

## Outside Counsel

## Expert Analysis

# Court of Appeals to Consider Fiduciary Duties of Insurance Brokers

Earlier this year, the New York State Court of Appeals agreed to hear a case that could have enduring legal ramifications for the insurance brokerage industry. In *People ex rel. Cuomo v. Wells Fargo Insurance Services Inc.*, an action brought by New York's Attorney General arising from a broker's acceptance and alleged nondisclosure of contingent commissions, the Court will address if, and under what circumstances, insurance brokers owe fiduciary duties to insureds. As New York courts have traditionally declined to impose a fiduciary duty on an insurance broker absent exceptional circumstances, the Court's ruling could significantly change how state law treats the relationship between insurance brokers and the clients for whom they procure insurance coverage.

The Court's willingness to hear the case is significant, both for its implications and its timing. In February, following years of enhanced regulatory scrutiny of compensation arrangements between insurance brokers and insurance companies, the New York State Insurance Department (NYSID) released its final broker compensation disclosure rule, which will take effect Jan. 1, 2011.

With this disclosure regulation on the horizon, a rule shaped by public and industry input, the question arises whether a judicially-crafted solution to the need for compensation transparency is necessary or even advisable—particularly since the Attorney General's proposed remedy, imposition of a fiduciary duty on insurance brokers, including the disclosure

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obligations that go along with such duties, could significantly expand the potential scope of brokers' civil liability for a broader range of conduct.

### New York Law

New York courts that have faced the question of whether insurance brokers owe fiduciary

The impact on the potential civil liability of the insurance brokerage industry could be significant.

duties—particularly the duties of care and loyalty—to their clients, have drawn on the Court of Appeals' 1997 decision in *Murphy v. Kuhn*.<sup>1</sup> In *Murphy*, an insured brought suit against his insurance agent alleging the agent's failure to advise him of potential additional coverage needs. Affirming summary judgment for the defendant, the Court imposed a standard of care on agents and brokers that was limited in scope. Specifically, the Court held that while insurance agents "have a common-law duty to obtain requested coverage for their clients within a reasonable time or inform the client of the inability to do so...they have no continuing duty to advise, guide or direct a client to obtain additional coverage."<sup>2</sup>

The Court noted the absence of a "special relationship" of trust and confidence between the parties because "[i]nsureds are in a better position to know their personal assets and

abilities to protect themselves more so than general insurance agents or brokers, unless the latter are informed and asked to advise and act."<sup>3</sup>

The Court of Appeals later reaffirmed the principle that the duties owed by brokers to their clients are limited in *Chase Scientific Research Inc. v. NIA Group Inc.*<sup>4</sup> There, the Court held that claims against brokers are not subject to the three year statute of limitations for claims against "professionals" for non-medical malpractice,<sup>5</sup> but rather the limitations periods applicable to negligence and breach of contract actions generally.

In so holding, the Court contrasted the broker-client relationship with other types of "professional" relationships (for example, the lawyer-client relationship) that, unlike the broker-insured relationship, carry with them heightened duties and are characterized by shared trust and confidence, and an ongoing duty to counsel and advise.<sup>6</sup>

Following *Murphy*, New York courts have dismissed breach of fiduciary duty claims by insureds against brokers, almost without exception, holding that absent exceptional circumstances, the broker-insured relationship is not fiduciary in nature.<sup>7</sup>

For example, in *People ex rel. Cuomo v. Liberty Mutual Insurance Co.*, the Appellate Division, First Department, citing *Murphy*, reaffirmed that an insurance broker "owes no common-law duty to its customer other than to obtain the policy requested within a reasonable time, or to inform the customer that it could not do so."<sup>8</sup>

The principle derived from these cases is that in order to sustain a claim for breach of fiduciary duty against a broker, an insured must plead and prove the existence of a special relationship of trust and confidence between them.

Although the factual allegations asserted in support of breach of fiduciary duty claims against insurance brokers vary widely, one issue on which some of these cases have focused in

the last few years is contingent compensation in the insurance brokerage industry, particularly whether brokers' receipt and nondisclosure of contingent commissions calls into question their ability to serve their clients' needs loyally and violates a duty owed by insurance brokers to their clients.

### Contingent Commissions

While standard commissions received by brokers are calculated as a percentage of the premium paid to an insurer on each policy sold with the assistance of the broker, contingent commissions are usually based on the aggregate book of business placed by a broker with a particular insurer over the course of the year.<sup>9</sup> For example, a broker may earn contingent compensation if it manages to place a specified volume of insurance premiums with a particular carrier over a twelve-month period, or contingent commissions may be earned based on the number or percentage of clients who renew policies with an insurer during that period.

Although contingent commissions have been utilized and accepted in the insurance brokerage industry for decades, they have in recent years drawn greater scrutiny given concerns about their potential to influence brokers' placement proposals to their clients.

In 2007, the NYSID focused its efforts on drafting a broker compensation disclosure regulation.<sup>10</sup> Throughout 2008, the department conducted joint hearings with the Attorney General's office and heard testimony from all sides of the issue, including consumers, broker groups, and public officials. Draft proposals were submitted for public comment, culminating in the NYSID's February 2010 release of a proposed regulation entitled "Producer Compensation Transparency."<sup>11</sup>

Set to take effect Jan. 1, 2011, the proposed rule will require brokers to inform clients either orally or in writing prior to the time of the insurance application, of their right to seek information concerning the compensation they anticipate receiving based on the sale. Should an insurance purchaser request such information, only then must a broker provide a description of the nature, amount and source of any compensation, as well as other information, upon or prior to the issuance of the insurance contract.

The disclosure requirements do not apply to policy renewals unless the policyholder requests information regarding broker compensation within 30 days of the date of renewal. Also outside the scope of the rule are reinsurance placements, placements with captive insurance companies, and placements by wholesale brokers who have no direct sales or solicitation contact with the purchaser. Despite these carve outs, the rule generally levels the disclosure playing field, imposing uniform obligations on brokers without regard to

whether they have been subject to regulatory scrutiny or legally imposed disclosure responsibilities in the past.<sup>12</sup>

### The 'Wells Fargo' Case

In *Wells Fargo*, the Attorney General alleged that an insurance broker steered clients toward particular insurance carriers in order to secure lucrative contingent compensation payments, and that Wells Fargo's acceptance and nondisclosure of such payments violated its duty of loyalty to its clients.<sup>13</sup> The Supreme Court dismissed the breach of fiduciary duty claim,<sup>14</sup> a decision later affirmed by the First Department which, citing *Murphy* and other prior judicial decisions on the issue, held that "an insurance broker may not be liable to its client for breach of fiduciary duty absent a special relationship, which does not exist here."<sup>15</sup> The court further added that "contingent commissions are not illegal in [New York] and disclosure of the commissions was not required as of the time of the conduct alleged in the complaint."<sup>16</sup>

In January 2010, the Attorney General persuaded the Court of Appeals to take the case. Despite prior decisions limiting the scope of the duties owed by insurance brokers to their clients, and setting an extremely high burden for an insured to meet before fiduciary obligations are imposed on a broker, the Attorney General has raised a number of legal arguments before the Court of Appeals which could reverse this trend.

First, the Attorney General has argued that while *Murphy* frees a broker from fiduciary liability for failing to anticipate and procure other forms of coverage a client might have required but did not request, it does not necessarily relieve a broker from more generalized duties of care and loyalty while working on a client's behalf. The Attorney General has also argued that under New York's Insurance Law, brokers are agents of their clients,<sup>17</sup> and that common law agency principles dictate that agents owe fiduciary duties to their principals.

Further, the Attorney General has highlighted the Court's recent decision in *People ex rel. Cuomo v. Coventry First LLC*.<sup>18</sup> There, the Court held that life settlement brokers who work to sell clients' life insurance policies to third parties stand in a fiduciary relationship to their clients.<sup>19</sup> In *Wells Fargo*, the Attorney General has argued that similar principles should be applied to insurance brokers vis-à-vis insureds.

### Potential Significance

Should the Court of Appeals hold that the broker-insured relationship possesses some inherent fiduciary quality, the impact on the potential civil liability of the insurance brokerage industry could be significant. Not only would such

a decision reverse a number of judicial precedents relieving brokers from fiduciary liability for failing to disclose contingent compensation, but it could also render brokers subject to liability for a wide range of alleged errors and omissions in the conduct of their business. There also exists the possibility that other state courts would follow New York's example, creating a ripple effect in state law on broker fiduciary liability.

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1. 90 N.Y.2d 266 (1997).  
 2. Id. at 270 (citations omitted).  
 3. Id. at 271-73 (citation omitted).  
 4. 96 N.Y.2d 20 (2001).  
 5. See N.Y. C.P.L.R. §214(6) (2009).  
 6. See *Chase Scientific*, 96 N.Y.2d at 29-30.  
 7. See *Core-Mark Int'l v. Swett & Crawford Inc.*, 71 A.D.3d 1072 (2d Dept. 2010); *Bruckmann, Rosser, Sherrill & Co., L.P. v. Marsh USA Inc.*, 65 A.D.3d 865, 867 (1st Dept. 2009); *People ex rel. Cuomo v. Liberty Mut. Ins. Co.*, 52 A.D.3d 378, 380 (1st Dept. 2008); *Hersch v. DeWitt Stern Group Inc.*, 43 A.D.3d 644, 645 (1st Dept. 2007); *Sutton Park Dev. Corp. Trading Co. Inc. v. Guerin & Guerin Agency Inc.*, 297 A.D.2d 430, 431-32 (3d Dept. 2002); *Scotto Princeton LLC v. Felsen Assocs. Inc.*, 807 N.Y.S.2d 546, 548 (Sup. Ct. Nassau County 2005); *Tesoriero v. MeLife*, 800 N.Y.S.2d 357 (Sup. Ct. Kings County 2004). Courts in other states have adopted a similar view. See, e.g. *Sempra Energy v. Marsh USA Inc.*, No. 2:07-cv-05431-SJO-SS, slip op. at 5-6 (C.D. Cal. Sept. 2, 2008) ("This Court will not expand the doctrine of fiduciary duty to include insurance brokers, given that it has not been recognized by California courts.") (citation omitted); *Kotlar v. Hartford Fire Ins. Co.*, 83 Cal. App. 4th 1116, 1123 (2000) ("[Plaintiff's] attempt to analogize the broker-client relationship to the attorney-client relationship is wide of the mark. The relationship between an attorney and client is a fiduciary relationship of the very highest character, and attorneys have a duty of loyalty to their clients. Thus, while an attorney must represent his or her clients zealously within the bounds of the law, a broker only needs to use reasonable care to represent his or her client.") (internal citations omitted); *Wal-Mart Stores Inc. v. AIG Life Ins. Co.*, 901 A.2d 106, 113-14 (Del. 2006) (rejecting argument that brokers shared fiduciary relationship with insureds and noting that "it is vitally important that the exacting standards of fiduciary duties not be extended to quotidian commercial relationships"); *Baldwin Crane & Equip. Corp.*, 687 N.E.2d 1267, 1269 (Mass. Ct. App. 1997) ("The relationship between an insurance broker and the insured is not normally thought to be fiduciary in nature, absent 'special circumstances'....") (internal citations omitted). *Contra Faulkner v. Gilmore*, 621 N.E.2d 908, 911 (Ill. App. Ct. 1993) ("The relationship of an insurance broker and the proposed insured is a fiduciary one."); *A.G. Edwards & Sons Inc. v. Drew*, 978 S.W.2d 386, 394-95 (Mo. Ct. App. 1998) ("When an insurance broker agrees to obtain insurance for a client, with a view to earning a commission, the broker becomes the client's agent and owes a duty to the client to act with reasonable care, skill, and diligence.")

8. *People ex rel. Cuomo v. Liberty Mut. Ins. Co.*, 52 A.D.3d at 380 (citation omitted).

9. See generally J. David Cummins & Neil A. Doherty, *The Economics of Insurance Intermediaries*, 9/1/06 J. Risk & Ins. 359 (2006).

10. See 2008 N.Y. Ins. GC Opinions LEXIS 10, at 2 (Jan. 30, 2008).

11. See Press Release, N.Y. Ins. Dep't, Department Announces New Protection for Consumers (Feb. 9, 2010) available at <http://www.ins.state.ny.us/press/2010/p1002091.htm>.

12. See Producer Compensation Transparency, 11 N.Y. Comp. Codes R. & Regs. §30 (2010).

13. The Attorney General has also asserted claims for statutory fraud under Executive Law §63(12), common law fraud, and unjust enrichment.

14. *People ex rel. Cuomo v. Wells Fargo Ins. Servs. Inc.*, 856 N.Y.S.2d 500 (Sup. Ct. N.Y. County 2008).

15. *People ex rel. Cuomo v. Wells Fargo Ins. Servs. Inc.*, 62 A.D.3d 404, 404 (1st Dept. 2009).

16. Id.

17. See N.Y. Ins. Law §2101(c).

18. 13 N.Y.3d 108 (2009).

19. Id. at 115-16.