker was not liable for the insurer's loss. The insurer and broker were on equal footing regarding the underwriting procedures that flowed from taking an insurance application, issuing a quote and binding insurance. There was nothing in their contractual relationship and there was no common-law duty to require the broker to advise the insurer that its underwriting procedures were deficient, or to do anything further to ensure that the insured was aware of the subject warranties.

The broker did owe a duty of care to the insurer to communicate the content of the standard warranties to the sub-broker and breached its duty by failing to do so, but this breach was not found to contribute to the loss. The insurer failed to prove causation against the broker. The court found that it was the insurer's deficient underwriting procedures, mismanaged by its agent, that caused the insurer to be on risk without enforceable warranties.

A broker's duty of care to the insurer may extend beyond its contractual obligations to the insurer. However, in this particular decision, we see that this was not the case with respect to risk assumed and caused by the insurer as a result of deficient underwriting practices. The broker does not owe a duty to the insurer to advise them of the deficiencies in their underwriting practices. A broker also does not owe the insurer a duty of care to communicate the content of the standard warranties to the insured, but the broker does owe such a duty of care to the sub-broker. TB

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