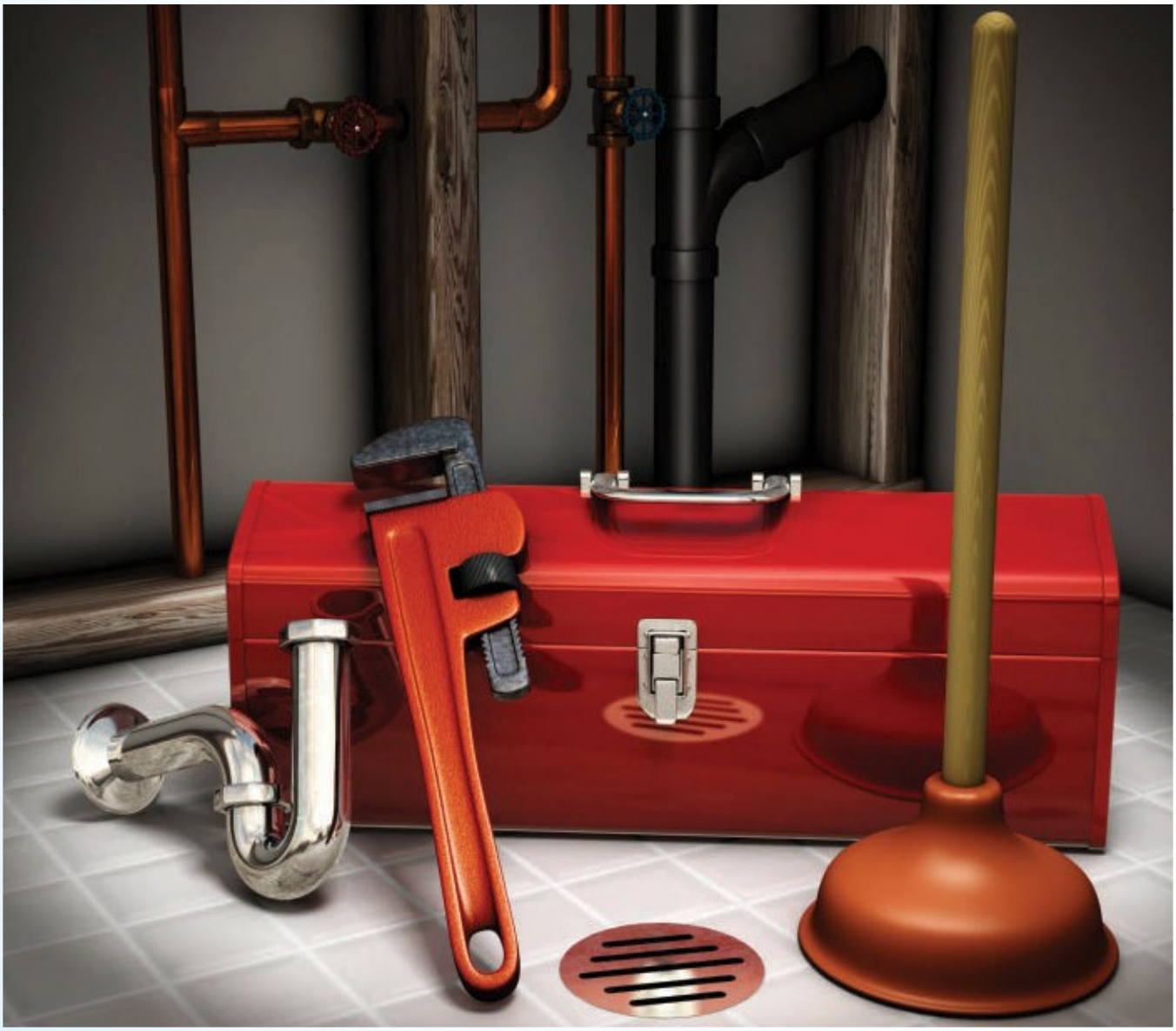
The New Frontier

Navigating Broker Exposure and Additional Insured Endorsements

By Michael Leahy and Larry Beemer

"How could this have happened," the broker wondered. He had been in business for over 20 years without one complaint and now his largest client, a plumbing subcontractor, is telling him that it is being sued for failing to provide a proper additional insured endorsement. His largest company market is telling him that it is being sued for denying coverage to a purported additional insured and would look to the broker for its losses, and on top of it all he was being sued by a developer that he had never even heard of, claiming that he should have provided a completed operation additional insured endorsement on the plumber's CGL policy.

How could this have happened? The answer is that it can happen easily, and



it's happening all the time these days as more and more general contractors and developers are either going bare, or retaining significant risk on the front end through self-insured retentions. In virtually every subcontract entered into between a general contractor/developer and any subcontractor trade, there are two risk transfer provisions found. First, an indemnity provision, and second, a provision requiring the subcontractor to name the general contractor/developer as an additional insured on its general liability policy. Because many jurisdictions are adopting additional insured statutes, additional insured endorsements are becoming more important. Often, the contract will specify the exact type of endorsement called for and in most instances that specification will be for an endorsement that provides completed operations coverage.

Growing Pressure

Over the years, brokers and agents have had tremendous pressure put on them especially in the construction area to provide certificates and additional insured endorsements for their clients. Many brokers and agents have been provided with the actual wording required in the endorsement, generally requiring completed operations coverage and a primary other insurance provision. While issuing these endorsements for a client who is required by contract to provide one may seem easy, it often creates tremendous coverage issues down the road for the carrier on the risk as well as the broker agent.

The law is fairly uniform that insurance brokers owe a limited duty to their clients, which is to use reasonable care, diligence and judgment in procuring the insurance requested by an insured. The insurance broker will generally not have any liability for failing to procure a specific kind of insurance unless the broker misrepresented the nature, extent or scope of the coverage provided, or there was a request or inquiry by the insured for a specific and particular type and extent of coverage, or if the broker assumes the additional duty by either express agreement or by holding himself out as having expertise in a given field of insurance being sought by the insured. In this area, a broker can find himself in hot water in any of the three exceptions to the general rule.

Be Aware

A broker who holds himself out as having expertise will be held to a higher standard of care. In determining whether a broker has held himself out as having expertise, courts will generally look to the broker's knowledge or history with the insured and his or her representations to the insured in that respect, the extent of the information the insured has provided to the broker, the relevant sophistication of the insured and the extent of its reliance on the broker.

A common mistake made by brokers occurs when the insured either specifically requests a type of coverage or the broker has been provided a copy of the subcontract that calls for a specific type of endorsement. Failure to obtain that specific coverage when provided a copy of the subcontract can expose the broker to liability not only to his client, but also to the intended third party beneficiary general contractor. In general, the court is likely to find that the broker could reasonably foresee the risk of harm to the general contractor if the broker did not place the coverage called for in the subcontract. And worse, in certain instances, the broker's action can bind the insurer, creating coverage out of thin air. The case law nationwide does suggest, however, that a duty to obtain requested coverage may not arise if the insured's request is not specific. An insured's request for "sufficient coverage," and an agent's assurance that the policy provided "adequate" coverage will not subject the broker to liability for failing to obtain the coverage the client wanted.

A broker can face liability to its carriers as well. In general, broker agreements

STAYING OUT OF HOT WATER

An insurance broker is open to liability if:

- He or she misrepresented the nature, extent or scope of the coverage provided.
- There was a request or inquiry by the insured for a specific and particular type and extent of coverage that was overlooked.
- The broker assumes the additional duty by either express agreement or by holding himself out as having expertise in a given field of insurance being sought by the insured.

with a carrier do not provide the broker with any binding authority over the carrier. Conversely, agency agreements will have some binding authority with certain parameters built into the contract. In many cases, the broker was never given authority by the carrier to issue these endorsements or if they were given authority it was for a specific endorsement such as an additional insured that only provides coverage for ongoing operations.

It has become commonplace for the staff at a brokerage to issue additional insured endorsements and it is not unheard of to see an additional insured endorsement containing the cut and pasted signature of a carrier president or CEO who has not been around for years!

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These endorsements are and have been issued at an alarming rate over the years and many times the carrier has never been sent a copy of the endorsement for its underwriting file. Since the carrier has no documentation of this endorsement, it has no idea of the risk it unwittingly and likely unwillingly assumed, which causes insurers significant problems. When faced with this issue, questions arise about whether the broker had binding authority, and if not whether ostensible authority can be proved. If the underwriting staff told the broker on multiple occasions that it was OK for it to issue additional insured endorsements without sending copies, ostensible authority could be created by this practice. Single grants of authority will not usually create ostensible authority. All of this is dependent on the evidence in an individual case and, ultimately, a judge's views on the subject — a risk not many wish to take.

Current Issues

In the past, before the days of huge expenses for additional insured claims, underwriters would routinely provide this authority to broker/agents. Now this is not the case and presents real issues between carriers and their business partners broker/agents on how these matters are to be resolved. The issuance of additional insured endorsements without the carrier authority is now creating very difficult situations for the carrier. For instance, while there may be no written authority in the broker/agency agreement nor has there been any ostensible authority established, there are certain states that indicate the carrier must stand in the shoes of the broker/agent. In other states it depends on the wording of the contract between the carrier and broker/agent.

These issues are increasingly of major concern for carriers, who realistically have three choices:

- Handle the additional insured claim as usual and do nothing with the broker/agent. This approach usually occurs with a major business producer for a carrier who does not want to lose accounts due to one claim.
- Handle the additional insured claim as usual and then sue the broker/agent.
- As soon as the issue with the additional insured endorsement is realized, the carrier would immediately put the broker/agent on notice of claim and ask it to tender the matter to its E&O carrier.

The last two options will create significant business issues with a broker/agent. However, the broker/agents status with the carrier can significantly drive how a carrier will proceed. As the economy has gotten worse, carriers have less margin to absorb these types of cases and are less hesitant to pursue the broker/agent.

In today's marketplace, brokers and agents face more risks than ever. The placement of additional insured endorsements is only one such risk, but a very large one. LM

Michael Leahy is a senior partner at the California firm of Haight, Brown & Bonesteel. Larry Beemer is a National Claim Director for Fireman's Fund Insurance Company.