LIABILITY OF AGENTS OR BROKERS FOR PLACING BUSINESS WITH AN INSOLVENT INSURER

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I. BACKGROUND

A. Change In Events As To Insurance Company Insolvencies

Until rather recent times the issues involving insurance company insolvencies were mistakenly thought by some to almost be a thing of the past. This conclusion was generated in a large part because of increased state regulation of the financial condition of companies both before and after licensing and admission by state insurance departments. However, the number of insurer insolvencies have increased substantially over the past several years, leaving many insureds with unpaid claims. This study does not deal directly with the unfortunate plight of these insureds, but with the developing law on the liability and duties of insurance agents and brokers who sell the coverage.

In this connection, this study deals with lawsuits against the agent or broker where recovery is sought under tort theories. As the cases discussed herein will show the tortious conduct with respect to the failure to place coverage with a solvent insurer is usually pleaded as negligence and the allegation is usually a breach of the duty of care. This article will consider items of defense and items of planning from the insurance agent's point of view.

If one or two noteworthy items were to be picked out as a starting point and to show the change in events as to company insolvencies and insurance agent or broker liability, such would include the related items of a lower court decision in Texas and a front-page article in the *National Underwriter*. The lower court decision, if it were to be upheld on appeal,

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would have put insurance agents and brokers in a most dangerous position and the rather brief, but to the point front-page article, in one of the leading trade publications not only alerted insurance agents and brokers to the problem, but put many of them in fear of the way the law might develop.

B. The August 17, 1987 Article in The National Underwriter Which Brought Widespread Attention to This Issue

This article, entitled Agents Liable For Insurer Solvency?,[1] brought widespread attention within the insurance industry to the case of *Higginbotham & Associates Inc.* v. *Greer* and agent liability. The article discussed the implications of a 1986 trial court decision (the 71st Judicial District Court, Harrison County, Texas) and pointed out that critics of the decision feared that if the trial court's decision were affirmed on appeal that the case . . could cast agents as guarantors of company solvency and threaten the financial health of carriers with ratings below 'A' . . ." The trial court held the insurance agency liable for insured's loss (including lost profits, lost equity, and attorneys' fees) when the insurance company (rated "B+" by AM. Best & Co.) became insolvent after (not before) the insured filed its claim.

C. The Effort of the Trade Associations to Aid in the Appeal of the Higginbotham & Associates Case

The article pointed out that "a coalition of insurance agent and company trade associations ... filed an *amici curiae* brief... in support of the agency's appeal..." to the Court of Appeals of Texas. This legal brief (dated July 22, 1987) was filed in support of the independent insurance agency. *Amici curiae* consisted of ten associations and related organizations in the insurance industry having a common goal of fostering the provision of quality, economical insurance for all types of coverage.[2]

The article points out that the insured's loss was $490,000 and that the state guaranty fund reimbursed him for $50,000 of such loss. The lower court awarded him the $440,000 balance of his claim, plus $212,000 damages for lost profits, $100,000 for lost equity and $20,000 for attorney’s fees. Here, Mulcahy and Arndt point out that the coalition of insurance agents and company trade

1.Colleen Mulcahy & Sheril Arndt, *Agents Liable For Insurer Solvency*, NAT*I. UNDERWRITER. Aug. 17, 1987, at 1.

2.See Brief in Support of Appellant of Independent Insurance Agents of Texas. Professional Insurance Agents of Texas, National Association of Casualty Surety Agents, Independent Insurance Agents of America, American Insurance Association, National Association of Life Underwriters, National Association of Professional Insurance Agents, National Association of Insurance Brokers, National Association of Surety Bond Producers and Assured International As *Amici Curiae*, Higginbotham & Associates, Inc. v. Greer, 738 S.W.2d 45 (Tex Q. App. 1987) (No. 9546) [hereinafter *Arruci Curiae* Brief in Support of Higginbotham].

associations argued in their *amici curiae* brief that awarding damages in excess of the insurance claim was contrary to precedent and completely unwarranted.

The Mulcahy and Amdt article also pointed out that such coalition was protesting the judge's instructions to the jury where "the judge said an agent is obligated to place coverage with the best possible company at the best possible price to insure that the client is covered at all times . . ." The article quoted such industry coalition as stating that:

> . . . the court has instructed agents to select the carrier with the highest financial rating for their business. Therefore, an agent placing business with a 'B+' rated carrier would be negligent if it failed.
> ... Any carrier not rated 'A' or 'A+' could go under because agents are afraid to place coverage with them since they could be held liable . . .[3]

II. THE HIGGINBOTHAM & ASSOCIATES CASE WHICH CAUSED THE UPROAR

A. Higginbotham & Associates, Inc. - The Lower Court Decision

In 1980 Jack Greer purchased a bowling center and insured his center by a multi-peril insurance policy written by Proprietors Insurance Corporation (PIC) an Ohio company, which was an admitted and approved carrier in Texas. At the time the policy was written, PIC was promptly paying its claims, was paying policyholder dividends, and had an underwriting profit for the preceding year. The policy was procured by Higginbotham, an independent agency. The center was destroyed by fire in 1981 and Higginbotham submitted Greer's claim to PIC. PIC paid the claim by check, but such check was returned unpaid because PIC had become insolvent.

Greer sued Higginbotham alleging negligence in the procurement of the policy and misrepresentations under the Texas Deceptive Trade Practices Act. The jury found for Greer on both causes of action. However, the district court disregarded the finding of misrepresentation.[4]

B. Higginbotham & Associates Case on Appeal

On appeal **Higginbotham** asserted several points of error, including the assertion that the evidence was insufficient to support a finding of

3.Mulcahy & Arndt, *supra* note 1, at 41-42.

4.The history and facts of this lower court case can be found in Higginbotham & Associates. ,nc- v. Greer, 738 S.W. 2d 45, 46, 48 (Tex. Ct. App. 1987); *see also Amid Cunae* Brief in Support °f Higginbotham, *supra* note 2, at 6-14.

negligence on Higginbotham's part. Greer's cross-points urged that the jury's finding of misrepresentation should not have been disregarded and that he was entitled to treble damages under the Texas Deceptive Trade Practices- Consumer Protection Act.

Fortunately for Higginbotham, and also (in this writer's mind) fortunately for insurance agents in general, the trial court decision was reversed. The Texas Court of Appeals ruled in this connection as follows:

> We . . . conclude that an agent is not liable for an insured's lost claim due to the insurer's insolvency if the insurer is solvent at the time the policy is procured, unless at that time or at a later time when the insured could be protected, the agent knows or by exercise of reasonable diligence should know, of facts or circumstances which would put a reasonable agent on notice that the insurance presents an unreasonable risk.[5]

The Court of Appeals also dealt with whether or not the insurance agent should be a guarantor of the solvency of the insurance company he or she obtains coverage from and stated "the general rule" as follows:

> The general rule is that an insurance agent or broker is not a guarantor of the financial condition or solvency of the company from which he obtains the insurance. He is required, however, to use reasonable skill and judgment with a view to the security or indemnity for which the insurance is sought, and a failure in that respect may render him liable to the insured for resulting losses. Thus, where a policy is procured in a company known by the agent to be insolvent, the agent is liable for a loss suffered by reason of such insolvency. On the other hand, where the company was solvent when the policy was procured, its subsequent insolvency generally does not impose liability on the agent or broker.[6]

5.Higginbotham & Assocs. Inc. v. Greer, 738 S.W.2d 45,47 (Tex. Ct. App. 1987). Please note that this case uses the words "reasonable diligence" in the above quotation. More recently the board of directors of the American Society of CLU and ChFC passed a resolution endorsing the use of "due care" terminology rather than "due diligence" to describe the role of agents in reviewing an insurer's solvency. For the reasoning behind this, *see 'Due Can Terminology Adopted ByAmer. Society*," NaT*L UNDERWRTTER, Aug. 5, 1991, at 29.

6.Higginbotham & Assocs. Inc. v. Greer, 738 S.W.2d 45, at 46-47 (Tex. Q. App. 1987).

Since the evidence showed Higginbotham had no actual knowledge of any financial instability of the insurance company and no evidence was established nor offered to show that the agent reasonably should have known that the insurance company was in trouble, Higginbotham was held not to have been negligent and not to be liable. [7]

Thus, the Court of Appeals of Texas, in applying the above-quoted rules to the facts of the case found no evidence to support the jury's finding that Higginbotham was negligent. This was in spite of testimony of Greer's expert witness that "the 'B+' rating given to PIC for the years 1979 and 1980 placed PIC in the lower twenty-five percent of Best's rated Companies for that year." The Court in dealing with this negligence issue did make the additional point that "the evidence shows that Greer knowingly exercised independent choice to insure his property with PIC."[S] This additional point noted in the *Higginbotham* case is the next item to be considered.

III. WHERE THE INSURED INSISTS ON A PARTICULAR COMPANY FOR COVERAGE

A. The Somewhat Hidden Point in Higginbotham That Greer (the Insured) Wanted to Continue the Existing Coverage of the Prior Owner

The Court of Appeals of Texas found nothing in the evidence that would lead a reasonable agent to know that PIC constituted an unreasonable risk at the time the insurance was taken out or at any time prior to loss. However, the Court of Appeals went into some consideration under its "Additionally, the evidence shows" statement dealing with the evidence showing Greer selected the insurance company. Since this writer feels that selection of the company is an important factor, the portion of the opinion dealing with such is next set forth. There the Court of Appeals said:

> Additionally, the evidence shows that Greer knowingly exercised an independent choice to insure his property with PIC. The prior owner of the center, Ronald Rhodes, was insured by PIC through Higginbotham. Rhodes told Bob Ballard, who worked for Higginbotham, about the forthcoming sale to Greer, told him that Greer had reviewed and was satisfied with the current insurance coverage, and

[7] *Id.* at 48-49. *See also* 1 BERTRAM HARNETT, RESPONSIBILITIES OF INSURANCE AGENTS AND BROKERS, § 3.15[1] (1992).

8. Higginbotham & Associates. Inc. v. Greer, 738 S.W.2d 45, 48 (Tex. Q. App. 1987). In this connection the Court said; "These facts conclusively demonstrate that Greer selected the insurance he wanted, and there is no evidence to support a finding of negligence on the part of higgmbotham." *Id.* at 48.

> wanted to continue it as it was then written. Ballard contacted Greer about the continued coverage, and Greer agreed he was interested in continuing the policy as written.
>
> Greer then called Rhodes and inquired about coverage and about the reliability of Higginbotham. Rhodes told Greer Higginbotham was a reputable company and recommended Ballard as an agent. Greer then told Ballard to take care of the coverage.
>
> These facts conclusively demonstrate that Greer selected the insurance he wanted, and there is no evidence to support a finding of negligence on the part of Higginbotham. If it can be considered that some evidence supports the jury finding of negligence, we find that evidence to be factually insufficient to support the answer.[9]

The above quotation from the case does come close to a fact pattern where the prospective insured demands a particular insurance company or conditions the coverage on the agent or broker obtaining it from an insurance company that the insured requires. However, in this writer's mind, it does not actually go so far as to show that the insured demanded a particular insurer. The closest the facts in *Higginbotham & Associates* come are that Greer "had reviewed and was satisfied with the [prior] coverage, and wanted to continue it."

B. The Prospective Insured Insists on a Particular Carrier

A leading insurance law text concludes that in this situation (where the prospective insured insists on a particular insurance company) that the agent or broker is not usually responsible if the carrier turns out to be defective.[10]

Such text points out that there may be an exception if the agent or broker is aware that there is something wrong or defective with the company and he or she believes or should reasonably believe that the prospective insured is unaware of such.

However, it seems this situation (where insured insists on a particular carrier) is not common in connection with property and casualty lines. The

9.For additional consideration of this factor of the insured selecting the company see 1 Harnett, *supra* note 7, 5 3.15, where such text covers the situation where "a prospective insured insists on having his insurance placed with a carrier of his choice."

[10]Such text states the rule as follows: "When a prospective insured insists on having his insurance placed with a carrier of his own choice, the agent or broker is not normally responsible if the carrier is in some way a defective one." 1 HARNETT, *supra* note 7, § 3.15.

situation where the insured exhibits a marked preference as to an insurance company is more common in the life insurance area.[11]

It seems it is the situation where the agent or broker has the "leeway" to select or designate the insurance company to be used, which (in a large part) leads to the duty on the part of the agent or broker to place the insurance with a solvent insurance company. Thus, the agent or broker, whether he is procuring life, health or casualty insurance, should be aware of the possible exception to liability where the insured is insisting on the particular carrier to be used.[12]

With the above discussion firmly in mind, it is now intended to consider in more detail in the next topic the liability of agents and brokers for placing business with an insolvent carrier.

IV. THE DUTY TO PLACE INSURANCE WITH A SOLVENT INSURANCE COMPANY

A. *The "Solvency Recognition Issue," Until Recent Times, Was Thought to Be a Rather Rare Legal Issue*

As indicated earlier, this "solvency" issue was mistakenly thought by some to almost be a thing of the past due to extensive state regulation both before and after licensing and admission. This way of thinking can be harmful if it creates the false confidence that periodic state examinations will insure that the company is solvent. An expert witness testified in *Higginbotham & Associates* that certain facts should be noted by a reasonable agent. One factor stressed was that a declining Best rating over a period of five to seven years was "a pretty good indication a company was headed for financial trouble."[13] The case law does require the agent or broker to play a role here, in that he or she is required to use reasonable skill and judgment with a view to providing the indemnity for which the insurance is sought. This duty placed on the agent or broker is the item considered herein. It concerns the duty involved in initial placement of the insurance with a solvent carrier and the subsequent duty, where after placement of the insurance, the agent learns that the company is having financial difficulties.

The general rule set forth in *Higginbotham* that the agent or broker is required to use reasonable skill and judgment with a view to the security or indemnity for which the insurance is sought," does not give the specific guidelines needed for the agent or broker to safely represent an insurance company. What next follows is a consideration of whether or not the agent

11. 1 Harnett, *supra* note 7, § 3.15.

12. *See id.* & 3.15, at 3-144.

13. Higginbotham & Associates, Inc. v. Greer, 738 S.W.2d 45, 48 (Tex. Ct. App. 1987).

or broker has a specific duty to assess the financial solvency of the insurer before placing the insurance with it. First, as a part of such consideration we must determine whether or not there is a possible difference in potential liability where a salesperson is classified as a broker rather than as an agent.

B. *The Title of "Agent" or "Broker[1]' Either m Company Contract or By State License Has Little to Do With the Legal Duty to Place the Insurance With a Solvent Insurer*

The title of "agent" or "broker" as set forth in the salesperson's contract with his or her company, or as set forth in the license granted by the state, is not determinative of legal status.[14] Illustrative of this is the rule as stated by the Georgia Supreme Court: "Whether the defendant was licensed as an 'agent' or as a 'broker' under the Insurance Code of Georgia ... is immaterial to a determination of this case for the relationship of the parties, not the license held by the defendant, is the controlling issue."[15]

Thus, as pointed out by the Georgia court, it is not the label of "broker" or "agent" that matters; it is the actual relationship between the three parties (the insured, the salesperson, and the insurer) that counts.[16]

The above is not the only problem in this area, for there is a further problem involving liability where, as a finding of fact,[17] it is determined that the salesperson is the agent of the insurance company and not a broker (who represents the insured).

C. *The Possible Difference in Potential Liability Where a Salesperson is Determined as a Finding of Fact to be an Agent, Rather than a Broker*

It is clearly accepted agency law that one who is determined as a finding of fact to be a broker represents the insured so that he or she should be well aware of his or her potential liability. In addition, if as a finding of fact it is determined that the salesperson represents the insured, such

[14] *See* 3 BERTRAM HARNETT & IRVING I. LESNICK, THE LAW OF LIFE AND HEALTH INSURANCE, § 11.04(4] (1992).

[15] Wright Body Works v. Columbus Interstate Ins., 210 S.E2d 801, 803 (Ga. 1974). *See also* in this connection 1 HARNETT, *supra* note 7, § 3.15(3] where such text states: "... this distinction is really a semantic tangle, for the real inquiry is the relationship of between the three parties, the insured, the agent or broker, and the carrier."

[16] *See also* 3 HARNETT & LESNICK, *supra* note 14, § 11.04(4] where such text states in this connection: "In reality, whether a selling person is called an agent' or a 'broker' is of less legal consequence than the actual relationship of the insured and the selling person, the parties' actual conduct, the availability of information, and the reasonableness of reliance and expectations "

[17] *See* Eddy v. Republic Nat l. Life Ins. Co., 290 N.W.2d 174,176 (Minn. 1980) where this court stated: "In which capacity a person is acting is a question of fact."

salesperson's liability for faulty placement of coverage will stand up notwithstanding what his or her contract or license calls such salesperson ("agent" or "broker"). On the other side of the coin, where the insurance representative is deemed an agent of the insurance company (assuming the facts do not establish any special duty to the insured), such salesperson is the agent of the insurance company (the disclosed principal) and thus, it seems, should have no liability to the insured.[18] Illustrative of this last point is the holding in the Georgia case of *Sutker* v. *Penn. Ins. Co.*,[19] where it was concluded: "... it appears that there is no liability in *tort* for the failure of the defendant insurance agent... to procure ... a policy of insurance where the defendant is the *insurance company's* agent and not the plaintiffs agent."[20]

Based on the above, it seems that the issue of faulty placement of coverage would involve in the main property and casualty companies where the salesperson operates in a broker classification. In this connection one insurance law text concludes that: "The problem of placement by agents with authorized and solvent insurers customarily arises in the property and casualty instances, not with life or health insurance."[21]

Notwithstanding the above (that the question of faulty placement does not customarily arise in connection with agents selling life and health insurance) the question involving their liability is still important and needs an answer. In this connection, the law on liability of the life insurance agent has been summarized by a leading life and health insurance text as follows:

> Conceivably, an "agent" of a new or small life insurance company will have some pertinent information on the solvency of a carrier and in such case his technical status as an "agent" should not control if he places insurance in an apparent free-lance context. The full-time agent of a life carrier, on the other hand, is patently the insurer's man and he would not theoretically have the duty to the client of inquiring as to the insurer's solvency although he may be chargeable with knowledge he actually has. Any conceded agent, in the sense of carrier representative, however, soliciting insurance as such within a jurisdiction should carry with him the representation that the insurer is authorized to conduct its business in that jurisdiction.[22]

[18] *See* 1 HARNETT, *supra* note 7, § 3.15[3] and the cases cited therein.

19. Sutker v. Penn. Ins. Co., 155 S.E.2d. 694 (Ga. 1967).

[20] *Id.* at 698. In this case the complaint alleged that the named individual agent was the duly authorized agent, employee, and servant of the insurance company acting in the prosecution of the company's business and within the scope of his authority." *Id.* at 696.

[21] 3 Harnett & Lesnicx. *supra* note 14, § 11.11(2].

22. l HARNETT, *supra* note 7, § 3.17.

The above quotation generates some interesting conclusions on a life insurance agent's liability as to an insurer's insolvency. First, it generates the conclusion that a full-time agent of a life insurance carrier[23] may be liable for loss if he or she knows the company is insolvent. Second, it generates the possible conclusion that a life insurance agent may be liable for loss due to the company's insolvency, if the insurer is not authorized to conduct business in the state.[24]

D. *Courts Have Held that Agents or Brokers Do Not Need to Overlap the Insurance Department's Statutory Role in Assessing the Financial Solvency of Admitted Insurance Companies*

At least the courts of two states have decisions which provide support for the rule that agents or brokers have no duty to assess the financial condition of admitted insurance companies. In this connection a California court[25] specifically held that an insurance broker has no duty to assess the financial condition of an insurer before placing insurance with it, provided the insurer is conducting business pursuant to a certificate of authority.

The facts of this California case are similar to the facts in *Higginbotham.* The insurance company was properly licensed in California by the State Insurance Commissioner. The carrier was solvent when the agent placed the coverage and it did not become insolvent until later, when the plaintiffs claims were pending.[26] The pertinent reasoning of the court in deciding that the agent or broker owes no duty to its client to investigate the financial condition of the insurer before placing the insurance is worth noting. Here, the court said:

> It would be superfluous, and would create a conflict with the regulatory scheme outlined in the insurance code, to impose upon an insurance broker a similar duty to ascertain the financial soundness of an insurer. Moreover, the imposition

[23]*Compare* the words in this quotation (that a "full-time agent of a life carrier ... is patently the 'insurers man") *with* those in I.R.C. § 7701(a)(20) (that "the term 'employee' shall include a full-time life insurance salesman . . ."). *See* in this connection Malcolm E. Osborn, *Compensating the Big Producer and Certain Tax Aspects Involved Therewith,* XIX ASSOC. OF I ıfr Ins. COUNSEL PROC. 477 at 779-789 (1966), for a detailed discussion on whether or not an insurance agent is an employee of the life insurance company for certain tax fringe benefits.

[24]*See* 3 Roland a Anderson & Mark S. Rhodes, Couch Cyclopedia of Insurance Law § 25.51 (rev. 1984 & Supp. 1991); *see also* 16A JOHN Alan APPLEMAN & JEAN APPLEMAN, Insurance Law and Practice 8 8834 (rev. 1981 & Supp. 1991) where it is concluded: "Liability arises where the agent places insurance in a company not authorized to do business within the state, particularly where it also proves to be insolvent." *Id.* at 55.

25.Wilson v. All Serv. Ins. Corp., 91 Cal. App. 3d 793, 153 Cal. Rptr. 121 (Cal. Q. App. 1979).

26.Id. at 793,153 Cal. Rptr. at 121.

> would be meaningless inasmuch as a broker has no power to compel an insurer to divulge information regarding its financial condition. Accordingly, we hold that insurance broker such as defendant, owes no duty to its clients to investigate the financial condition of an insurer before placing insurance with it on their behalf. If a broker places insurance with an insurer conducting business pursuant to a certificate of authority, the broker has fulfilled its duty to clients.[27]

An earlier Kentucky Court of Appeals decision lends support to this rule when it states: "The agent of any company authorized by the insurance department to come into the state may safely represent that it is a solvent and responsible company; and, if it is not, he will not be held answerable for its default."[28]

It seems the above-discussed rule, that agents do not have a duty to assess the financial condition of admitted carriers, is indeed fortunate. This is because, in the usual situation, an agent or broker does not have the expertise to even attempt to determine the solvency of an insurer.[29] This is also because it is universal that each state's insurance department has the statutory duty to audit regularly the financial condition of each insurer and the insurer's ability to meet its liabilities.[30]

Since in the usual case (if not in all cases), the state "insurance department," or its equivalent, operates under a statutory mandate to oversee the financial condition of insurance companies operating in such state, it should be the one to determine financial solvency and not the insurance agent or broker.[31]

[27] Id. at 798.153 Cal. Rptr. at 124. *See also* in this connection *Amici Curiae* Brief in Support of Higginbotham, *supra* note 2, at 37-38 for discussion of this case.

[28] Vertrees v. Head & Matthews, 127 S.W. 523 at 526 (Ky. Ct. App. 1910).

[29] 1 HARNETT, *supra* note 7, § 3.15[1] points this out by stating: "Determining the an insurer is a formidable matter, involving -les^h «in baffle^ ^ accountants." *See also* in this connection *Amici Cunae* Bnef in buppon ^ *&rnri* note Z at 15-16 and its discussion on "financial analysis" and its conclusion\ ^ - financial agents have neither the expertise nor access to information necessary o per

[30] Every state and the District of Columbia has an "insurance Every sute requires an annual statement or report of insurers. others from one financial examination of licensed insurers. Most states ermine *every* & „pm to five years; some, however, examine with no specific schedule. notc 14, § 1.0213). . . The National

[31] In this connection one should take note of the NAICsearty _ , J c d naming test" Association of Insurance Commissioners ("NAIC") has developed mandate to oversee the in order to assist state insurance departments in executing their statu o connection *Amici* financial condition of insurance companies operating in their V l s s l o n of hc NAICs *Curiae* Brief In Support of Higginbotham, *supra* note 2, at 31-3 early warning test.

E. *As a General Rule It Is Only in Connection With Nonadmitted Insurers That Agents or Brokers Have a Duty to Investigate Financial Condition*

As a general rule, the only situation where a duty to investigate the financial condition of an insurer is placed on the agent or broker and not on the insurance department is when a nonadmitted, surplus line carrier is involved.[32] It seems this exception arises due to the insurance law of certain states. It seems the applicable state statute may impose upon surplus line agents the duty to investigate the financial condition of the unauthorized issuer before it places the coverage.[33]

Since this particular exception, which dictates agent or broker investigation of the financial condition of the alien surplus line company depends on each state's statutory scheme, it seems the applicable state's particular surplus line statute must be carefully studied.[34] The measure of damages for procuring coverage in an insolvent surplus line insurer may involve recovery for the whole loss.[35] This potential liability for choosing a surplus line carrier which is insolvent should be of prime concern to the agent or broker who is a surplus line licensee.

F. *The Liability of the Agent or Broker in Obtaining Coverage With an Admitted and Authorized Company Which Was Then Insolvent*

[32]*See* 1 HARNETT, *supra* note 7, § 3.15[1], at 3-146. The author also explains "surplus line" as follows:

> [T]here are instances in which local insurance may be validly placed with an unadmitted or unauthorized insurance company. This is sometimes referred to as 'exporting' insurance risks. Ordinarily such insurance is obtained through so-called surplus line or excess line brokers who are licensed for this purpose by their state insurance department. These coverages are typically for liability insurance (but not restricted to it) which is not standardly available in the particular state. These lines are, in a sense, surplus or in excess of coverages domestically available on a standard basis. *Id.* § 3.15(2], at 3-151.

[33]This point was made in th*Amici Curiae* Brief in Support of Higginbotham, *supra* note 2, at 36-37. There it was argued that the only circumstance in which the Texas Insurance Code imposes a duty "to assess and monitor the financial condition of a carrier" is when a nonadmitted surplus line carrier is involved. As support for this point, Tex. Ins. Code Ann. art 1.14-2(8) (Vernon 1981) was cited and quoted. *Id.* at 36.

34.See 1 HARNETT, *supra* note 7, § 3.15(2] for an excellent treatment of the law (both statutory and case law) of certain states involving this special duty imposed on so-called surplus line or excels line brokers. Also, as evidence of the importance of the need for careful examination of the particular law of the involved state, such text points out at the end of its treatment on this, that it has a "Statute Finder at Appendix 1" which "contains citations to principal surplus line statutes." *Id.* § 3.15(2], at 3-154.

35. *Id.* at 3-152 where such text states in this connection: I f . . . the insurer is insolvent, the whole loss is recoverable."

The *Higginbotham* case adopted what it determined to be the "general rule" in this area after considering leading insurance law texts,[36] Texas cases "illustrative of the general rules regarding insurer insolvency and negligence"[37] and cases of other states.[3]® However, it should be remembered that while *Higginbotham* did not specifically deal with facts covered under this heading, it did set forth the "general rule" by saying: "The general rule is that an insurance agent or broker is not a guarantor of the financial condition or solvency of the company . . .'[139]

An up-to-date insurance law text gives the rule on an agent or broker in obtaining insurance with an admitted and authorized company as follows:

> As a practical matter then, the vitality of the rule of responsibility must remain in two general situations. The rare situation where the broker for some reason is in possession of some knowledge which belies the solvency of the insurer . . . The second situation is an increasingly common one, and deals with placement with unauthorized foreign carriers where little information is available.[40]

Thus, it seems rather clear based on the considerations discussed under this heading[41] and also under the two preceding headings[42] that an insurance agent or broker is not generally liable for obtaining insurance with an admitted and authorized company which was then insolvent, unless of course the agent or broker has knowledge of such insolvency when the insurance is placed.

36.Higginbotham & Associates, Inc. v. Greer, 738 S.W. 2d 45 at 47 (Tex. Ct. App. 1987). This Court cited as direct authority for "the general rule" the following sources: "3 Couch on Insurance 2d § 15:48 (rev 1984); 43 Am. Jur. 2d Insurance § 143 (1982); ANNOT. 29 A.L.R. 2d 171,182 (1953)." *Id.* at 46-47.

[37.] *Id.* This Court pointed out that while the Texas cases were ". . . illustrative of the general niles regarding insurer insolvency and negligence, they do not directly address the issue . . . because in each of them, the agent had actual knowledge of insolvency during a time when an insured could have been protected." *Id.* at 47.

[38.] *Id.* In particular the Court turned to a decision by the Wisconsin Supreme Court in Master Plumbers Ltd. Mut. Liab. Co. v. Cormany & Bird, Inc., 79 Wis. 2d 308, 255 N.W. 2d 533 (1977) and commented that its facts "more closely resemble" those of the Wisconsin case. The Texas Court also set forth the holding of the Wisconsin case with approval. *Id.* at 47.

[39.] *See* text accompanying note 6 *supra*, for the full quotation of such "general rule including the requirement "to use reasonable skill and judgment" and the example of an agent or broker liability "where the policy is procured in a company known by the agent to be insolvent.

40.1 HARNETT, *supra* note 7, § 3.15(1]. *But see* 3 COUCH CYCLOPEDIA OF INSURANCE LAW *"*pra* note 24, § 25:48 (rev. 1984 & Supp. 1991), where such text says: "Ordinarily, an agent to Procure a policy is liable where he places a risk in a company which is insolvent if the use of Proper diligence would have revealed that fact before the insurance was procured... / •

41.See supra notes 36-40 and accompanying text.

42.See supra notes 25-35 and accompanying text.

V. THE DUTY "TO EXERCISE REASONABLE DILIGENCE" WHERE THE INSURER "PRESENTS AN UNREASONABLE RISK" AFTER THE POLICY WAS WRITTEN

A. The Liability of an Agent or Broker Where the Insurer Becomes Insolvent After the Policy Was Written

There are numerous authorities which hold the agent or broker is not liable upon the subsequent insolvency of the insurance company, where the company was solvent when the policy was obtained.[43] However, this statement standing alone does not give a complete answer. The *Higginbotham* case dealt with facts directly in point with this topic (where the insurer becomes insolvent after the policy was issued). *Higginbotham* adds to the "no liability rule" as follows:

> We . . . conclude that an agent is not liable ... if the insurer is solvent at the time the policy is procured, unless .
> . . at a later time when the insured could be protected, the agent knows or by the exercise of reasonable diligence should know, of facts and circumstances which would put a reasonable agent on notice that the insurance presents an unreasonable risk.[44]

This case establishes the requirement that the agent exercise some sort of "reasonable diligence" (after the sale of insurance) so as to be continuously aware that the insurance company is in sound financial condition or not. There seems to be little or no guidelines as to what lengths an agent must go to here. The *Higginbotham* decision seems to put the agent or broker, who sells a product of an admitted and licensed company, in a somewhat similar position to the agent or broker who places insurance with a nonadmitted surplus line carrier. If so, then such agent or broker has some duty (after the insurance is procured) to continuously investigate the soundness of the financial condition of the insurer.

43.Higginbotham & Associates, Inc. v. Greer, 738 S.W.2d 45 (Tex. G. App. 1987); Williams- Berryman Ins. Co. v. Morphis, 249 Ark 786, 461 S.W.2d 577 (1971); Master Plumbers Ltd. Mut. Liab. Co. v. Cormany & Bird, Inc., 79 Wis. 2d 308, 255 N.W.2d 533 (1977); *stt* 16A JOHN ALAN Afpleman & Jean Appleman, Insurance Law and Practice § 8833 at 49 (rev. 1981 & Supp. 1991); 3 Ronald A Anderson & Mark S. Rhodes, Couch Cyclopedia of Insurance Law § 25:48 (rev. 1984 & Supp. 1991).

44.Higginbotham & Associates, Inc. v. Greer, 738 S.W.2d 45 at 47 (Tex. Ct. App. 1987). Here the words, "unless ... at a later time ... the agent ... by the exercise of reasonable diligence should know, of facts and circumstances which would put a reasonable agent on notice . . s t a n d out to create a further continuing duty on the agent to avoid liability. Such words require the exercise of "reasonable diligence" to be aware that the company is financially stable or to be aware that it is in financial trouble ("presents an unreasonable risk").

B. The Lack of Guidelines on "Reasonable Diligence"

However, no guidelines on this dilemma involving "reasonable diligence" were given in the *Higginbotham* decision. Some agents or brokers may take solace in the last sentence of "the general rule" of the *Higginbotham* case, which reads: . . where the company was solvent when the policy was procured, its subsequent insolvency generally does not impose liability on the agent or broker."[43]

This writer has trouble with the word "generally" in this quotation when it is considered along with "the exercise of reasonable diligence," discussed above. The agent or broker who wants to be on the safe side may establish a continuous and customary procedure of examining appropriate weekly insurance publications,[44] or monthly publications.[47] The agent or broker who has concerns about a company's financial condition may make inquiries to his or her state insurance department and ascertain written evidence of the financial condition of an insurer by examining the financial data contained in Best's Insurance Reports.[4]®

If a careful agent is going to go through the trouble of policing financial condition, it may be wise to document such in a folder for possible future proof that he or she continuously or periodically complied with his or her self-imposed obligations to ascertain written evidence of the financial condition of certain insurers (which he or she utilize).[49]

45.Id. Note the Court cited 3 COUCH CYCLOPEDIA OF INSURANCE LAW *supra* note 43, as the first of its three authorities.

46.One «ample of many would be the NATIONAL UNDERWRITER which is published weekly.

[47]One example, again, out of many, would be LIFE INSURANCE SELLING, which is published monthly.

[48] A.M. Best issues annual ratings on each of thousands of life and property/casualty insurers in the United States. However, both Moody's Investor Services and Standard & Poor's Corp. (SAP) have entered the insurance business. See in this connection M Rowland, *StiU the Best'!,* 19 FINANCIAL planning 88 (Sept. 1989). *See also* Richard L Phillips, Jr,, *The Rating Game: Alphabet Soup?,* 66 LIFE INSURANCE SELLING 38 (Nov. 1991) where he mentions a fourth rating service. Duff & Phelps. However, it stands to reason that the agent undertakes a financial analysis in a source, such as BEST'S INSURANCE REPORTS, should look beyond the rating to the narrative on financial condition. *Cf. Amici Curiae* Brief in Support of Higginbotham, *supra* note 2, at 11, where the insured's expert witness explained that, "to determine which company is best, an ordinary agent would look beyond the rating to at least read the narrative in Best's Insurance Reports."

49.Compare Stemoff Metals Corp. v. Vertecs Corp., 39 Wash. App. 333, 693 P. 2d 175 (1984), where a surplus lines broker writing surplus line insurance complied with the statutory obligation [t0] Certain written evidence of the financial condition of the surplus lines insurer. *See also Amici* [Curiae] Brief in Support of Higginbotham, *supra* note 2. at 12-14 (for expert witness testimony as the significance of the financial data concerning PIC available to insurance agents in 1980).

C. Notice to the Insured That the Insurer "Presents an Unreasonable Risk" and the Dangers Involved With Such Notice

Assuming (after the policy has been issued) the agent by exercise of reasonable diligence finds facts and circumstances indicating the "insurance presents an unreasonable risk," what does he do then? It seems, that if by exercise of reasonable diligence the agent obtains information indicating that the insurance company is insolvent, or on the verge of insolvency, he or she should give notice to the insured.

Assuming there is a duty to give such notice to the insured that the company has, subsequent to the issuance of the policy, become insolvent (or seems to be headed in that direction), is there something in the insurance law to compare this duty with? A somewhat related duty to notify the insured arises when the insurance company informs the agent or broker that it intends to declare the policy void because of misrepresentation.[50]

However, as next to be considered, there seems to be a significant difference between a situation involving the passing on of information to an insured that the insurance company has given to the agent or broker and the situation involving the notifying of an insured that the agent has discovered evidence indicating the insurer is in financial trouble. The requirements here to give notice seem to arise due to the fact that the agent or broker has come upon evidence indicating insolvency (or that insolvency may be a clear possibility). The carrying out of this apparent duty by giving the insured notice concerning insolvency of the company may create grave problems for the agent or broker, if in fact the company remains solvent. One danger would be a possible lawsuit by the company against its agent (or former agent) for intentional and unlawful interference with the company's contractual relations with its policyholders. Another danger could also be a possible lawsuit by the insurance company against such agent (or former agent) for violation of the appropriate state's unfair trade practices provisions.[51]

[50]*See* 3 HARNETT & LESNICK, *supra* note 14, § 11.10. Here this text describes this somewhat related duty to notify the insured as follows: "When an insurer advises an agent that it wishes to declare a policy void because of misrepresentation, the agent apparently has a duty to promptly pass on the information to the insured." *Id.* at 11-46.

51.This writer has had some first-hand experience in both these situations, for he most recently appeared as an expert witness for the insurance agent in just such a lawsuit. In such case the insurance company's counterclaim ("Count One") alleged that the insurance agent contacted Georgia International Life Insurance Company's policyholders and made false and misleading representations about ". . . Georgia International's financial condition" Also the insurance company, by way of counterclaim ("Count Two") alleged that such false and misleading representations violated the Georgia Insurance Trade Practices Act, Ga CODE ANN. §§ 33-6-1 through 33-6-14. See for example, Ga. CODE ANN. § 33-6-4(b)(3) on "making ... oral or written statement . . . which is false ... or substantially misrepresents the financial condition of the insurer . . . " In the decision it was ordered and adjudged among other things that on the "Counterclaim for Interference with Contract Rights, judgment in favor of Plaintiffs [the insurance

D. Notwithstanding the Problems Where the Insurer "Presents an Unreasonable Risk," the "General Rule" Should Give Some Comfort

Notwithstanding the confusion caused by the "exercise of reasonable diligence" words in *Higginbotham* and the lack of legal authority to guide a careful agent or broker in compliance with such wording, the actual decision in *Higginbotham* should be kept in mind. The Court in effect followed that portion of the "general rule" which states " . . . where the company was solvent when the policy was procured, its subsequent insolvency generally does not impose liability on the agent or broker."[52] In this connection the Court in deciding that Higginbotham was not negligent and not liable said:

> ... It was undisputed that PIC was an admitted, authorized carrier in Texas at all relevant times. There is nothing in this testimony constituting evidence that a reasonable agent would have known or should have known that PIC constituted an unreasonable risk at the time the insurance was procured, or at any time prior to the loss.[53]

Thus, since no evidence was offered by the insured to show that a reasonable agent should have known that the insurer constituted an unreasonable risk, the agent was not negligent and was not liable.

VI. CONCLUSION

Using the starting point that this writer selected (the 1987 Texas district court decision in *Higginbotham)* the law has developed in a favorable manner. It seems the fear, resulting from the Texas lower court decision, that agents and brokers would be guarantors of company solvency so as not to dare sell for carriers with ratings below "A," has been removed entirely. The Texas trial court's decision that the agent was liable even though the insurance company was solvent when the business was placed has been overruled on appeal. This coincides with the prevailing rule of law.

This study went on to consider in some detail the additional wrinkle caused by the classification issue involving "agent" versus "broker" status. The resulting conclusion was that (in the main) both the agent and the broker

agents]." Shaw v. Integon Corp., Georgia Int'l Life Ins. Co., No. CV90-1185, slip op at 2 (Ga. Super. Ct,, Bartow County, May 15,1992) (on file with author). *See also Longest Trial In Recent History Ends Here With Verdict For Shows*, THE DAILY TRIBUNE (Cartersville, Georgia), May 11.
1992 at 1.

52.Higginbotham & Associates, Inc. v. Greer, 738 S.W.2d 45, 48 (Tex. Q. App. 1987).

53.Id. at 48 (emphasis added).

receive the same treatment under the law as it has developed in this particular area of insurer insolvency.

This writer took notice of the point made by the Texas Court of Appeals that "the evidence shows that Greer [the insured] knowingly exercised independent choice . . . " in selecting the insurance company. In this connection, other authorities were discussed on the proposition that the agent or broker is not usually liable if the carrier turns out to be defective, when the insured was the one insisting on such carrier.

The duty of the agent or broker to use reasonable skill and judgment in placing insurance with a solvent insurance company was considered at length. The primary argument that the broker or agent need not overlap the State Insurance Commissioner in determining financial soundness of a company was considered. However, this writer did not feel secure by such approach, in particular where the agent has some personal knowledge which indicates the company may be insolvent or may be heading toward such. Also, the greater duty of agents or brokers to investigate financial condition of nonadmitted surplus line insurers was examined.

This study shows that the case law has adopted a so-called "general rule" that the agent or broker is not liable for unpaid losses due to the subsequent insolvency of the insurance company (where the company was solvent at the time the policy was issued). However, caution is needed here, for the smallest of facts and circumstances, may create exceptions to this "general rule." Also, it seems some planning is always needed to insure the best facts prevail on the insurer solvency issue in order to have a safe defense just in case subsequent insolvency occurs and the agent or broker is sued. Such planning should include a self-imposed duty, or a duty based on interpretation of the "general rule," to keep abreast of the financial condition of the carrier and to give notice to an insured if, after the coverage is issued, it is learned that insolvency is imminent (or a good possibility that insolvency exists).

The dangers in giving notice to the insured that the insurer is in bad financial shape, where such opens the door to the insurance company suing the agent or broker for damages for unlawful interference with the insurer's contractual relations with its policyholders, was analyzed. Such was illustrated by reference to a most recent Georgia case and the two different theories used by the insurer in such action for damages. It seems if the agent or broker gives the notice to the insured too soon without proper evidence to show pending insolvency the insurer may sue. On the other hand, if the agent or broker gives the notice too late (after the insurer becomes insolvent), the insured may sue. The minimum requirements to be followed here to best protect the agent or broker from a lawsuit by the company and from a lawsuit by the insured include a determination that the insured can still be protected if notice is given, and that there are real facts in existence to evidence insolvency or that insolvency is just around the comer.

The purpose of this study is to cover the developing law on the liability and duties of insurance agents and brokers for both the initial placement of insurance with a then insolvent carrier and also for allowing such insurance to remain with a carrier, which subsequent to such placement, becomes insolvent. In this connection, this study considers items of defense and items of planning from the point of view of the agent or broker so as to avoid liability in either situation. It is only by neglect of the law or by failure of proof (due to lack of proper facts) that the agent or broker will lose a case involving these solvency recognition issues. The cases and authorities discussed herein show that the agent or broker should be safe from liability if the guidelines of the law are kept in mind and followed.