CASE STUDY PREPARED FROM ORIGINAL PUBLISHED OPINION

ERNEST A. LONG
Alternative Dispute Resolution
❖ Resolution Arts Building ❖
2630 J Street, Sacramento, CA 95816
ph: (916) 442-6739 • fx: (916) 442-4107
elong@ernestalongadr.com • www.ernestalongadr.com

Pacific Rim Mechanical Contractors v AON Risk Services 2/28/12

Professional Negligence; Insurance Brokers; Insolvency of Insurer

This case arises from a construction project, completed in 2002. The developer, Bosa, engaged Aon as its insurance broker to obtain insurance for the project with Legion Indemnity Company. Legion was solvent at the time. Bosa hired PacRim as a subcontractor, and the parties entered a contract in which Bosa agreed to provide PacRim with liability insurance for its work on the project. Aon was not a party to the insurance contract. Aon provided PacRim with a "certificate of liability insurance," identifying PacRim as Legion's insured. In April, 2003, after the project was complete, an order of liquidation with a finding of insolvency was entered against Legion. Neither Bosa nor Aon notified PacRim of the insolvency or the earlier order of rehabilitation. PacRim alleged it would have ceased work on the project if it had known of the change in Legion's status.

In 2009, the project's homeowners association filed a complaint for construction defects against Bosa and its subcontractors, including PacRim. Alleging failure to provide insurance as required by contract, PacRim cross-complained against Bosa for breach of contract, negligence and fraud. It further claimed that Aon negligently or intentionally failed to disclose Legion's deteriorating financial condition and eventual insolvency. Aon demurred to the cross-complaint, asserting that since PacRim was not a party to the contract, Aon had no liability to it, and that it had no duty to notify PacRim of Legion's insolvency post-issuance of the policy. The trial court sustained the demurrer, finding Aon had no duty to notify an insured of an insurer's post issuance insolvency, citing *Kotlar v Hartford Fire Ins. Co.* (2000) 83 Cal.App.4th 1116. The court entered a judgment and PacRim elected to appeal instead of amending.

The Fourth DCA explained that insurance brokers owe a limited duty to their clients, which is only "to use reasonable care, diligence, and judgment in procuring the insurance requested by an insured. (*Jones v Grewe* (1987) 189 Cal.App.3d 950) As such, an insurance broker does not breach its duty to clients to procure the requested insurance policy unless "(a) the broker misrepresents the nature, extent or scope of the coverage being offered or provided … (b) there is a request or inquiry by the insured for a particular type or extent of coverage…, or (c) the broker assumes an 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." (*Fitzpatrick v Hayes* (1997) 57 Cal.App.4th 916)

PacRim asked the court to create a new legal duty of notification of Legion's insolvency after the policy was procured. The Justices explained that *Kotlar* is an analogous case. In *Kotlar*, the issue presented was whether an insurance broker has a common law duty to give notice to an insured of discontinued coverage after the broker properly placed the policy. There, the tenant maintained an insurance policy naming the landlord Kotlar as an insured pursuant to the tenant's lease; and, like PacRim here, Kotlar received a certificate of insurance from the broker. Kotlar, the plaintiff's insured, sought to impose liability on the broker for its alleged failure to notify Kotlar that the insurer intended to cancel the policy for nonpayment of premiums, which rendered Kotlar without coverage when a later loss occurred.

The *Kotlar* trial court sustained the broker's demurrer, finding the broker owed no duty to notify the insured that the policy was being cancelled. The Court of Appeal upheld the ruling, noting that because Insurance Code section 677.2 imposes a duty on the insurer to notify the named insureds of its intent to cancel the policy there could be no purpose in judicially imposing such a duty on a broker. The relationship between an insurance broker and its client is not the kind which would logically give rise to such a duty. The duty of a broker, by and large, is to use reasonable care, diligence, and judgment in procuring the insurance requested by its client. The *Kotlar* court also distinguished a broker-client relationship from an attorney-client relationship, which is fiduciary in nature.

Here, Aon had no legal duty to provide notice of the discontinuation of coverage caused by Legion's insolvency. PacRim does not allege Aon failed to use reasonable care in procuring the policy. Rather, PacRim seeks to impose upon brokers a legal duty of notification after the policy has been procured, to an insured that has a certificate of insurance, of the insolvency of an insurance company. That duty, as enumerated in Insurance Code section 677.2, rests with the insurer.

In addition, the Justices addressed the question of public policy. Whether, and the extent to which a new duty is recognized is a question of public policy. (*Butcher v Truck Ins. Exchange* (2000) 77 Cal.App.4th 1442) The California Legislature has already imposed a number of statutory duties on insurers and insurance brokers. The duty urged by PacRim would significantly expand and redefine a broker's role. The duty PacRim seeks to impose on brokers is unpredictable because what constitutes an adverse change in the insurer's financial capability that triggers the duty to notify the insured is exceedingly ambiguous. The scope of such a standard would take an unknown amount of time to define. The costs necessary to determine its exact scope through litigation, as well as the costs for brokers to effectively perform the duty would be substantial.

These concerns led the 4th DCA to conclude that imposing the duty on insurance brokers as PacRim requests is properly the role of the Legislature, not the courts. (See *Green v Ralee Engineering Co.* (1998) 19 Cal.4th 66) If anyone had a duty to inform PacRim of Legion's insolvency, it was Legion. (See Insurance Code section 677.2) The trial court's judgment is affirmed. Aon shall recover its costs on appeal.

All Case Studies and original Opinions from 2008 through the present are now archived on our Website:
http://www.ernestalongadr.com/index.php/library.html

/////

This case study is provided in the hope it may prove useful in your practice or in the handling of litigated cases. If you receive a forwarded copy of this message and would like to be added to the mailing list, let me know.

Mediation and Binding Arbitration are economical, private and final. Alternative dispute resolution will allow you to dispose of cases without the undue time consumption, costs and risks of the courtroom. Your inquiries regarding an alternative means to resolve your case are welcome.