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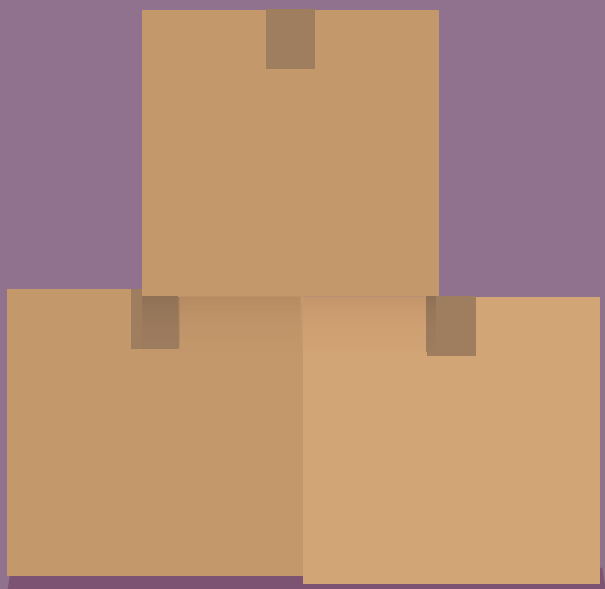

Also in This Issue . . .

The State of the Buyer Broker Commission Rule a Year Later

Insurance Producer Exposure When Procuring Cover for Sophisticated Clients

By Ashley Parrish

For complex placements, the customer may have insurance expertise comparable to that of the producer.

Generally speaking, insurance producers face fairly routine obligations when procuring cover. Every state imposes a general duty to exercise that degree of care, skill and diligence a reasonable producer would exhibit to his client under the same or similar circumstances. If a producer is unable to obtain the cover requested, he is generally required to advise his customer of this fact in a timely fashion. Most states do not require a producer to provide general advice regarding a customer's needs, absent the existence of a special relationship. In the vast majority of circumstances, the producer is far more knowledgeable about insurance matters than his client. However, for complex placements, the customer may have insurance expertise comparable to that of the producer.

Consider a reinsurance placement. The producer's client is actually an insurance carrier looking to cede risk. Under these circumstances, is the producer's duty relaxed given the expertise of his client? After all, an insurer obtaining reinsurance should be familiar with the insurance terminology and have some idea of how potential claims will be handled. Obviously, the producer would still be obligated to be truthful, and if he was unable to obtain the requested cover, he must promptly advise his client. But absent the rudimentary duty obligations, would the producer be able to act as a mere order taker, given the sophisticated nature of his client? Interestingly, many courts who have addressed producer negligence claims in this context haven't given the producer an automatic pass just because his client is sophisticated or knowledgeable on insurance matters.

One example is National American Ins. Co. v. Hannover Ruckversicherungs-Aktiengesellschaft, 2005 WL 2035042, a decision from the United States District Court for Western District of Oklahoma. In NAICO, the plaintiff underwriter sought reinsurance for its property and casualty business through Benfield, Inc., a leading international reinsurance broker. Benfield was tasked with replacing a 20% reduction in reinsurance which had been in place with NAICO's existing reinsurer, Employers Reinsurance Corporation (ERC). In addition to finding another reinsurer, Benfield told NAICO that it would perform an analysis of the ERC reinsurance contracts to determine whether any provisions were problematic or could be improved. The ERC reinsurance contracts defined net premium income as "written premiums, less unearned premiums returned, entered on the books and records of the REINSURED from policies becoming effective on the effective date and prior to the termination date of this Agreement. Reinsurance premium shall be deemed earned when reported to the CORPORATION." Benfield approached Hannover and obtained a slip which contained the following clause: "Net earned premium as used herein is defined as the Company's gross earned premium for the classes of business subject to this Contract, less only the earned portion of premiums, if any ceded by the Company for reinsurance which inures to the benefit of this Contract". The slip was provided to NAICO; however, a policy was ultimately bound which did not include the slip definition of net earned premium.

Benfield asserted that NAICO had rejected the slip definition and directed Benfield to use the language contained in the ERC reinsurance contracts. NAICO asserted that it did not direct Benfield to

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The fact that an insured is sophisticated does not mean that the insured cannot hire experts to assist it with particular matters.

use the ERC language but instead sought Benfield's advice, counsel, and services concerning that issue. Specifically, NAICO's president testified that he told Benfield's representative that it was "probably okay" to use the ERC reinsurance contracts unless Benfield saw a reason that NAICO should not do it. In any event, Benfield informed Hannover of the major differences between the language used in the proposed slips and the bound policy. Benfield specifically informed Hannover that the premium base has been revised to written premium and the definition of net premium income treated written premium as earned when ceded to the reinsurer.

NAICO sought to terminate the Hannover contracts on a cut-off basis one year later and requested Benfield to ask Hannover to waive the minimum premium provisions in the contracts and to return the unearned portions of the reinsurance premium that it had paid. Hannover refused and informed NAICO, through Benfield, that there was no unearned premium to return because the reinsurance contracts stated that "[r]einsurance premium shall be deemed earned when reported to the Reinsurer." NAICO disagreed with Hannover's interpretation of the contracts and again requested Hannover to return the unearned portions of the reinsurance premium that it had paid. Hannover refused and NAICO filed suit, claiming in part that Benfield had been negligent in drafting the reinsurance contracts and in failing to advise it of the effect of the clauses dealing with net premium income. Benfield moved for summary judgment asserting that that it had no duty to advise NAICO of things of which NAICO should already have been aware. Specifically, Benfield asserted that it did not have a duty to advise NAICO regarding the net premium provision at issue because the provision is unambiguous, the reinsurance contracts were provided to NAICO, and NAICO approved and signed those contracts. Benfield also asserted that it did not have a duty to provide legal advice regarding the effect of the provision at issue.

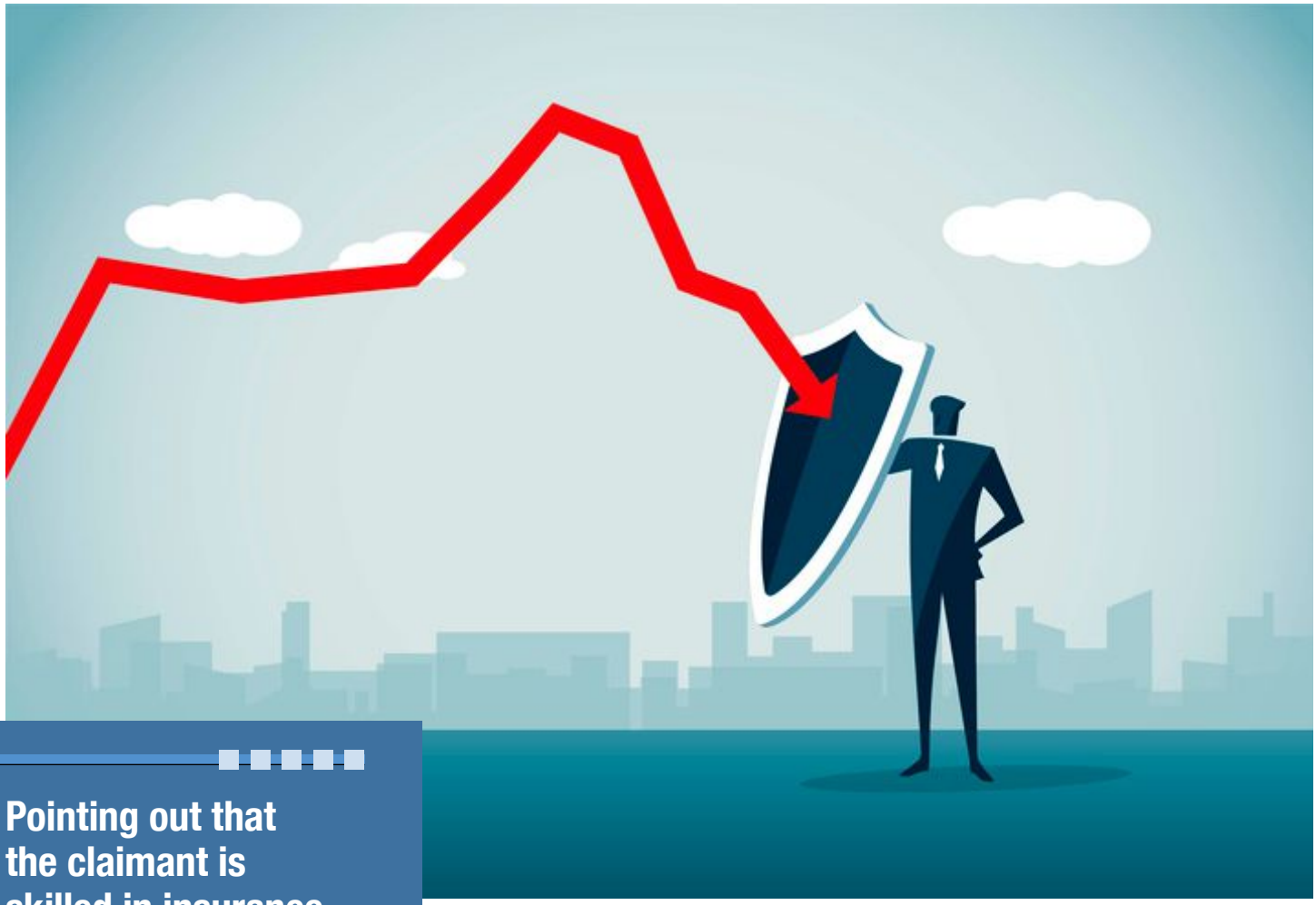
The Court agreed that Benfield had no duty, as a non-lawyer, to provide legal advice and granted summary judgment as to certain claims on that basis. National American Ins. Co., 2005 WL 2035042 at p. 4. However, the court denied Benfield's motion on the negligence counts, finding that a fact issue existed as to whether Benfield was acting as an expert in procuring the reinsurance and whether NAICO had relied on Benfield's expertise. Id. Benfield emphasized the fact that NAICO was itself an insurance company and has acquired reinsurance directly from reinsurers. However, the court noted, "the fact that an insured is sophisticated does not mean that the insured cannot hire experts to assist it with particular matters." *Id. at p. 5, footnote 7, citing Westchester Specialty Ins. Servs., Inc. v U.S. Fire Ins. Co., 119 F. 3rd 1505, 1509 (11th Cir. 1997).*

Another example is provided by the decision in *Holborn Corp. v. Sawgrass Mutual Ins. Co, 304 F.Supp.3d 392 (S.D.N.Y. 2018).* Holborn was a reinsurance intermediary who marketed its services to clients across the US. Sawgrass was a mutual insurance corporation who retained Holborn to place reinsurance cover for its homeowners policies. According to Sawgrass, Holborn represented that it would need to carefully analyze" Sawgrass's potential risk exposure under its homeowners policies, as well as design a specific reinsurance program custom tailored to Sawgrass' unique business needs. Additionally, Holborn allegedly made specific representations regarding its expertise which included the following:

1. It possessed advanced analytic tools, global market access, and responsive account services to clients across the country;
2. It was committed to understanding each clients' needs, corporate culture, risk tolerance and overall business approach;
3. It promised to maintain a relentless commitment to giving clients what they truly need, with no two client solutions exactly the same;
4. It would keep [its] finger on the pulse of both the traditional market and alternative market, when exploring risk solutions, to ensure [its] clients have the most efficient, innovative and secure reinsurance program available.

Holborn and Sawgrass entered into a broker agreement whereby Holborn was designated as Sawgrass's reinsurance intermediary for a period of 3 years. Holborn then recommended a specific reinsurance program which Sawgrass purchased. At some point later, Sawgrass unilaterally terminated the agreement because Holborn had failed to recommend the procurement of "Top and Drop" coverage, a multi-layer insurance product which allows the insured to reuse the top excess-of-loss layer of reinsurance if it is not breached by the first loss event. Holborn sued for breach of contract and Sawgrass filed a counterclaim asserting that Holborn had been negligent by failing to recommend "Top and Drop" cover. The Court, in analyzing Holborn's motion to dismiss under FRCP 12(b)(6), noted that a determination of whether a "special relationship" existed between the parties would have to be made. Holborn Corp., 304 F.Supp.3d at 403. The Court referenced that the New York Court of Appeals had held that where a special relationship develops between the broker and client, the broker may be liable ... for failing to advise or direct the client to obtain additional coverage. See *Voss v. Neth. Ins.Co., 22 N.Y.3d 728, 985 N.Y.S.2d 448, 8 N.E.3d 823, 828 (2014).* Under New York law, A special relationship may be established in one of three ways:

(1) the agent receives compensation for consultation apart from payment of the premiums;
(2) there was some interaction regarding a question of coverage, with the insured relying on the expertise of the agent; or
(3) there is a course of dealing over an extended period of time which would have put objectively reasonable



Pointing out that the claimant is skilled in insurance matters should allow the assertion of a comparative fault or contributory negligence defense.

insurance agents on notice that their advice was being sought and specially relied on. *Murphy v Kuhn, 90 N.Y.2d 266, 682 N.E.2d 972, 975–76 (1997).*

Sawgrass alleged that a special relationship existed between itself and Holborn based on the second method identified in Murphy, i.e., an interaction regarding a question of coverage. However, because there were no allegations that the parties ever specifically discussed the topic of "Top and Drop" coverage, the court declined to find the existence of a special relationship. Sawgrass merely alleges that it required Holborn "to carefully analyze Sawgrass' potential exposure ... [and] design a specific reinsurance program custom tailored to Sawgrass' unique business needs. Holborn, 304 F.Supp.3d at 404. The Court further noted that all insurance customers are seeking the most advantageous insurance policy, and as a result, a discussion generally about what policy will be the most advantageous does not suggest "that the Plaintiff enjoyed anything other than an ordinary consumer-agent insurance relationship." *Long Beach Road Holdings, LLC v. Foremost Ins. Co., 75 F.Supp.3d 575, 590 (E.D.N.Y. 2015*).

Perhaps the special relationship test makes it easier for producers to argue that the expertise of the sophisticated client precludes liability for failing to advise on coverage procurement in certain jurisdictions. However, the result in Holborn would have been different if Sawgrass had specifically asked about "Top and Drop" cover. Sawgrass's failure to address the subject was fatal. Accordingly, the principle that experts are entitled to rely on the advice of other experts seems to be applicable.

Finally, a case from England illustrates an attempt to push the producer's scope of liability to an absurd level. While this case may not have precedential value for most of us in the US, it does represent the outer limits of what insurance experts may try to argue in shifting liability to producers. In the matter of ABN AMRO Bank v. Underwriters and Edge Brokers (London) [2021] EWHC 442 (Comm), the Court addressed two different, distinct and novel questions which may arise when an unusual term is included in an insurance policy, namely:

(1) does the broker owe Underwriters a duty to explain (to Underwriters) the unusual term and/or

(2) does the broker owe the insured a duty to explain (to Underwriters) an unusual term? Edge Brokers on behalf of ABN placed a fairly routine marine risk with various underwriters. However, the

policy contained an unusual transaction premium clause which covered losses associated with defaults by ABN's customers irrespective of physical losses or damage to the items insured.

ABN provided structured commodities' finance to clients who were in the business of buying and selling cocoa products. These "repo" transactions involved ABN providing working capital by purchasing the client's cocoa products for a defined period of time, after which the client was contractually obliged to buy them back. Two of ABN's clients collapsed financially and were unable to comply with their contractual obligations. ABN accordingly submitted claims under the policy based on the transaction premium clause. Following a denial of coverage, litigation ensued amongst the parties.

The Underwriters defended the claim, in part, by arguing that Edge Brokers owed them a duty to disclose and explain the meaning of the transaction premium clause upon placement. The Court rejected this argument on the basis that Underwriters either knew or should have known about the existence of the clause. The clause was not ambiguous or inartfully drafted. If the Underwriters had taken the time to consider the clause (which apparently, they did not), they could have raised questions, declined the inclusion of the clause in the policy or taken other measures to protect themselves. However, with respect to ABN's claim that Edge Brokers owed it a duty to explain to the Underwriters the existence of the clause, the court reached a different conclusion. The Judge held that, based on the facts of the case, the fulfilment of the relevant duty owed by Edge Brokers to its client (i.e. to arrange cover which clearly and indisputably met the client's requirements, and did not expose the client to an unnecessary risk of litigation) did require Edge Brokers to discuss with the Underwriters the nature of the cover which was being sought in the clause (i.e. that it was credit risk cover). This was necessary in order to avoid the potential for future disputes in circumstances where the new cover sought was of considerable importance to the client; the cover had no precedent in the marine cargo market; there did exist an established and different market in which such risks would usually be placed; the Underwriters were being asked to write a risk which would materially increase the potential for losses; and where the relevant clause was long and tightly drafted and its full import would not necessarily be grasped by an underwriter on a first reading.

Given that a producer cannot simply defeat a breach of duty claim by asserting that his client was skilled in insurance matters, what are some key takeaways when advising producers who have sophisticated clients? First, from a risk management standpoint, every producer should be familiar with the concept that experts can rely on the opinions of other experts. In defending claims with an adversary experienced in insurance matters, producer/client communications will be key. Are there risk management agreements in place? Are there specific communications where the producer has agreed to assess and evaluate the insurance needs of his client? Does a special relationship exist? While using the other side's expertise may not be a silver bullet to decide the case, it is still valuable in terms of jury argument. Pointing out that the claimant is skilled in insurance matters should allow the assertion of a comparative fault or contributory negligence defense. Most producer negligence cases will not be decided by dispositive motion, so fully developing the factual background of the relationship between the parties will be crucial. One last observation from personal experience: sophisticated adversaries typically have the financial resources to fight aggressively. Be prepared for a long, drawn out fight.