Searching For a Higher Duty When An Insurer Refuses To Admit Its Own Mistakes

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A. Why won't they just "do the right thing?"

People make mistakes. It's part of being human.

Even so, over and over we see cases where an insurance carrier or its designated agent makes an error and then stubbornly denies responsibility. The carriers/agents just won't "do the right thing" in industry parlance.

The result is always the same. Innocent insureds are left to fend for themselves. The carrier and agents defend based on the notion that they owe "no duty" to have prevented or to right the particular wrong. A struggle ensues.

Bad faith law may be insufficient to address the situation, especially if the mistake has to do with a faulty insurance application or a failure to provide adequate limits or coverages. Breach of the implied covenant of good faith and fair dealing generally requires a breach of the insurance contract and the policy declarations or coverages are often exactly what the agents/carrier mistakenly put into place.

Catch 22, anyone?

The solution is to think outside of the box just a little bit and examine what is really going on in the insured/agent/insurer relationship, because the nature and extent of the relationship will ultimately define where the duty truly lies. Fortunately, this area is one of the few in insurance law that has grown more sympathetic to insureds during the past decade.

B. Defining Different Levels of Duty.

The typical agent/carrier mistake problem requires analyzing duty at multiple levels. The duties can involve a fiduciary duty under certain circumstances, a duty to perform reasonably or a duty created by an oral or written contract.

The duties themselves will define the remedies available to the insured in the event of a breach so the level of duty involved becomes critical in prosecuting a claim.

Breach of fiduciary duty is the most interesting, both because it has recently been affirmed as available under certain circumstances (*Tran v. Farmers Group, Inc.* (2002) 104 Cal.App.4th 1202, 128 Cal.Rptr.2d 728) and because it presents a potential for obtaining punitive damages.

Negligent breach of a duty to perform resulting in damages is also important, but will generally only become available where the agent or insurer have acted in such a fashion where they can be seen to have adopted a special duty towards the insured. *See e.g., Paper Savers, Inc. v. Nacsa* (1996) 51 Cal.App.4th 1090, 59 Cal.Rptr.2d 547; *Desai v. Farmers Ins. Exchange* (1996) 47 Cal.App.4th 1110, 55

Cal.Rptr.2d 276; Free v. Republic Ins. Co. (1992) 8 Cal.App.4th 1726, 11 Cal.Rptr.2d 296. Under this theory, both agent and insurer may be liable for the agent's negligence in misrepresenting policy terms or the extent of coverage provided. In addition, the measure of available damages may, in the right case, include attorneys fees and costs. *Saunders v. Cariss* (1990) 224 Cal.App.3d 905, 274 Cal.Rptr. 186.

Finally, where there is an oral or written agreement to provide a certain level of insurance protection, there is the potential for a breach of contract to provide insurance. The damages available would be the same as for any contractual breach.

C. The Fiduciary Duty as applied to a Carrier.

1. A significant duty in the proper case.

The common notion is that a carrier's duty to act reasonably towards its insured arises from the *quasi-fiduciary* nature of the insurer/insured relationship. *Branch v. Home Fed. Bank* (1992) 6 Cal.App.4th 793, 8 Cal.Rptr.2d 182. That relationship, the cases say, creates duties that are similar to, but not the same, as a trustor/trustee relationship and is the foundational basis for claims for breach of the implied covenant of fair dealing, more commonly known as insurance bad faith.

There is, however, a situation where the insurer and insured are involved in a true fiduciary relationship and that is where the insurer is a reciprocal insurer and the insured has signed a power of attorney, also known as a "subscription agreement."

Reciprocal insurers, also known as interinsurance exchanges, are insurance entities that are as strange to the novice as they are fascinating to any student of the industry. Governed by Insurance Code section 1280 et seq.:

An interinsurance exchange is an unincorporated business organization made up of subscribers and managed by an attorney-in-fact. The exchange is the insurer and the subscribers are the insureds. The subscribers execute powers of attorney appointing the attorney-in-fact to act on their behalf. The attorney-in-fact executes the exchanges insurance contracts.

* * *

"Courts which have considered the relationship between a reciprocal insurer's board, its attorney-in-fact and its subscribers have concluded the relationship is analogous to the relationship between the directors, management and participants in other kinds of organizations. For example, at least one court has held that '[t]he position of the attorney-in-fact of a reciprocal insurance exchange, who manages the business of the exchange under powers of attorneys of the subscribers . . . is fiduciary in character *to the same extent as that of the management of an incorporated mutual insurance company* . . ."
Tran, supra, 104 Cal.App.4th at 1210-1211 [Emphasis in original] (quoting *Industrial Indem. Co. v. Golden State Co.* (1953) 117 Cal.App.2d 519, 256 P.2d 677).

California based Farmers Insurance is our best known reciprocal insurer and is a fine example of how the *Tran* duty may be applied.

As a reciprocal, Farmers consists of many separate entities, which makes it difficult for the uninitiated to even name them in a lawsuit.

The correct way to name Farmers is to name the appropriate exchange, the claims handling entity and the management company. The reason for this is, a reciprocal breaks up of its functions into different companies, and so a company that played a part in injuring the insured must be named.

For example, Farmers' exchanges are much like bank accounts where the subscriber funds are pooled to pay claims and management company fees. Farmers' primary exchanges are: Farmers Insurance Exchange, Fire Insurance Exchange or Truck Insurance Exchange. The declarations page of the policy will identify the proper exchange.

Fire Insurance Exchange and Truck Insurance Exchange have no employees, they are exchanges in their purest form. Farmers Insurance Exchange handles claims for the entire Farmers organization and so is usually a proper party when claims handling is part of the case, in addition to the exchange identified on the declarations page.

Farmers Group, Inc. is the management company, otherwise known as the attorney-in-fact. Farmers generally frowns when the "Group" is named in a lawsuit and will usually fight fiercely to get the management company out of harms way. However, the Group is a proper party in a bad faith case *(Delos v. Farmers Ins. Group Inc.* (1979) 93 Cal.App.3d 642, 155 Cal.Rptr. 843) and is *the* central player where a breach of fiduciary duty claim is made.

The reason has to do with how a reciprocal functions. Exchanges, which are essentially single pools of money, can't act on their own. Exchanges rely on a management company to provide all the services that make an insurance company function. In turn, the management company acts on behalf of both the exchange and the subscribers (we call the later "insureds.") The subscribers, in turn, authorize the management company authority to act on their behalf by appointing the management company as their attorney-in-fact (the "subscription agreement.") For its trouble, the management company charges a percentage of each policy dollar as a fee for its services.

The bottom line is, when Farmers Group, Inc. enters into an attorney-in-fact relationship with an insured - which happens whenever a policy is issued - Farmers takes on a special duty that is fiduciary in nature.

We believe respondents, having chosen to conduct their insurance business through interinsurance exchanges that require the appointment of attorneys-in-fact to execute contracts on behalf of subscriber/insureds, are bound by the ordinary rule that an attorney-in-fact is an agent owing a fiduciary duty to the principal.
Tran. Supra, 104 Cal.App.4th at 1213.

This duty has significant implications when Farmers Group, Inc. or its agents make an error and refuse to"^"do the right thing."

Fiduciary duties are the same duties owed by a trustee to a trustor, which means they are significant and far reaching. (Civ.Code § 2322(c).) So, an agent is required to disclose to the principal all information relevant to the subject matter of the agency. *Orfanos v. California Ins. Co.* (1938) 29 Cal.App.2d 75, 80, 84 P.2d 233. An agent is liable to the principal for intentional or negligent torts against the principal. *Cecka v. Beckman & Co.* (1972) 28 Cal.App.3d 5, 11, 104 Cal.Rptr. 374.

A trustee owes a duty of loyalty and has a duty to administer the trust solely in the interest of the beneficiaries. (Prob.Code § 16002; *Estate of Gump* (1991) 1 Cal.App.4th 582, 596, 2 Cal.Rptr.2d 269.) A trustee has a duty to apply the full extent of the trustee's skills. (Prob.Code § 16014(a).)
A trustee has a duty to avoid conflicts of interest and may not use or deal with trust property to the trustee's own profit nor take part in any transaction in which the trustee has an interest adverse to the beneficiary. (Prob.Code § 16004(a).) "A transaction between the trustee and a beneficiary which occurs during the existence of the trust or while the trustee's influence with the beneficiary remains and by which the trustee obtains an advantage from the beneficiary is presumed to be a violation of the trustee's fiduciary duties. (Prob.Code § 16004(c).)

Persons who owe a fiduciary duty to the trustee of a trust may be liable to the trust beneficiaries for breach of fiduciary duty whenever such fiduciaries actively collude with the trustee in breaching the trustee's own fiduciary duties. The right of the beneficiary against the third party, in such a case, is a direct right. *City of Atascadero v. Merrill, Lynch, Pierce, Fenner & Smith* (1998) 68 Cal.App.4th 445, 467, 483-484, 80 Cal.Rptr.2d 329.

"A fiduciary or confidential relationship may arise whenever confidence is reposed by persons in the integrity and good faith of another. If the latter voluntarily accepts or assumes that confidence, he or she may not act so as to take advantage of the other's interest without their knowledge or consent." *City of Atascadero, supra*, 68 Cal.App.4th at 483.

In a breach of fiduciary duty action, the plaintiff bears the initial burden of proof regarding the parameters of the fiduciary(s duty. Then, the burden shifts to the defendant to demonstrate that the particular transaction was entered in good faith and the inherent fairness of the transaction from the beneficiary(viewpoint. *Robinson, Leatham & Nelson, Inc. v. Nelson* (9th Cir. 1997) 109 F.3d 1388, 1391.

Since it is the attorney-in-fact that issues policies on behalf of the exchanges. The upshot to all this is, the management company may be held responsible for breaches of its important duties or a fiduciary when it or its agents drop the ball in policy formation.

D. Finding a Duty of Care.

An agent/carrier error in providing coverage can also give rise to a duty of due care if the agent/carrier acted in such a way that they can be said to have adopted a "special duty."

It is black letter law that where an insurance agent contracts in the name of an insurer and does not exceed that authority, the insurer - in its role as a principal - is liable. *Kurtz, Richards, Wilson & Co., Inc. v. Insurance Communicators Mktg. Corp*. (1993) 12 Cal.App.4th 1249, 1257-1258; 16 Cal.Rptr.2d 259; *Lippert v. Bailey* (1966) 241 Cal.App.2d 376, 382; 50 Cal.Rptr.478*; Briano v. Conseco Life Ins. Co.* (C.D. Cal. 2000) 126 F.Supp.2d 1293, 1297-1298.

Where an agent has adopted a special duty and is negligent in its efforts on behalf of the insured, the insurer in turn is vicariously liable for the agent's negligence. See, e.g., *Paper Savers, Inc. v. Nacsa* (1996) 51 Cal.App.4th 1090, 1096-1098 (rev. den. Mar. 12, 1997); 59 Cal.Rptr.2d 547.

A long line of decisional authority, including *Free v. Republic Ins. Co.* (1992) 8 Cal.App.4th 1726; 11 Cal.Rptr.2d 296, *Desai v. Farmers Ins. Exchange* (1996) 47 Cal.App.4th 1110 (rev. den. Nov. 20, 1967); 55 Cal.Rptr.2d 276 and *Paper Savers, Inc. v. Nacsa* (1996) 51 Cal.App.4th 1090, impose liability for negligence on a carrier in such circumstances.

In *Free v. Republic* (1992) 8 Cal.App.4th 1726; 11 Cal.Rptr.2d 296, an insured alleged that despite repeated inquiries, an insurance agent failed to inform that the coverage limits on a homeowners policy were inadequate to replace the proper in the event of a fire loss.

After the trial court sustained the insurer's demurrers without leave to amend, the Court of Appeal reversed.

Clearly defendants were not required under the general duty of care they owed plaintiff to advise him regarding sufficiency of his liability limits or the replacement value of his residence. Nonetheless, once they elected to respond to his inquires, a special duty arose requiring them to use reasonable care. *Id*. at 1729.

Likewise, in *Desai v. Farmers Ins. Exchange* (1996) 47 Cal.App.4th 1110; 55 Cal.Rptr.2d 276, an order sustaining an insurer(s demurrers without leave was reversed after an agent wrongly assured an insured that there was sufficient coverage in place to protect against loss due to covered risks, including fire. *Id.* at 1118-1121. In reversing, the Court of Appeal cited *Free* in support of the proposition that an insurer will be vicariously liable where, despite an agent's assurances, property policy limits proved insufficient to protect the insured "against the very specific eventuality: the destruction of his [property]." *Id.* at 1121.

Again, the Court of Appeal in *Paper Savers, Inc. v. Nacsa* (1996) 51 Cal.App.4th 1090, reversed a grant of summary judgment on behalf of a property insurer where an insured alleged an agent misled him regarding the losses of business personal property provided by the insurance policy he purchased. *Id.* at 1092.

The Court of Appeal followed both *Free* and *Desai* in finding a duty on behalf of both the agent and the insurer.

[T]his case involves a special duty to ensure such coverage based on alleged affirmative assertions made to induce the insured to purchase the policy . . . . The instant case has nothing to do with the interpretation of insurance policy terms. No one is disputing the policy terms or their meaning. The dispute is whether [the agent] actively misled [the insured] as to the effect of those terms. *Paper Savers, supra*, 51 Cal.App.4th at 1101-1102.

Defendants will generally argue that they owe no duty, citing *Jones v. Grewe* (1987) 189 Cal.App.3d 950; 234 Cal.Rptr 717. However, that argument is misplaced where a special duty is involved, particularly where there is a clear mistake.

As the Court of Appeal has repeatedly observed, Jones dealt with the issue of whether an agent might be held responsible for failing to recommend adequate liability insurance limits. The appellate court declined to announce such a duty, reasoning "[n]either an insurance agent nor anyone else has the ability to accurately forecast the upper limit of any damage award in a negligence action against the insured by a third party." *Free, supra*, at 1730.

Such a rationale has no support where there is an error in such finite coverages as setting property insurance limits, since the value of lost or destroyed property can be calculated in advance. "Under such circumstances, defendants must be deemed to have assumed additional duties, which, if breached, could subject them to liability." *Id.*

[T]he Free court held once an insurer or its agent elects to respond to an insured's questions about coverage, a special duty arises which requires them to use reasonable care to provide accurate information. The *Free* court found the *Jones* decision is distinguishable. It noted *Jones* involved a liability policy for which the upper limit of desirable coverage cannot truly be known at the time of purchase. Whereas the type of insurance involved in the *Free* case involved the amount required to rebuild one's home, characterized by the court as a "specific eventuality" and one that is determinable. *Paper Savers, supra,* 51 Cal.App.4th at 1097-1098.

Carriers and agents may also attempt to rely on *Fitzpatrick v. Hayes* (1997) 57 Cal.App.4th 916; 67 Cal.Rptr.2d 445, but it actually doesn't help their cause where a special duty is involved. First, like the *Jones* case, *Fitzpatrick* analyzes an insurance agent's duty in the context of liability insurance, specifically, umbrella coverage. Second, *Fitzpatrick* affirms that a duty arises where (a) the agent misrepresents the nature, extent or scope of coverage, (b) there is a request for a particular extent of coverage, or (c) the agent assumes an additional duty by holding himself or herself out as having expertise in a given field of insurance being sought by the insured. *Fitzpatrick, supra,* at 927.

Kurtz, Richards, Wilson & Co., Inc. v. Insurance Communicators Mktg. Corp. (1993) 12 Cal.App.4th 1249, 1257-1258, agrees that where, as here, an insurance agent serves in a dual agency capacity, a duty to exercise reasonable care is owed the insured. Accord, *Lippert v. Bailey* (1966) 241 Cal.App.2d 376; see also, *Clement v. Smith* (1993) 16 Cal.App.4th 39; 19 Cal.Rptr.2d 676 (liability imposed where insured dissuaded from purchasing additional coverage by agent misrepresentations); *Butcher v. Truck Ins. Exchange* (2000) 77 Cal.App.4th 1442, 1461; 92 Cal.Rptr.2d 521 (agent's failure to deliver agreed upon coverage is admissible).

E. Finding a Contractual Duty.

Finally, an agent/carrier's mistake in coverage may give rise to a breach of contract claim.

The graveman of a breach of contract cause of action where there is agent/carrier error is that the agent/carrier undertook a special duty, such as to ensure that the Plaintiff's property was insured to value, breached that duty and so, breached their contract of service to protect the Plaintiff's property with adequate insurance. Such a failure is actionable. 3 Witkin Summary of Cal. Law (2005 10th) Agency, § 119, p. 162.

Where an insured is misled by the negligence of an insurance agent, there is no duty to read the policy and the insured may sue for breach of the contract to procure insurance *(Butcher v. Truck Ins. Exch*ange (2000) 77 Cal.App.4th 1442, 1465) or breach of contract to insure (*Eddy v. Sharp* (1988) 199 Cal.App.3d 858, 867; 245 Cal.Rptr. 211).

Also, to the extent the insured can allege that through fraud, mistake or accident, the subject insurance policy fails to express the real intention of the parties, ie, to adequately protect the Plaintiff's property from loss due to a covered risk such as fire, the intention controls and any language in the written policy form contradicting that intent is disregarded under the normal rules of contract construction. *Civ.Code* § 1640; *Heidlebaugh v. Miller* (1954) 126 Cal.App.2d 35, 38; 271 P.2d 557.

F. Conclusion.

Insureds sometimes need to rely on the expertise of agents and carriers to obtain the correct coverages and limits that will best protect them. When agents and carriers act as insurance experts but drop the ball, they should do the right thing. When they won't, it's up to the consumer lawyer to set things right.

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