

Agency Law: Insurance Applications

INSURANCE PRODUCER CLASSIFICATIONS

Like other businesses, insurers act through various representatives to accomplish their goals. Some of these representatives are employees of the insurer, and others are independent contractors who perform certain functions for the insurer. The acts of these representatives on behalf of the insurer may legally bind the insurer.

The insurance business uses the generic term **insurance producer** to denote the broad category of persons involved in arranging the placement of insurance business with insurers. The term producer encompasses agents and brokers, because the person or group acting as intermediary between the insurer and insured “produces” the business.

An understanding of how the roles of agents and brokers interrelate is necessary to understand the respective duties of producers. The producer classifications have distinct legal significance, as the authority and potential liability of each type of producer differs significantly.

Agents

The term **insurance agent**, or agent, refers to an intermediary who arranges contracts of insurance between a specific insurer with which they have an ongoing relationship and prospective insureds. The prospective insured is the customer. Insurance agents can fall into three categories based on the degree of discretion they have in carrying out their functions: (1) **general agent**, (2) **special agent**, and (3) **soliciting agent**. See the exhibit “Categories of Insurance Agents.”

Brokers

While an insurance agent represents the insurer, the insurance **broker** usually represents the insurance customer. An insurance broker is independent, does not work for a particular insurer, and typically assists large insureds to obtain coverage from competing insurers.

Some insurance brokers have expanded their roles beyond finding available insurance coverage and coordinating the placement of their clients’ insurance business. Some brokers have become risk consultants, who advise clients how to handle their loss exposures. This includes using both alternative risk financing techniques and traditional insurance. Brokers may also offer risk control or claim services, or assist insurers in obtaining reinsurance coverage.

Insurance producer

Any of several kinds of insurance personnel who place insurance business with insurers and who represent either insurers or insureds, or both.

Insurance agent

A legal representative of one or more insurers for which the representative has a contractual agreement to sell insurance.

General agent

An agent that transacts all of a principal’s business of a particular kind or in a particular place.

Special agent

A person or an entity that is employed to act for the principal in a specific transaction or only for a particular purpose or class of work.

Soliciting agent

An insurance producer whose authority is limited by contract with an insurer to soliciting applications for insurance and performing other acts directly incident to those activities.

Broker

An independent producer who represents insurance customers.



Categories of Insurance Agents		
General Agent	Special Agent	Soliciting Agent
Broad powers within underwriting guidelines	Authority restricted by express agreement with insurer	Narrow authority derived directly from the agency contract
<ul style="list-style-type: none">Solicits applications for insuranceReceives premiumsIssues and renews policiesAppoints subagentsAdjusts losses, in some cases	<ul style="list-style-type: none">Induces third parties to apply for insuranceForwards applications to the insurerDelivers policies to the insureds on receipt of premiumPossible additional duties, such as inspecting property, quoting rates, collecting premium payments, and assisting with changes in coverage	<ul style="list-style-type: none">Solicits applications for insuranceForwards applications to the insurer

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PRODUCERS' AUTHORITY

Arising from different circumstances, the different forms of a producer's authority differ in legal significance for insurers.

There are two types of producer authority:

- Actual authority
- Apparent authority

The insurer can bind itself to the unauthorized acts of a producer through subsequent conduct ratifying the producer's acts. If an insurer ratifies a producer's unauthorized actions with full knowledge of the acts, then the insurer accepts the benefits or consequences of those actions.

However, an insurer must be careful in ratifying such producer actions. If the insurer develops a pattern or practice of ratifying this producer's actions, an agency relationship can arise by implication. The insurer must evaluate whether it should enter into a formal relationship through an agency contract or deny the relationship and refuse to ratify the producer's submissions.



Actual Authority

Actual authority is that which the principal (insurer) intentionally confers upon the producer or allows the producer to believe he or she possesses. See the exhibit “Example: Agent’s Authority.”

Example: Agent’s Authority

Jane is an insurance agent associated exclusively with MutualCo, a regional insurer. When MutualCo appointed Jane as an agent, they entered into a standard written agency contract that MutualCo uses for all agents. This agreement sets out, among other things, the following terms:

- The agent’s commission arrangement with the insurer, financial assistance, and other support that MutualCo will provide to Jane’s agency
- Jane’s authority and methods allowed for binding coverage
- Types of insurance Jane can write
- Duration of the agency contract
- Termination methods for the agency contract

Jane has express authority to act within those terms.

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Typically, the insurance producer and the insurer establish the terms of the principal/agent relationship through a formal written contract that grants the producer express authority. This agency contract states the producer’s powers and authority and specifies any restrictions on that authority. If the contract does not state an authority, the producer does not have that express authority. An insurance producer who is an exclusive agent of one insurer might have one contract. A producer who is an independent agent representing multiple insurers might have several contracts.

The application for insurance and the insurance policy itself also can limit the extent of the producer’s express authority. For example, a clear statement on the insurance application that the producer has no authority to bind coverage eliminates the producer’s express power to do so. A producer has no express or implied authority to act contrary to those limitations. Unless the producer has some other basis for the authority, such an action does not bind the insurer.

Actual authority can also be implied. Although express agreements create most insurance principal and agent relationships, the parties can agree to the relationship by less formal means. For example, an agent’s submission of an insurance application can create an agency relationship if the producer has solicited and forwarded insurance applications to the insurer previously, and if the insurer has accepted them. The agent has the implied authority to bind the insurer in this manner. The insurer must voluntarily accept the applications from the agent and then voluntarily issue policies. Merely forwarding applications for insurance under an automobile assigned risk or other residual



market automobile insurance plan does not create an implied authority for the agent. See the exhibit “Exercise: Determine Producer’s Authority.”

Exercise: Determine Producer’s Authority

Alice is an independent insurance agent who places her insurance customers’ business with a variety of insurers with whom she has agency contracts. Alice does not have a contract with CoverageCo, a large national insurer.

In a local professional meeting, Alice hears that CoverageCo is soliciting independent agents to send business to them. Alice sends business to CoverageCo on several occasions, and CoverageCo issues a policy and forwards its standard commission to Alice.

CoverageCo then forwards to Alice its application forms for use in soliciting more insurance applicants along with rating material and manuals describing CoverageCo’s products and procedures.

Does Alice have authority as a producer for CoverageCo?

Alice is CoverageCo’s agent by implication, not by express authority. The parties did not create an agency contract, nor did CoverageCo give Alice any direct expression of authority to act on its behalf. CoverageCo’s conduct in accepting applications submitted by Alice and forwarding to her applications and manuals, however, gives her implied authority in the agency relationship.

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Apparent Authority

Even without actual authority, an agent can have apparent authority. An insurer does not give apparent authority to the producer (nor does the producer create this authority), but appearances may lead a third party to believe that a producer has authority. Apparent authority usually arises in one of two overlapping circumstances:

- An insurer grants less actual authority to the producer than producers in the same position in that business usually have.
- The method of operation of the principal’s business differs from the method of operation of other businesses of the same kind in the principal’s area.

If a third party’s assumptions regarding an agent’s authority are unreasonable and do not have a factual basis, the insurer can legally deny the existence of the agency relationship. Likewise, the purported agent’s statements or actions are insufficient to create an agency by estoppel. The insurer’s acts alone create the apparent authority. For example, if an insurance agent created the appearance of an agency relationship with an insurer by stating falsely that he or she is its agent, by misappropriating its company logo, or by copying its applications without authorization, the insurer could deny the agency relationship because it did nothing to create this misunderstanding. However, if



Example: Producer's Apparent Authority

Beta Agency advertises that it is an agent for Jumbo Insurance Company. The other insurance agency in town, Alpha Agency, is also an agent for Jumbo. Alpha is a general agent for Jumbo with express authority to issue auto insurance policies for Jumbo. Beta is a special agent for Jumbo with authority only to submit applications for auto insurance policies.

After receiving a quote from Alpha for an auto insurance policy with Jumbo, Henry goes to Beta Agency to compare prices. Beta quotes Henry a price that is \$50 lower for a Jumbo auto policy. Henry pays the premium to Beta, and Beta tells Henry that the policy is in effect. There is no statement on Jumbo's application form regarding authority of the agent to bind coverage.

Jumbo's price for the policy is actually the amount that was quoted by Alpha. However, Beta had apparent authority to Henry to quote a price for the policy. Jumbo may need to issue Henry a policy, although Jumbo may seek to recover the additional \$50 from Beta.

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the insurer becomes aware of this situation and fails to act in a timely fashion to prevent the agent from improperly using its logo, an agency by estoppel can arise.

EXTENT OF PRODUCERS' AUTHORITY

A producer's authority is defined by whether the producer represents an insurer or an insurance customer and is limited to the authority conferred by the insurer or the customer.

Once an agency relationship is established between a producer and an insurer, the producer can act on the insurer's behalf. The producer's actions must be consistent with the authority granted within the agency relationship. An insurer, like any other principal, is liable for the acts performed or contracts made by one of its agents within the scope of that agent's actual or apparent authority.

Producers' Status as General Agents, Special Agents, or Brokers

The extent of a producer's authority varies depending on whether the producer is a general agent, special agent, or broker. The general agent has the broadest authority of all insurance agents and fully represents an insurer, meaning any action the producer takes according to the agreed-on authority binds the insurer. General agents can accept loss exposures, agree on and settle the terms of insurance, waive policy provisions, issue and renew policies, collect premiums, and adjust claims. Even if the contract does not confer the broad powers discussed, the producer may have those powers by apparent authority.



If a contract between producer and insurer expressly limits the producer's power to soliciting business, as is the case with many special agents, any action the agent takes beyond soliciting and forwarding prospective business to the insurer usually will not bind the insurer unless an insured can establish apparent authority. See the exhibit "Examples: Producer's Authority."

Examples: Producer's Authority

- Paul has an agency contract with InsurCo that calls him a general agent and that specifically grants him several powers, among them the power to renew policies. One of Paul's insurance customers' policies comes up for renewal. Without consulting InsurCo, Paul tells the customer that the policy is renewed and collects the renewal premium. Paul is acting pursuant to express authority, and his action binds InsurCo, whether or not InsurCo wanted to renew the policy.
- JoAnne has an agency contract with InsurCo that does not attach any description to the relationship created. The contract gives JoAnne several powers, among them the powers to bind the insurer to new business, to collect premiums, to issue policies, and to adjust small claims. JoAnne does not have the power to renew policies. Her office displays the company logo prominently in several places, and all of InsurCo's forms that JoAnne uses have her name on them and label her as InsurCo's agent. JoAnne places a substantial amount of insurance with InsurCo. One day, JoAnne decides to renew one of her best customers' insurance on her own, without consulting InsurCo, and collects the appropriate renewal premium. A covered loss occurs the next day. Despite JoAnne's lack of actual authority to renew the policy, she has bound InsurCo to cover the loss. JoAnne acted with apparent authority. Under these circumstances, JoAnne's customer reasonably believed that she had the authority to renew the policy on InsurCo's behalf. InsurCo has acted as though JoAnne is its general agent and is estopped from denying this relationship.

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The extent of producer authority for brokers is different from that for general and special agents. Brokers represent insureds. Thus, the broker's principal is the insurance customer, not the insurer. Accordingly, an insurance broker usually has no actual or apparent authority to bind the insurer. Instead, the broker typically has the power to bind the insurance customer.

A broker's typical duties include these:

- To procure insurance for the insurance customer-principal
- To select the insurer to provide the desired coverage
- To arrange for the payment of premiums
- To cancel and receive unearned premiums on a policy the broker has obtained
- To obtain a new policy upon cancellation of one previously obtained



A broker can be both an agent and an insured's representative in two instances. First, through apparent authority, the broker is legally the insurer's agent if the insurer allows the broker to act in a manner leading a reasonable third party to believe that the broker is the insurer's agent. Apparent authority does not arise merely by the insurer's furnishing a broker with application forms that the broker routinely submits to the insurer. However, a broker who has a particular insurer's application forms, receives premiums ostensibly on that insurer's behalf, and issues material identifying the customer as presently covered by that insurer can be the insurer's agent.

Second, some state statutes provide that, for some specific purposes, a broker is the insurer's agent. Once a policy is issued, the broker acting on the insured's behalf is the insurer's agent regarding premium payments, and the broker's receipt of the payments is effectively the insurer's receipt. The reasoning behind such statutes is that, once a policy is issued, the broker who facilitated the placement of the customer's business with the insurer is indistinguishable from an insurance agent in the eyes of many customers; therefore, the laws provide some extra protection to insurance customers.

Producers' Notice and Knowledge

In agency law, any knowledge possessed by an agent, general or special, is considered to be possessed by that agent's principal as well. In an insurance context, the authorized agent's knowledge is imputed to the insurer—whether the insurer actually receives the information from the agent is irrelevant.

Questions of imputed knowledge often arise when agents possess knowledge that would have caused the insurer to decline coverage, had the insurer been aware of the information. In these circumstances, a court will hold that the insurer knew what the agent knew, and the court typically finds that coverage exists. See the exhibit "Example: Imputed Knowledge."

Example: Imputed Knowledge

John, the insurer's authorized agent, assisted a customer, Mary, in arranging automobile insurance for a car owned by Mary's son. John told Mary that the insurer's policy provided the coverage. Later, a loss occurs. The insurer denies coverage based on policy language conferring coverage only for a named insured's vehicles, and not for the insured's son's vehicle. The insurer cannot deny coverage, because it is held to know what its agent knew at the time the policy was issued.

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Imputed knowledge also applies to a physical location to be insured. For example, a court may hold that a binder conferring coverage on an insured's business is effective over an insurer's objection that it would not have provided coverage if it had known the location of the insured. In such a case,



the insurer's authorized agent might have been aware of the location of the property to be insured and that the binder issued was broad enough to cover the location. The insurer's lack of actual knowledge would be irrelevant.

A court might not bind an insurer by a producer's knowledge in these circumstances:

- When no actual agency relationship exists between the producer and insurer
- When the agent has supplied false information

An agent's knowledge is not imputed to an insurer if no agency relationship exists between them. Therefore, a general agent's knowledge is imputed to the insurer, but under most circumstances, an insurance broker's knowledge is not imputed. The broker's agency relationship is with the insured, not the insurer.

Cases involving soliciting agents are less clear. Some courts hold that the limited nature of the soliciting agent's authority is such that the insurer is not chargeable with that agent's knowledge. Because the soliciting agent cannot bind coverage, these courts reason that the connection between principal and agent is too tenuous to bind the insurer by the producer's knowledge.

Other courts hold that a soliciting agent is a general agent under their state laws; therefore, the soliciting agent's knowledge can be imputed to the insurer. Still other courts impute some of the soliciting agent's knowledge to the insurer if it is consistent with that agent's more limited authority to obtain and forward insurance applications.

In cases that involve an agent being aware that information provided by an insured was false, many courts refuse to bind the insurer by that agent's knowledge. The agent's decision to act adversely to the insurer's interests breaks the agency relationship, which is the basis of the imputed knowledge rule. No hardship results to the insured as an innocent third party because the insured was involved in the dishonest behavior. If an agent is unaware that information provided by an insurance customer is false, no knowledge is imputed to the insurer. The insurer can avoid liability under the policy if it can prove fraud, misrepresentation, or some other defense. See the exhibit "Exercise to Determine Imputed Authority."

Producers' Authority to Bind Coverage

The need for immediate insurance coverage arises frequently. In many cases, people or organizations acquire property or assume duties with little or no advance notice. Before issuing a policy on a given loss exposure, however, insurers usually must undertake an underwriting process that can take several weeks or longer to complete. Because this delay leaves applicants unprotected, many insurers authorize producers to issue temporary oral or written policies pending acceptance of the application.



Exercise to Determine Imputed Authority

James visits Steve, a general insurance agent for InsurCo, to insure all his family cars through Steve's agency. James tells Steve that a member of his household has been convicted of driving while intoxicated. Steve knows this information would disqualify James from coverage with InsurCo. Eager to receive the commission from the sale, Steve falsely enters on the application that no driving offenses have occurred in James's household. James does not read the application before signing it, and InsurCo issues a policy to him. Later James has a loss, and InsurCo discovers the conviction during the claim investigation.

Will InsurCo be required to cover the loss?

InsurCo must cover the loss. The knowledge of its agent, Steve, is imputed to InsurCo. Steve, and thus InsurCo, knew of the conviction, but a policy was issued. Steve's knowledge stops InsurCo from denying coverage under the policy.

If James did not tell Steve about the driving while intoxicated conviction, is InsurCo required to cover the loss?

If neither Steve nor InsurCo had knowledge of the conviction and James falsified the insurance application, InsurCo can deny coverage for the loss based on fraud and misrepresentation.

If James and Steve colluded to conceal information about the conviction, is InsurCo required to cover the loss?

If James colluded in providing false information, InsurCo does not have a duty to provide coverage for the loss.

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In many cases, a producer can form an oral insurance contract with a customer. For example, an applicant can call an insurance producer from a car dealership, provide the details of the car to be purchased, and request immediate insurance on the car. By consenting to provide the coverage, the producer has created a valid insurance contract binding the insurer.

Courts generally have upheld the propriety of oral insurance contracts, although they are not valid in a few states. These contracts must contain sufficient agreement on essential terms, such as these:

- Subject matter of the insurance
- Loss exposures insured
- Premium
- Insurance contract duration
- Coverage amount
- Identity of parties

The contract need not mention these terms specifically, but the parties must agree to them, even if implicitly. In many situations a party can prove essential contractual elements by evidence showing an understanding, express or implied, that the insurer's customary policy terms are to apply.



Sometimes, a writing, such as a binder (binder receipt, or binding receipt), can provide a temporary insurance contract. A binder receipt contains a written temporary contract of insurance, sets out its essential terms and conditions, and proves the main elements of the temporary insurance contract. The contract remains in effect until cancellation occurs, the time period elapses, or the final insurance policy issues. The issuance of the insurance policy usually supersedes and replaces the temporary insurance contract.

These are the two most common legal issues regarding oral and temporary insurance contracts:

- A producer's lack of authority to form the contract
- A producer's failure to designate which insurer was to be bound by the oral or temporary contract

If the producer has actual authority, the oral or temporary insurance contract is valid and binding on the insurer. In those cases, the focus shifts to whether the producer had apparent authority. A third party could reasonably believe that a general agent had the power to bind coverage orally or in writing. If the producer is not a general agent and no apparent authority exists, the producer's oral or temporary contract would not bind the insurer.

If a producer representing multiple insurers contracts with a customer and then fails to designate the insurer providing coverage before a loss occurs, the legal issue is which, if any, insurer is liable for the loss. Courts look for reliable evidence that the producer intended to bind a particular insurer to the contract, as in these examples:

- The producer represents only one insurer that issues the coverage on the terms sought.
- In previous dealings, the producer has placed all the insured's business with one insurer.
- The producer issued a note or memorandum before the loss showing an intention to form the contract with a particular insurer. A mere mental note or a subsequent writing does not bind an insurer.

If the evidence does not reveal that the producer selected an insurer before the loss, the contract does not bind any insurer. The insured has no coverage but can sue the agent for errors and omissions and seek damages equivalent to the loss.

Appointment of Subagents

In many instances, insurance producers employ people to assist them in various aspects of their duties. These persons are subagents because they are the producer's agents. Insurance producers also may have clerical employees who assist in administration of their agencies, and they may retain the services of others who assist in the sales or marketing of their insurance products. The general rule is that an insurance producer cannot delegate duties that involve



the producer's individual care, skill, and judgment. See the exhibit "Example: Subagent's Apparent Authority."

Example: Subagent's Apparent Authority

Martha is an agent representing multiple insurers. Alice, Martha's office administrator, has varied job duties, including taking new applications for personal insurance and making changes to existing accounts at customers' requests. Paula insures her cars, home, and business through Martha's agency. Paula has changed her car and homeowners insurance by telephoning Alice. Paula visits the agency to add business interruption coverage to her commercial coverage. Alice tells Paula she can handle this addition, obtains the necessary information, and issues a thirty-day binder. In fact, Alice has no authority to issue the binder, and Martha would not have approved adding this coverage for Paula. A court would have to determine whether Alice's action has bound Martha's agency to provide Paula the additional coverage. Paula probably reasonably believed that Alice had the authority she purported to have. Alice assumed a large number of duties for Martha, and a customer probably would not distinguish between Alice's other duties and the issuance of a binder.

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The appointment of subagents is permissible because of these three exceptions to a general rule against delegation to subagents:

- Producers can appoint subagents to discharge their mechanical, clerical, and ministerial (nondiscretionary) duties, including tasks relating to the placement or renewal of insurance with the producer's principal insurance agency. These acts include soliciting insurance applications, countersigning insurance policies when discretion is not involved (if state law allows), delivering policies, and collecting premiums. An insurance producer retained to use skill and judgment can delegate any duties that do not involve this skill and judgment.
- A subagent can discharge even discretionary duties and those involving skill and judgment when those acts are ratified by the insurance producer. For example, a producer could authorize a subagent to bind coverage for an insurer or could ratify the subagent's act. As long as the producer accepts full responsibility for the subagent's actions, a court will view those actions as the producer's actions.
- Appointing subagents is authorized when discharging the producer's duties to the insurance principal would not be otherwise possible. To illustrate, a producer may need to appoint a subagent to conduct business in another state. If the insurer has authorized the producer to market its products in the state and state law allows such marketing only by residents of that state, the producer may appoint a resident subagent.

The doctrine of apparent authority also can apply to subagents. To the public, an insurance producer's subagents appear to have authorization to act for the insurer, even when they do not have such authority. In many such circum-



stances, these subagents' acts bind the insurer under the doctrine of apparent authority. One frequent example involves commitments by producers' office employees to extend coverage in various situations. Generally, the insurer is bound by these commitments even if the employee acted without actual authority.

TERMINATION OF PRODUCER AUTHORITY

As with other agency relationships, if one party no longer wants the relationship to continue, that party has the power to terminate the relationship. Thus, an insurer can revoke a producer's authority to act on the insurer's behalf even if a valid agency contract that would not support the termination exists between the parties.

Usually the circumstances for termination of a producer/insurer relationship are specified in a contract. For example, a contract might identify a period after which the relationship will terminate, or it might set out circumstances that warrant termination of the relationship, such as failure to meet production standards or producer misconduct.

The producer/insurer agency relationship is terminated by any act of one of the parties that the other party might reasonably construe to show the intent to terminate. Typically, termination occurs through a written or an oral communication, which severs the producer's actual authority to bind the insurance principal. The principal must take appropriate action to inform third parties that the relationship has terminated to avoid the potential for apparent authority. After notification to third parties, the producer cannot bind the insurer in any way regarding that party. If a third party who has dealt with the producer does not receive notification, however, the producer's acts, purportedly on the insurer's behalf, might bind that insurer.

The producer can bind the insurer regarding third parties whom he or she has not dealt previously if these parties had prior knowledge of the existence of the former agency relationship, but no notice of the termination. The safest way to avoid the possible adverse consequences of apparent authority is for the insurer to take these actions:

- Notify all third parties known to have dealt with the producer
- Repossess from the producer any evidence of the agency relationship, such as application forms and insurer stationery

Although termination by the parties' contract or expression is most common, the agency relationship can terminate by other means, including operation of law, the producer's death or insanity, or the insurer's insolvency. See the exhibit "Example: Agency Termination."



Example: Agency Termination

John is an independent insurance agent. One of the insurers with which John has an agency contract for ten years, MutualCo, decides to terminate its arrangement with him and instructs him to stop writing business. John still has MutualCo application forms, manuals, and rating information in his office and displays a MutualCo plaque on the wall. MutualCo remains listed in the local telephone directory as one of the insurers with which John is associated.

One month after John's agency termination with MutualCo, a new customer, Alex, consults with John about his personal insurance needs. John issues a thirty-day binder to Alex through MutualCo covering all of Alex's cars, then forwards Alex's application for a one-year car insurance policy to MutualCo.

John's actions in issuing the binder bind MutualCo to coverage for Alex. John's actual authority has ended, but the various indications that John is still a MutualCo agent (manuals, office plaque, application forms, telephone listing) have created apparent authority on John's part.

A second example assumes the same facts, except that at the time John's association with MutualCo terminates, MutualCo representatives repossess from John all application forms, rating materials, manuals, and other material displaying the MutualCo company logo. At the time Alex visits John, John possesses no indication that he ever represented MutualCo. John's only connection to MutualCo is his unsupported assertions that he represents the insurer.

Because John has never represented Alex as a MutualCo agent, John's attempt to bind coverage probably would not bind MutualCo. John, of course, has no actual authority because MutualCo expressly terminated it. John also probably has no apparent authority because he possesses nothing that would support a reasonable conclusion that he represents MutualCo. Unless other facts emerge that provide Alex with a reasonable basis to conclude that John represents MutualCo, John's issuance of the binder is not authorized and thus is not binding on MutualCo.

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PRODUCERS' DUTIES AND LIABILITIES

Insurance producers often act on behalf of persons who have little or no knowledge of insurance matters. Insurance purchasers expect their producers to assist them capably in obtaining appropriate insurance. Insurers also rely on producers, with expectations of certain standards of conduct, in various relationships and transactions. The law recognizes the reasonableness of these expectations and imposes various duties and responsibilities on insurance producers.

It is important for insurance professionals to understand the legal principles that govern producers' roles and responsibilities in four key areas:

- Producers' duties and liability to insurance customers
- Producers' defenses to liability



- Producers' duties and liability to third parties
- Producers' duties to insurers

Producers' Duties and Liability to Insurance Customers

Insurance producers have a duty to exercise reasonable care and skill in performing their duties, to deal with their customers in good faith, and to exercise reasonable diligence on their customers' behalf. They also have a duty to have reasonable knowledge about the insurance policies they sell, the policy terms, and the coverages available in the areas for which their customers seek insurance protection. Insurance producers also have a duty to follow their customers' instructions. Producers who accept requests to insure must not exceed their authority or depart from the customers' instructions. The standard of care imposed on producers generally reflects the public's expectations that the producers be competent, diligent, loyal, and professional.

The general standard of care governing insurance producers applies to a variety of specific factual situations. There are five duties that producers owe their customers:

- Duty to follow instructions
- Duty to procure insurance
- Duty to maintain coverage
- Duty to place insurance with a solvent insurer
- Duty to advise

There is liability associated with failing to perform each duty.

Producer's Duty to Follow Instructions

The duty to follow instructions is clear and fundamental to the insurance producer and customer relationship. A producer must strictly follow the customer's instructions and is liable to the customer for any damages that result from not doing so. Therefore, a producer who fails to add an available coverage requested by an insured is liable for a subsequent loss that the policy would have covered had the producer followed instructions. Additionally, a producer who fails to add newly acquired property to the list of the insured's covered properties at the insured's request would be liable for the financial consequences resulting from any uninsured loss involving the property.

The insurance customer, however, also has duties. The customer has the duty to provide clear instructions to the producer. If instructions are ambiguous, the producer is justified in acting in good faith on any reasonable interpretation of the instructions. See the exhibit "Example: Producer's Duty to Follow Instructions."



Producer's Duty to Procure Insurance

The duty to procure insurance is similar to the duty to follow instructions. Although the latter duty might involve nondiscretionary acts, the duty to procure insurance involves care, skill, effort, and diligence on the insurance producer's part.

The producer cannot guarantee to the customer that the insurance can be obtained, because coverage might not be available for the customer's loss exposures, or at the price or limits the customer wants. However, the producer must make a good faith effort to procure the desired insurance and promptly inform the customer if this is not possible.

Issues about this duty arise when the customer solicits an insurance producer's services to locate an insurer who will accept the customer's business on favorable terms. The producer has the duty to exercise reasonable skill, care, and diligence in assisting the customer in obtaining insurance. A producer who undertakes to procure insurance and through neglect or fault fails to do so is liable to the customer for any resultant damages. See the exhibit "Producer's Liability for Failure to Procure Insurance."

Producer's Duty to Maintain Coverage

Producers also owe customers the duty to maintain coverage. A producer's status as an insurance agent or broker does not, by itself, impose a duty to secure renewal of a customer's insurance or to advise the customer of an insurer's impending cancellation or nonrenewal. However, these duties can arise by agreement between the parties or by their past course of dealings.

A producer who simply arranged insurance on a customer's behalf has no duty to advise the customer of cancellation or nonrenewal. Usually, the insurer handles such notifications, and the producer can reasonably rely on this practice. If by agreement, however, the producer assumed the obligation to advise the customer of any impending lapse in coverage, the producer must discharge this obligation or be liable to the customer for loss resulting from cancellation or nonrenewal.

Additionally, a producer who has previously advised a customer of any coverage cancellation or nonrenewal might be liable for damages resulting from the failure to give notice at a later time. To succeed in such a suit, the customer must show that the producer assumed this duty and that a course of conduct sufficiently lengthy and consistent warranted the customer's reasonable reliance on the producer for notification. The producer's occasional reminder that a premium is due probably would be insufficient to prove the assumption of such a duty. See the exhibit "Example: Producer's Duty to Maintain Coverage."



Example: Producer's Duty to Follow Instructions**Example 1**

Paul is Jane's insurance producer for her personal and business insurance needs. Jane purchases two cars, a new Ford and an older Toyota. She instructs Paul to, effective immediately, place liability coverage and physical damage coverage on the Ford and only liability coverage on the Toyota, because of its age. Paul erroneously reverses the coverages on the cars and places only liability coverage on the Ford and liability and physical damage coverages on the Toyota. The Ford then sustains physical damage.

Has Paul breached the producer's duty to follow the insured's instructions?

Paul has breached the producer's duty to follow the insured's instructions. Jane's instructions were clear and not subject to reasonable disagreement or interpretation. Paul would likely be found liable for the physical damage to Jane's Ford.

Example 2

Alice is Joe's business insurance producer. Joe insures ten trucks through Alice's agency, all under separate business vehicle policies. Eight of the ten trucks are covered for liability and physical damage. The liability coverage limit is \$500,000 per vehicle, aggregate. The physical damage coverages have \$500 deductibles under each policy. The other two trucks in Joe's business are insured only for liability, with aggregate limits of \$300,000 on each vehicle.

Joe contacts Alice just before he purchases two additional trucks and asks to insure them. Joe then says, "Because these are new trucks, I'll need more than just the liability coverage. Go ahead and write them with the full coverage." Alice places the same coverages on the new vehicles as the coverage on Joe's eight trucks—\$500,000 aggregate liability limits and physical damage coverage with \$500 deductibles.

The next day, one of the new vehicles is involved in a serious accident resulting in substantial damage to the vehicle and serious injury to the driver of the other vehicle. When Joe learns of the coverage on his truck, he asserts that what he meant by "the full coverage" was the maximum liability limits written by his insurer on commercial vehicles, \$5 million aggregate, and the lowest physical damage deductible offered, \$100 per vehicle.

Did Alice breach the producer's duty to follow the insured's instructions?

Alice's interpretation of Joe's instruction regarding the new trucks, "to write them with the full coverage," was one of several reasonable interpretations of an insured's instruction that was not clear. It was a reasonable interpretation on her part that by "full coverage" Joe meant her to provide the same coverage for the new trucks as the liability and property damage coverage in effect for his eight trucks. Although it would have been prudent for Alice to ask Joe to clarify exactly what he meant by "full coverage," Joe had a duty as an insured to provide additional instructions if he wanted something different than the type of coverage he had for eight of his trucks. It is unlikely that Alice would be found liable in this situation for any damages that exceeded the coverage limits, although a jurisdiction that applies comparative negligence principles in professional liability situations may hold her partially responsible for such damages.

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Producer's Liability for Failure to Procure Insurance

To sue the producer, the customer must prove that the producer agreed or undertook to obtain insurance coverage:

- If, for example, the producer promised to contact only one insurer on the customer's behalf, did so, and then advised the customer of the insurer's decision, no ongoing agreement to procure insurance existed. The producer would have no liability in that case. On the other hand, a producer who assumes the obligation to procure insurance could be liable for not doing so.
- If, for example, a producer agreed to locate an insurer and then waited several months before making any contacts on the customer's behalf, eventually making only one unsuccessful contact and failing to report to the customer, that producer would be liable. In this set of circumstances, an insurance customer would reasonably believe that the producer placed the insurance business promptly.

The duty to procure insurance also includes the duty to procure the appropriate coverage:

- A producer who succeeds in arranging the coverage the customer requests but who fails to advise the customer of exclusions for certain persons, property, or causes of loss for which the customer requested coverage, is liable for a subsequent uninsured loss falling within the exclusions.
- For example, a broker who promises to locate snowmobile coverage for all persons using a snowmobile, but who procures coverage only for the named insured and his family, would be liable to the customer for not obtaining the requested coverage.

These questions are important in cases of alleged failure to procure insurance:

- Was there an agreement to procure insurance?
- Did the producer fail to discharge the duties under the agreement?
- Did the insurance customer reasonably believe that the producer would secure the requested coverage under the facts presented?

The customer who can answer these questions affirmatively can sue the producer for failure to procure insurance. The producer would be liable for any damages resulting from the failure to obtain coverage.

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Producer's Duty to Place Insurance With a Solvent Insurer

The insurer's solvency should be one of the most important criteria for placing insurance business. Both the producer and the customer should seriously consider factors bearing on solvency in reaching the decision about where to place the customer's business. The producer should make reasonable attempts to inquire into prospective insurers' solvency and to disclose to the customer any information revealing a weak financial condition.

The producer is not usually liable for any loss to the insurance customer resulting from an insurer's insolvency. The producer is not the guarantor of the insurer's financial condition or solvency. However, a producer might be liable for negligently placing business with an insurer when the producer



Example: Producer's Duty to Maintain Coverage**Example 1**

Dave purchases his personal insurance through Martha, an InsurCo agent. Dave has met Martha only once, three years ago, to arrange his insurance through her agency, and there is no written agreement between Dave and Martha. Dave has always made coverage changes over the telephone, usually through Martha's assistant. Dave's car insurance lapses when he forgets to make a premium payment billed by InsurCo. He suffers a loss and claims he should have coverage because Martha failed to remind him when the premium payment was due.

Did Martha breach a duty to maintain coverage for Dave?

Martha is unlikely to be found liable for breach of a duty to maintain coverage. There was no agreement between Martha and Dave. The prior dealings between Dave and Martha also do not support the allegation that she had a duty to maintain coverage for Dave. There were no previous reminders from Martha, or anyone in her office, to Dave regarding premium due, and nothing in Martha's conduct would reasonably have led Dave to rely on her to keep his coverage in force.

Example 2

John has been insured through Martha's agency for ten years. Martha has John's payment dates on her office calendar so she can have her assistant call John to remind him to pay his premiums. Martha has told John on several occasions, "I don't usually do this, but yours is a very good account and I understand that you travel frequently on business, so I'll make sure your coverage won't lapse." Three times in the last ten years Martha has actually paid John's premium for him when he was traveling to prevent a lapse in his coverage. John reimbursed Martha after he returned from his business travel.

Martha leaves for two months to assist with the opening of a new agency branch, and her assistant forgets to remind John about his premium payments. John is out of the country on business, and his coverage lapses. While he is driving home from the airport after returning from his travels, he is in an accident, and he finds he does not have coverage for his Mercedes.

Did Martha breach a duty to maintain coverage for John?

Martha would likely be found liable for breach of duty to maintain coverage in this situation. Martha's explicit statement to John and her conduct over the course of ten years indicate that she had an agreement with John to maintain his insurance coverage and that she owed him this duty.

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either knew or should have known of the insurer's insolvency. A reasonable effort, not a perfect one, to remain informed of the insurer's financial condition is required. The producer does not need to request a financial audit or examination of each insurer when contemplating placement of business. The producer can rely on public information, financial rating services, and any information available through a state department of insurance. At a minimum, a producer should disclose any information relevant to the solvency of



an insurer to the insurance customer and make an appropriate record of this disclosure.

A producer also should be careful in placing business with an insurer not legally admitted to do business in a state. All states have enacted excess and surplus lines (E&S) statutes that establish requirements for procuring policies from nonadmitted insurers. Examples of such requirements include these:

- Only licensed producers can sell E&S insurance.
- E&S insurers must comply with minimum capital/surplus requirements.
- Producers must place E&S insurance only with an E&S insurer approved by the state as a nonadmitted insurer.
- Producers must appropriately notify the insured of the nonadmitted insurer's status.

In some states, if an insurer does not meet the requirements of the surplus lines statute, the agent or broker might be liable to the insured for any unpaid claims if the unauthorized insurer becomes insolvent.

Producer's Duty to Advise

Producers have the duty to advise their customers. Customers generally do not regard insurance producers as mere order-takers but seek out producers who are professional and knowledgeable about the insurance products they market. Many insureds rely extensively on their insurance producers' professional advice in selecting personal and commercial insurance coverages.

Occasionally, an insured has either inadequate or no insurance coverage for an unanticipated event or an event the insured incorrectly believed was covered. In these situations, the insured might sue the producer, claiming that the absence of or shortfall in coverage resulted from the producer's failure to advise the customer correctly about insurance needs. Traditionally, courts have rejected claims based on a producer's failure to function as an expert adviser because the producer has no duty to advise, guide, or direct a customer after procuring the insurance for the customer. In most jurisdictions, status as an insurance producer alone does not require the producer to undertake the duty to counsel and to advise insurance customers about their loss exposures, available coverages, or the adequacy of insurance coverage limits.

Applied strictly, this rule appears inconsistent with the concept of producer professionalism and customers' expectations. Accordingly, many jurisdictions have qualified this general rule, imposing liability on insurance producers for failure to advise their customers adequately if the facts show a special or expanded relationship between the producer and the customer. This relationship exists when a producer purports to be an insurance specialist, consultant, or counselor and has advised a particular customer about the customer's insurance needs on a long-standing basis.



Such a relationship would be, for example, a long-term producer-customer relationship in which producer and customer have discussed issues of coverage and the customer has come to rely on the producer's expertise. Evidence of the producer's acceptance of compensation for services (apart from a commission received from an insurer) is not essential to establish the special or expanded relationship, but it supports the producer's duty to advise. A court might consider a number of factors in determining whether a special or expanded producer-customer relationship gives rise to an affirmative duty to advise the customer completely about insurance needs.

Several important conclusions derive from case law dealing with the producer's duty to advise the insurance customer:

- The greater the producer's involvement in the customer's insurance matters and other matters bearing on insurance, such as the customer's business, the greater the chance that the courts will find a special or expanded producer and customer relationship.
- The more the producer leaves the arena of insurance order-taker or application conduit and begins to act as insurance adviser or counselor, the greater the chance that a court will find a special or expanded relationship.
- The more a customer relies on the producer's expertise and knowledge, the more likely that a court will find a special or expanded relationship.
- The greater the complexity of the insurance coverage sought, and the greater the level of specialized producer knowledge required, the greater the chance that a court would find the duty to advise on the producer's part.

Many producers are expanding their roles and offering more services, such as full insurance reviews, to their customers. As they do so, they approach the line separating the standard producer and customer relationship from the special or expanded relationship. Accordingly, insurance producers face a greater risk of liability for breach of the duty to advise. Producers need to be aware that they must advise their customers carefully on insurance matters to make sure the information provided is complete and accurate. As with the discharge of other producer duties, producers should keep written documentation of their advice to all insurance customers. See the exhibit "Exercise: Producer's Duty to Advise."

Producers' Defenses to Liability

The producer may have a defense to an allegation of breach of a duty owed to the customer. The producer can avoid liability by showing that his or her conduct was reasonable and appropriate or that factors not within the producer's



Exercise: Producer's Duty to Advise

Example 1

Allen obtains his homeowners coverage through Maria, a producer recommended by a friend of his. He wants to save money on his insurance premiums. The homeowners policy Maria obtains for Allen excludes watercraft liability. Maria was aware through casual conversation at the time of Allen's visit to her agency that Allen did not own any watercraft at that time and they did not specifically discuss watercraft coverage in the homeowners policy.

Allen does not read the insurance policy when he receives it. He later purchases a watercraft. Because Allen knows that his friend's homeowners policy, obtained through Maria, covers watercraft, he assumes that his policy also provides this coverage. Allen meets with Maria again at the time of policy renewal, but he does not mention his purchase of the watercraft. She does not ask about watercraft, nor does the topic come up during their casual conversation on this occasion. Shortly after the policy renewal, Allen sustains a loss to his watercraft and then discovers that it is excluded from coverage in his policy.

Did Maria breach a duty to advise Allen about coverage for his watercraft?

Maria did not breach a duty to advise Allen about coverage for his watercraft. Allen did not request from Maria, nor did she provide, expert advice on loss exposures and coverage options. At the time Allen first met with Maria to obtain a homeowners policy, Maria had knowledge that Allen did not own any watercraft and also that he wanted to save money on his insurance premiums. Allen did not advise Maria at the time of purchase or at the time of policy renewal that he had acquired a watercraft. Maria did not owe Allen a duty to inquire about additional loss exposures.

Example 2

A maritime construction company has a long association with a producer, a large commercial insurance brokerage that has expertise in maritime insurance. The company consults with the brokerage about buying a specific type of maritime insurance policy. The broker gathers extensive information about the customer's business to find the appropriate coverage. The customer leaves policy details to the broker to negotiate with the insurer.

The broker negotiates a maritime construction insurance contract that omits key language that would have provided the customer with coverage for "stand-down time," which includes costs for mobilized workers and equipment that must remain idle when a loss occurs. The insured sustains a covered loss but receives no compensation for "stand-down time."

Did the broker breach the duty to advise this customer?

The broker did breach the duty to advise the maritime construction company. Because of their special relationship and the broker's expertise, the broker owed the customer the duty to advise. The brokerage is not merely an order-taker and order-placer because of these criteria:

- Specialized line of insurance requiring unique knowledge
- Producer's specific knowledge about the customer's business and insurance needs
- Customer's clear reliance on the producer's expertise in a highly specialized field



- Customer's ceding of responsibility to the producer to negotiate an insurance contract
- Long-standing relationship between the customer and producer

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responsibility caused the damage to the customer. These are the five defenses available to the producer:

- The producer assumed no duty to the customer.
- The producer did not breach a duty to the customer.
- The insurance customer was partly at fault.
- The insurance customer failed to read the policy.
- Insurance was not available to the customer.

Producer Assumed No Duty to Customer

An insurance customer cannot force a producer to act on the customer's behalf. An agreement forms the basis of the producer-customer relationship, and the producer generally owes only duties that have been expressly or implicitly assumed. Therefore, a producer who has not agreed to obtain insurance for the client is not liable for breach of any duty to the client. When a customer alleges breach of the duty to maintain coverage, the producer who said or implied that the customer's insurance would be kept in force may have a valid defense if there was no agreement regarding the producer's responsibility. In cases alleging a breach of the duty to advise, the producer can defend the allegations on the basis that no special or expanded relationship ever existed between the producer and the customer and, therefore, the producer did not expressly or implicitly assume an obligation to advise the customer on insurance coverage matters.

Frequently, the outcome of cases against producers turns on what, if anything, the producer promised to do for the insurance customer. Any conversations between the parties and any supporting documents are important in establishing this defense. It is necessary for producers to retain good written documentation of transactions with their insurance customers.

Producer Did Not Breach Duty to Customer

If a customer can show that a producer agreed to do something, the next question is whether the producer carried out the agreement. If so, the producer has discharged the duty to the customer, has not breached the assumed duty, and is not liable to the customer.

The producer who has followed clear instructions fully and completely or followed ambiguous instructions according to a reasonable interpretation of



their meaning is not liable to the insurance customer. When allegations of failure to procure insurance arise, the producer has a valid defense if he or she acted reasonably and promptly on the customer's behalf and kept the customer informed about the progress toward obtaining the requested insurance coverage.

In a claim for failure to advise the insurance customer appropriately, the producer's defense would be to show that the advice provided was reasonable and appropriate, even if not perfect. The producer need not anticipate all possible contingencies or give perfect advice on insurance matters. Producers comply with the duty to advise their customers when they provide the advice that a reasonable producer would give under the circumstances.

Insurance Customer Was Partly at Fault

Although insurance customers can generally rely on the producer's knowledge, care, and skill, they must also act reasonably regarding the insurance transaction. If the injury or loss to the customer occurred through the customer's fault in whole or in part, the producer can offer this conduct in defense to the customer's claim.

Depending on the degree of the customer's fault, a court might reduce the claim against the producer either wholly or proportionately. For example, in a claim for an alleged breach of duty to procure insurance, the producer might offer the defense that the customer failed to cooperate in furnishing information that prospective insurers required.

In a claim for failure to advise an insurance customer appropriately, the producer might show that the customer did not present all of the facts necessary to allow the producer to give full and appropriate advice. For example, if a customer omitted essential details concerning a business operation in applying for broad, multi-peril coverage, the producer might not have had sufficient information to assess the various risks the exposure presented. If an uninsured loss occurs later and the customer sues, the producer can defend the lawsuit by showing that the customer's failure to provide essential information resulted in the lack of coverage.

In a claim for breach of duty to follow instructions, the insurance customer could be at fault because of vague, misleading, or erroneous instructions. A customer's inadequate instructions can defeat a claim or can result in reduced damages in proportion to the customer's own fault.

Insurance Customer Failed to Read Policy

Historically, a producer could defend a lawsuit successfully because an insured failed to read the policy. The insured's behavior was measured against what a reasonable insured would do, and courts considered the insured's reasonable conduct to be, at minimum, to read the insurance policy and verify the coverages requested. The rule was that an insurance customer's claim



against a producer would fail if an examination of the insurance policy would have revealed the absence of coverage or a term or condition that defeated coverage.

The strict application of this rule has eroded. Some states do not recognize the rule at all, reasoning that the insurance customer has the right to rely on the producer's expertise in insurance matters. These courts also recognize that many insureds do not read their insurance policies and that policy language is often difficult for customers to understand. In these states, the producer cannot use the defense that the customer could have discovered the lack of coverage by examining the policy and then could have taken steps to secure coverage.

Courts that recognize the traditional rule have developed exceptions. A producer who has intentionally misrepresented policy provisions or coverage cannot use the defense because the producer's fault is greater than the simple negligent conduct of the insurance customer. Additionally, some courts, either implicitly or explicitly, recognize this defense only when an examination of the policy reveals that exclusions, limitations, or conditions are clear without extensive analysis or interpretation. This line of reasoning requires only a reasonable examination of the policy, not an expert examination.

Insurance Was Not Available to the Customer

In most states, if a producer wrongfully fails to obtain insurance that actually is unavailable, the defense of "insurance not available" has been successful. The underlying concept is causation: if the producer cannot obtain insurance, the producer's alleged failure to act appropriately is not the true cause of the loss.

That the insurance was difficult to locate or would have required a great deal of effort to obtain is not a defense. That the insurance desired was more expensive than anticipated or was otherwise available on less favorable terms would also not likely constitute an adequate defense of unavailability. In these circumstances, the producer must locate the insurance and advise the customer of its terms and price. Unavailability would be a defense, however, if the customer clearly specified that certain terms or a price limit were necessary in the desired policy, and no insurance was available within these limits.

Some jurisdictions have declined to recognize the defense of unavailability of insurance. They reason that the producer still has a duty to act appropriately and diligently on a customer's behalf and must advise the customer promptly that coverage is not available. The customer then can assess options and plan to manage loss exposures through other means.



Producers' Duties and Liabilities to Third Parties

Under general contract law principles, the parties to an agreement owe duties and obligations to each other, but not to third parties who might come in contact with either of them.

The principal and agent relationship is based on consent, whether express or implied. The producer-insurance customer relationship is one of principal and agent. Accordingly, third parties generally acquire no rights under this relationship. The breach of any duty a producer owes to a customer does not create any rights in third parties. A third party who intends to sue an insurance customer (typically in tort) cannot sue a producer who wrongfully failed to assist the customer in obtaining insurance coverage for the event that is the subject of the suit. See the exhibit "Example: Third-Party Suit Against Producer."

Example: Third-Party Suit Against Producer

Joe, owner of a moving company, obtains his business and personal insurance through Insurance Agency. Recently, he met with Darla, an Insurance Agency broker, to review his business insurance. Joe advised Darla that he will soon acquire two new trucks, and as of July 30 of this year he will need full liability coverage on these trucks. Additionally, Joe said that he needs coverage for any damage to his customers' property while in the custody of his company, regardless of whether any member of his company is at fault. Darla said that she will obtain this coverage.

Darla does not obtain the liability coverage that Joe requested. Later, one of Joe's new trucks is involved in a serious accident, destroying the household property of his customer, Pete. Pete had no insurance for this property. He relied on Joe's insurance during the move.

As the insurance customer, Joe would have an action against Darla for failure to follow instructions and for failure to procure insurance. However, any lawsuit Pete files against Darla probably would not be successful. Pete was not a party to Joe's and Darla's producer-customer relationship and therefore acquired no rights under their contract.

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Many courts have held that the producer owes a duty to act competently and appropriately only to the producer's principal and not to any third party. That a third party could have collected from the customer had the producer discharged all duties appropriately and arranged for insurance coverage, but now cannot collect, usually does not give the third party any rights against the producer.

Some courts, however, have recognized a third-party right to sue an insurance customer's producer under certain circumstances. Generally, these cases concern automobile or workers compensation insurance and are based on the contractual principle of third-party beneficiary rights. In some cases, the importance of drivers' liability insurance as a source of compensation for other



drivers has resulted in conferring third-party beneficiary status on any driver who suffers loss from another driver's conduct. In other cases, injured drivers can sue negligent drivers' insurance producers if the negligent driver lacked liability insurance because of the producer's breach of a duty.

In workers compensation or employer's liability cases, some courts have allowed third parties, such as injured workers or their families, to sue the producers who provided the employer's insurance for failure to discharge a duty regarding insurance coverage. Courts have recognized this third-party right to sue because of the importance of injured workers receiving compensation and because workers are the intended beneficiaries of workers compensation or employer's liability insurance.

Producers' Duties and Liability to Insurer

In addition to the duties owed to the insurance customer, producers authorized to act on behalf of insurer principals must abide by a certain standard of conduct toward them. In many insurance transactions, a producer must represent both the insurer and the customer. Producers must, therefore, deal with insurers with care, skill, diligence, and loyalty. Breaches of duty to the insurer may make the producer liable for any resulting consequences.

The producer has four duties to the insurer:

- Duty to disclose risks
- Duty to follow instructions
- Duties of loyalty and accounting
- Duty to transmit information properly

Duty to Disclose Risks

The producer's first duty to the insurer is the duty to disclose risks. In most cases, producers are the "eyes and ears" of the insurers they represent. They have the first contact with prospective insureds and at times know them personally. Frequently, the producer is directly involved in the underwriting process and might, in some cases, be responsible for obtaining all of the information upon which the underwriting decisions are based.

Accordingly, producers owe a duty to their insurer principals to fully disclose any information material to the underwriting decision. Material information is that which would affect the decision about whether to issue an insurance policy covering the risk or that would affect the coverage, terms, or premium.

An insurance producer who fails to fully disclose all matters concerning the risks and hazards of a prospective insured is liable to the insurer for damages resulting from the lack of full disclosure. If the insurer establishes that it would not have issued the policy had it received the appropriate information, the producer is liable to the insurer for the amount of the loss the insurer must pay to the insured. For example, having noticed conditions on premises to be



insured that place the property below the insurer's underwriting standards, the producer must advise the insurer of this or bear the consequences of any loss that the insurer would not have covered had it known the facts. Similarly, a binder would not be appropriate if the producer knew that a building was below the applicable underwriting standards. The producer owes a continuing duty to protect the insurer and cannot let coverage take effect if it is based on false or inaccurate information.

If the insurer would have issued the policy but with a higher premium, the producer would be liable to the insurer for the difference in the premium. The producer is not strictly responsible for information not known. For example, producers in some lines of insurance assist in obtaining completed applications and do not become further involved in the underwriting process. These producers must truthfully and accurately note the information they receive from the insurance customer.

However, absent specific agreements with their insurer principals, producers need not investigate the accuracy of the information they receive. If, by agreement, the producer assumes certain duties in the underwriting process, such as inspection of premises or examination of books and records, the producer must discharge these duties and must disclose any information material to the underwriting decision. The failure to disclose immaterial information probably would not subject the insurance producer to liability.

Duty to Follow Instructions

The producer owes the insurer the duty to follow instructions, which essentially mirrors the duty to follow the insurance customer's instructions. Producers must follow insurers' general statements of authority or specific directions. A producer who exceeds the authority given or who fails to comply with specific directions is liable to the insurer for resulting damages. For example, a producer who fails to disclose factors that could preclude underwriting a policy could be liable to the insurer for losses resulting from the nondisclosed information. See the exhibit "Example: Producer's Liability to Insurer."

Cases involving breach of the duty to follow instructions arise in two areas. The first is in the improper use of binding authority. By agreement between the parties, insurers frequently grant producers the authority to bind coverage on the insurer's behalf, typically under a detailed statement outlining the circumstances under which the insurer can be bound. The doctrine of apparent authority can sometimes result in a producer binding an insurer to cover certain risks beyond those authorized. If a producer binds coverage contrary to explicit insurer instructions, the insurer must provide coverage but can sue the producer for the amount of the loss.

A second common situation involving breach of duty to follow instructions relates to an insurer's specific instructions to cancel, reduce, or otherwise limit coverage. A producer who has been instructed to cancel a certain policy and fails to do so is liable for the full amount of a loss that the insurer must cover.



Example: Producer's Liability to Insurer

Martha is an insurance agent associated with InsurCo. Formerly, InsurCo gave Martha express binding authority regarding certain specified types of small commercial exposures. InsurCo has provided Martha with appropriate binder and application forms, as well as rating manuals and policy forms. For the last five years, she has issued binders for these types of exposures.

Recently, InsurCo underwriters have noted increasing losses in Martha's commercial book of business. InsurCo's underwriting manager decides that a full review of Martha's accounts is necessary and withdraws Martha's binding authority for commercial business pending the outcome of the review.

After Martha receives notice of the withdrawal of her authority from InsurCo, she meets with Paul to discuss insurance for his small business. This exposure falls within the category of those for which Martha could formerly bind coverage. Martha believes that InsurCo would accept this risk. Despite the absence of actual authority, she binds coverage for Paul. Three days later, during the binder term, Paul sustains a loss.

Would InsurCo be required to cover this loss?

InsurCo must cover the loss. Although Martha did not have actual authority to issue the binder, she had apparent authority to do so.

Would Martha be liable to InsurCo for the cost of Paul's loss?

Martha would be liable to InsurCo for breach of the express direction not to bind any commercial insurance coverage.

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A producer who has failed to limit coverage as instructed is responsible for the difference between the coverage the insurer had to provide and the amount it would have paid had the producer followed its instructions.

A producer may have a defense against a lawsuit for failure to follow instructions if not given reasonable time to comply with the instructions, or if insurers' instructions were not clear. If the instructions were not clear, a producer who has acted according to a reasonable interpretation of the instructions would not be liable.

Duties of Loyalty and Accounting

The producer also owes the insurer loyalty and accounting. In many cases, insureds forward their premium checks to their insurance producer rather than directly to the insurer.

Under the law, payment to a producer, with actual or apparent authority, constitutes payment to the insurer. For example, an insured who brings a premium check for the amount due to the producer's office one hour before coverage is to lapse is covered for a subsequent loss, whether or not the premium check ever reaches the insurer.



The producer must receive and process premium payments on the insurer's behalf and transmit them to the insurer promptly. The producer also must keep accurate records of premiums received and verify receipt of correct compensation for coverage in force. A producer who causes any loss to an insurer because of failure to account appropriately is liable to the insurer for the financial consequences of the loss.

Duty to Transmit Information Properly

The producer has the duty to transmit information properly to the insurer. As discussed previously, producers must provide insurers with material information. One type of material information is a report of the facts surrounding a loss involving an insured. When an insurance agent receives notice of a covered loss, typically in a report completed by the insured, it must be forwarded promptly to the insurer. A producer is liable to the insurer only if failure to forward such records results in adverse consequences or harm to the insurer. For example, a producer receives a report of an insured's loss shortly after it occurs but waits six months before advising the insurer of the loss. If the six months' delay has not prejudiced the insurer's ability to investigate and resolve any claims resulting from the loss, the insurer has no cause of action against the producer.

In some instances, the producer's failure to transmit important information promptly does cause loss to the insurer. For example, an insured who is being sued sends notice of the suit to the insurance producer for forwarding to the claims department of the insurer. Typically, an insured's answer to a complaint is due at the court within a specified period. If the insurer fails to appear in court or to answer a pleading on behalf of the insured, the result is a default judgment against the insured. That is, the insured automatically loses the lawsuit, and the insurer is liable to the insured for the consequences of this judgment. In this case, the insurer can sue the producer for failure to transmit notice of a lawsuit promptly.

The producer is liable to the insurer for any money the insurer had to pay in resolving the liability claim over the amount it would have had to pay had it received prompt notification of the loss. The producer might be liable for the entire loss if the insurer had a valid defense to the insured's liability that was not asserted because of lack of notice.

SUMMARY

Insurance producers place business with insurers. Producers include agents, who typically represent insurers, and brokers, who typically represent insureds. Agents can be general, special, or soliciting agents. Brokers may provide consulting services in addition to assisting clients in obtaining insurance coverage.



Producers may have actual authority, express or implied, that an insurer intentionally confers or allows the producer to believe has been conferred. Producers may also have apparent authority when there is the appearance to a third party that an insurer has granted authority to a producer.

The extent of a producer's authority depends on four major factors. The first factor is the producer's status. General agents have the broadest authority of all insurance agents. Special and soliciting agents have more limited authority. Brokers represent insureds and usually have neither actual nor apparent authority to bind insurers. The second factor is the producer's knowledge and notice. The third factor is the producer's authority to bind coverage. The fourth factor concerns the producer's appointment of subagent.

Usually the contract specifies the circumstances for termination of the producer/insurer relationship. The agency relationship can also terminate by express communication from one of the parties or, occasionally, by other means. It is important for insurers to take steps to avoid a producer operating with apparent authority after the termination of an agency relationship.

Insurance producers have duties to their customers; to insurers; and, in certain circumstances, to third parties. Breach of these duties can result in liability. However, the law, in addition to requiring producers to meet certain requirements and standards, also provides defenses to producers against allegations of breach of duty.

