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The Insurance Salesman--A New Duty to the Insured

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NOTES

The Insurance Salesman—A New Duty to the Insured?

In a recent decision[1] the United States District Court for the District of Hawaii introduced its opinion by asking, "Is the purchase of $150,000 of life insurance a 'do-it-yourself' project?"[2] In answering that question in the negative the court laid the foundation for a re-evaluation of the duty owed by the insurance salesman to the insured.

Because the potential purchaser of insurance is frequently ignorant of the terms, conditions, limitations, and obligations related to the insurance agreement, and because he seldom deals directly with the insurer, he has come to rely upon the insurance salesman to provide him with his insurance needs. Consequently, when the insured becomes dissatisfied with the coverage provided by the insurance salesman, the courts are called upon to determine the respective rights and duties of the parties. The primary determinant of the rights of the insured and the duties of the insurance salesman is the nature of the salesman-purchaser relationship.[3]

The courts have generally restricted the rights and duties involved to those imposed by the normal relationship of principal-agent[4] or purchaser-solicitor.[5] However, in three recent decisions[6] involving the insurance salesman and the insured, the courts have determined that the "expert" insurance salesman should be held to a higher standard of care than that imposed in the normal principal-agent or salesman-purchaser relationship.

An evaluation of the implications and potential ramifications of these decisions results in a conclusion that, although a new professional-client relationship similar to that found in the traditional professions has

1. Knox v. Anderson, 159 F. Supp. 795 (D. Hawaii), *findings of fact and conclusions of law,* 162 F. Supp. 338 (D. Hawaii 1958), *aff'd,* Anderson v. Knox, 297 F.2d 702 (9th Cir. 1961), *rehearing denied,* 300 F.2d 296 (9th Cir.), *cert. denied,* 370 U.S. 915 (1962).

2. Knox v. Anderson, 159 F. Supp. 795 (D. Hawaii 1958).

3. See 3 COUCH, INSURANCE §§ 25:32, :39 (2d ed. Anderson 1960).

4. An insurance salesman may be the agent of either the insurer or the insured, and where there is no conflict of interests he may be the agent of both. 3 COUCH, INSURANCE § 25:39 (2d ed. Anderson 1960); 4 COUCH, INSURANCE § 26:345 (2d ed. Anderson 1960).

5. One who is acting neither for the insured nor within the authority of the insurer will be personally answerable in an action for false pretenses. Shuff v. Life & Cas. Co. of Tenn., 164 La. 741, 114 So. 637 (1923).

6. Hardt v. Brink, 192 F. Supp. 879 (W.D. Wash. 1961); Knox v. Anderson, *supra* note 1; Steadman v. McConnell, 149 Cal. App. 2d 334, 308 P.2d 361 (1957).

not been imposed by the courts, there is reason to believe that such a relationship may be imposed in the near future.

IMPORTANCE OF THE AGENCY RELATIONSHIP

In the eyes of the layman, the insurance salesman is the middleman, representing both the insurer and the insured in procuring and effecting a contractual agreement for insurance coverage. However, the law is not content with such a theory of dual representation. The law of insurance, as developed by the legislative and judicial branches of government, has adhered to the principles of agency in regard to the activities of the insurance salesman.

It is generally held that the "general agent" or person acting by authority of an insurer is the agent of the insurer.[7] On the other hand, a "broker" or one who procures insurance coverage through several companies is usually held to be the agent of the insured.[8] The primary reason for the distinction is to bind the insurance company by the statements and contracts of its "general agent" but to protect it from being bound by the acts of a "broker," to whom it has delegated no authority to act on its behalf.[9]

Because the principal is entitled to the benefit of his agent's skill and judgment, an agent has a duty to exhibit undivided loyalty to his principal.[10] When the insured relies on the law of agency for his recovery or when the insurance salesman alleges the agency relationship as a defense, the court must make a factual determination as to whether the salesman is the agent of the insurer or the agent of the insured.[11]

AGENT OF THE INSURED

The agreement by which the potential purchaser selects an insurance salesman to represent him is essentially contractual.[12] Frequently this agreement is oral.[13] Moreover, it has been held that the agency relation-

7. 3 COUCH, INSURANCE §§ 26:1-:2 (2d ed. Anderson 1960).

8. An insurance salesman may become the agent of the insured by express contract, implication, custom or course of dealings, estoppel, or ratification. 3 COUCH, INSURANCE §§ 25:1-:6 (2d ed. Anderson 1960).

9. 16 APPLEMAN, INSURANCE § 8725 (1944).

10. See 3 COUCH, INSURANCE § 25:39 (2d ed. Anderson 1960); MECHEM, AGENCY § 500 (4th ed. 1952).

11. See Jonas v. Bank of Kodiak, 162 F. Supp. 751 (D. Alaska 1958); Continental Cas. Co. v. Bock, 340 S.W.2d 527 (Tex. Civ. App. 1960). In both cases the factual determination of whose agent was the salesman resulted in non-liability for the insurance company.

12. See note 8 *supra.*

13. See, *e.g.*, Valdez v. Taylor Auto. Co., 129 Cal. App. 810, 278 P.2d 91 (1955); White v. Calley, 67 N.M. 343, 355 P.2d 280 (1960); Hamacher v. Tumy, 222 Ore. 341, 352 P.2d 493 (1960).

ship may be created by implication[14] as well as by express agreement. Thus, an insurance salesman may become the agent of the insured with little difficulty.

Standard of Care of the Ordinary Agent of the Insured

As a rule, by accepting employment with full knowledge of its requirements, the ordinary agent of the insured accepts the customary duty of the normal agency relationship.[15] This duty is that of exercising ordinary or reasonable skill and diligence in acting on behalf of and in compliance with the instructions of the insured.[16] By entering into this relationship the agent of the insured does not agree that he will make no mistakes whatever, nor does he agree to be subjected to the duty to exercise the highest degree of care.[17]

The duty to exercise reasonable or ordinary care has been applied as the standard where the agent of the insured has been sued for a failure to procure a contract of insurance,[18] a failure to effect satisfactory terms and coverage,[19] a failure to renew the contract of insurance,[20] and a failure to effect insurance coverage with a company which is both solvent and licensed to do business in the state.[21]

Though the normal agency relationship is essentially contractual, it has been held that the insured may sue his agent either for breach of contract or in tort for negligence in the performance of his duty.[22] Many courts have recognized this distinction between the two grounds for recovery, while others have failed to make the distinction.[23] One author[24]

14. See Barton v. Marlow, 47 N.J. Super. 255, 135 A.2d 670 (App. Div. 1957); Luther v. Coal Operators Cas. Co., 379 Pa. 113, 108 A.2d 691 (1954).

15. In Hardt v. Brink, 192 F. Supp. 879, 880 (W.D. Wash. 1961), the court stated: "Clearly the ordinary insurance solicitor only assumes those duties normally found in any agency relationship. In general this includes the obligation to deal with his principal in good faith and to carry out his instructions. No affirmative duty to advise is assumed by the mere creation of an agency relationship." However, this does not mean that the agent cannot assume additional duties either by express agreement or by holding out. MECHEM, AGENCY §§ 524-25 (4th ed. 1952).

16. See Hamacher v. Tumy, 222 Ore. 341, 352 P.2d 493 (1960), for a discussion of the extent of the instructions which should be given to bind the "broker."

17. See note 15 *supra.*

18. Altrocchi v. Hammond, 17 Ill. App. 2d 192, 149 N.E.2d 646 (1958); Rayden Eng'r Corp. v. Church, 337 Mass. 652, 151 N.E.2d 57 (1958).

19. Colpe Inv. Co. v. Seeley & Co., 132 Cal. App. 16, 22 P.2d 35 (1933); White v. Calley, 67 N.M. 343, 355 P.2d 280 (1960).

20. Barton v. Marlow, 47 N.J. Super. 255, 135 A.2d 670 (App. Div. 1957).

21. Gerald v. Universal Agency, Inc., 56 N.J. Super. 362, 153 A.2d 359 (App. Div. 1959). With regard to types of recovery by the insured from the insurance salesman, see Note, *Liability of an Insurance Agent or Broker in Procuring or Maintaining Insurance for an Owner,* 12 VAND. L. REV. 839 (1959).

22. Valdez v. Taylor Auto. Co., 129 Cal. App. 2d 810, 278 P.2d 91 (1955); Marano v. Sabbio, 26 N.J. Super. 201, 97 A.2d 732 (App. Div. 1953).

23. See, *e.g.,* Milliken v. Woodward, 64 N.J.L. 444, 45 Atl. 796 (Sup. Ct. 1900).

24. PROSSER, TORTS 478-83 (2d ed. 1955).

has attempted to distinguish between the two theories of recovery by basing the tort action on misfeasance rather than on nonfeasance. To illustrate, when the agent of the insured has expressly or impliedly contracted with the insured to procure coverage, a failure to do so will constitute grounds for an action in contract. On the other hand, when the agent of the insured takes it upon himself to procure the best possible coverage and is negligent in doing so, an action in tort will arise.

Because the courts remain confused as to whether the plaintiff is strictly limited to one form of action[25] and to the damages arising from that action,[26] it is difficult to ascertain whether the breach of the duty in a specific case arises from action or inaction. A positive effort should be made by the courts to make the necessary distinction in order to apprise both the insured and the agent of the insured of the type of damages which will accrue from a failure to exercise ordinary care.

Standard of Care of the "Expert" Agent of the Insured

While the agent of the insured has generally been held to the standard of ordinary care, he may also be liable for a failure to utilize a special skill which he has held himself out to possess.[27] In at least one case, *Colpe Investment Company v. Seeley & Company*,[28] it has been stated that the "professional" agent of the insured should be required to exercise the requisite skill of his alleged status and should have a knowledge of the various companies and terms available. In the *Colpe* case the court held that it was a jury question as to whether the defendant's failure to procure the least expensive adequate coverage constituted bad faith.[29]

In a recent case, *Hardt v. Brink*,[30] the court held that it was the duty of an insurance "expert" to advise the plaintiff of his potential liability under a lease and to provide him with the necessary coverage.[31] The court determined that the agent of the insured had an affirmative duty to examine the lease agreement under which the plaintiff was lessee, because:

25. *Id.* at 485.

26. Damages in a contract action may be limited to nominal damages for the breach, while only proximate cause limits damages in a tort action. *Id.* at 484. *Compare* Rayden Eng'r Corp. v. Church, 337 Mass. 652, 151 N.E.2d 57 (1958), *with* Hardt v. Brink, 192 F. Supp. 879 (W.D. Wash. 1961).

27. Hardt v. Brink, 192 F. Supp. 879, 881 (W.D. Wash. 1961), citing MECHEM, AGENCY §§ 524-25 (4th ed. 1952).

28. 132 Cal. App. 16, 22 P.2d 35 (1933).

29. In a similar case the same duty was recognized by the court, but the decision rendered was contrary due to the fact that the lower rates were not available at the time of the agreement. Roberts v. Sunnen, 38 Wash. 2d 370, 229 P.2d 542 (1951).

30. 192 F. Supp. 879 (W.D. Wash. 1961).

31. It is doubtful that the ordinary insurance "broker" would be required to assume such a duty.

> by his conduct and business practices defendant permitted a reasonable inference to be drawn by his customers, such as plaintiff, that he was a person highly skilled as an insurance advisor and that plaintiff relied upon him as such. Under these circumstances defendant assumed a duty to advise plaintiff as to his insurance needs in connection with his business, particularly where such needs had been brought to defendant's attention.[32]

The court in *Hardt v. Brink*[33] did not attempt to impose the traditional professional's duty on the agent of the insured. However, it did state that, as occupational groups strive toward professional recognition, the law will impose "an even higher standard of care in the performance of their duties."[34]

The court accepted the testimony of the plaintiff's expert witness, who stated that the prudent agent of the insured, knowing of such a lease, would either examine it or recommend that it be examined to determine the potential liability of the insured under the lease.[35] The defendant suggested that the duty to examine the lease was that of the insured's attorney. The court's response to that suggestion was: "Although this may be true it does not follow that defendant, as a skilled insurance consultant, did not also have this responsibility."[36] Thus, when the agent of the insured holds himself out to be highly skilled, he assumes the duty to perform his responsibilities with that degree of care practiced by other highly skilled insurance salesmen in the community.[37] This standard of care would seem to be imposed whether or not he in fact possesses an "expert" or high degree of skill.[38]

Although *Hardt v. Brink*[39] was limited to the fact situation being adjudicated, it illustrates that the courts are ready to recognize that in such situations a higher degree of care must be imposed to protect the innocent insured. While the specific type of conduct which necessitates the imposition of the higher standard of care remains a factual determination, holding oneself out to be an "expert" or "professional" through the medium of advertising would seem to be sufficient to require such an imposition.[40]

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32. Hardt v. Brink, 192 F. Supp. 879, 881 (W.D. Wash. 1961).

33. 192 F. Supp. 879 (W.D. Wash. 1961).

34. *Id.* at 881.

35. The testimony of this witness was the only expert testimony offered by either party.

36. Hardt v. Brink, 192 F. Supp. 879, 882 (W.D. Wash. 1961).

37. See Curran, *Professional Negligence — Some General Comments,* in PROFESSIONAL NEGLIGENCE 4 (Roady & Andersen eds. 1960), where it is stated that the courts seem satisfied with the average or minimum acceptable conduct of similar professionals as the requisite standard.

38. Curran, *supra* note 37, suggests that the average or minimum standard is utilized to avoid the problem of differentiating between actual skills and the requisite duties imposed.

39. 192 F. Supp. 879, 881 (W.D. Wash. 1961).

40. See *ibid.*

AGENT OF THE INSURER

The insurance salesman who is expressly or impliedly authorized to represent the insurer in dealing with third persons in insurance matters is generally termed the agent of the insurer or the "agent."[41] Because the law of agency restricts the agent's representation in a single transaction to one principal, the courts have generally held that the agent of the insurer owes no agency duty to the insured.[42] For this reason there are no cases in which the insured has recovered from the agent of the insurer on the basis of an agency duty.

While the agent of the insurer owes no agency duty to the insured, it would seem that he would owe the normal salesman-purchaser duty to be honest and fair in his dealings.[43] Because the insurer is secondarily liable for the "agent's" torts and contracts falling within the scope of the latter's authority[44] and because the plaintiff-insured seeks to recover from the "deeper pocket,"[45] cases dealing with a direct recovery from the insurance "agent" are not numerous.

However, in *Knox v. Anderson*[46] an insured was provided with a prosperous "agent" who was not a mere solicitor but rather an "expert" insurance counselor. Thus, the judiciary was presented with an opportunity to re-examine the duty of an insurance salesman who is alleged to be the agent of the insurer.

Standard of Care of the "Expert" Agent of the Insurer

In *Knox v. Anderson*[47] the federal district court proposed two theories upon which a recovery might be predicated against an "expert" insurance "agent" for overselling a purchaser of life insurance. The two theories are: (1) misrepresentation and fraud and (2) breach of a duty to disclose resulting from a relationship of trust and confidence.[48] While the court of appeals, in *Anderson v. Knox*,[49] ultimately established liability on the sole basis of misrepresentation and fraud, the considerations of

41. 3 COUCH, INSURANCE § 26:1 (2d ed. Anderson 1960).

42. See 3 COUCH, INSURANCE § 25:40 (2d ed. Anderson 1960), for a discussion of instances in which the courts have found no conflicting interests and permitted dual representation by the insurance salesman.

43. A failure to do so might well result in an action for deceit. PROSSER, TORTS 522-23 (2d ed. 1955).

44. MECHEM, AGENCY § 349 (4th ed. 1952).

45. *Id.* § 350.

46. 159 F. Supp. 795 (D. Hawaii), *findings of fact and conclusions of law*, 162 F. Supp. 338 (D. Hawaii 1958), *aff'd*, Anderson v. Knox, 297 F.2d 702 (9th Cir. 1961), *rehearing denied*, 300 F.2d 296 (9th Cir.), *cert. denied*, 370 U.S. 915 (1962).

47. *Ibid.*

48. Knox v. Anderson, 162 F. Supp. 338, 341 (D. Hawaii 1958).

49. 297 F.2d 702 (9th Cir. 1961), *rehearing denied*, 300 F.2d 296 (9th Cir.), *cert. denied*, 370 U.S. 915 (1962).

both the trial and appellate courts are enlightening in regard to the present and future status of the "agent's" duty to the insured.

Fiduciary Duty

The court of appeals in *Anderson v. Knox*[50] dismissed the theory of the fiduciary duty, assuming that the plaintiff knew that he was dealing with the agent of another party.[51] Since Anderson was the agent of the insurance company, he could not also owe the plaintiff a fiduciary duty.

However, the court of appeals did not dismiss the theory of a fiduciary duty without further comment. As a member of the National Association of Life Underwriters, Anderson subscribed to a code of ethics, the preamble to which states that its members owe a high *professional* duty to their clients.[52] The question thus raised is whether the "agent" who holds himself out to the public as an "expert" and who subscribes to professional standards of conduct should be permitted to hide behind the cloak of the agency relationship when he is accused of having breached the standard of conduct which he has imposed upon himself. The court of appeals recognized this problem but evidenced its desire to leave the determination to another body by suggesting that licensing statutes may impose upon the insurance "agent" and "broker" duties similar to those imposed upon members of the traditional professions.[53]

Perhaps the court of appeals should have looked more carefully at the district court's opinion, which states:

> A seller might classify himself as a salesman. Yet where this subjective classification differs greatly from representations he makes about himself in the business community, the court will be principally concerned with the consequences of these representations.[54]

The district court stated further: " 'Buyer beware' lingers now only in the argument of the lawyers."[55] Under such circumstances it would seem that the better rule would be to permit the agency defense only when the "agent" has not caused the insured to rely on his representations of expertness.

Nevertheless, there are strong arguments in favor of the agency defense and against the imposition of a high fiduciary duty. The insurance agent is not required to have completed any formal professional education, nor does he have the degree of discretion in determining provisions

50. *Ibid.*
51. *Id.* at 706.
52. *Id.* at 706 n.4.
53. *Ibid.*
54. Knox v. Anderson, 159 F. Supp. 795, 805 (D. Hawaii 1958).
55. *Id.* at 806.

and conditions of the contract which he provides, that an attorney might have. However, the strongest argument is that the courts do not wish to depart from the agency concepts, which have been applied to the status of the insurance "agent" in the past. For these reasons the professional fiduciary duty has not yet been applied to the "expert" insurance "agent."

Misrepresentation and Fraud

Although the court of appeals in *Anderson v. Knox*[56] did not impose a fiduciary duty on the "agent," it did utilize an exception to the general concepts of misrepresentation and fraud and thereby provided a higher standard of care for the "agent."

It is well established that a salesman is bound to regard the laws relating to misrepresentation and fraud when dealing with potential purchasers.[57] Under those laws the mere expression of an opinion does not generally justify reliance by another and a subsequent recovery.[58] However, an exception to this rule exists where an "expert" expresses a dishonest opinion to one entitled to rely upon it.[59]

Thus, Anderson was found liable for misrepresentation and fraud because:

> With a record such as this we find it impossible to hold clearly erroneous the finding of the trial judge that Anderson's expressed opinion of suitability was not an honest one but was made fraudulently and with intent to deceive; particularly because the facts clearly warrant a determination that Anderson made his representations recklessly in disregard of whether they were true or false.[60]

The reckless disregard upon which liability was predicated cannot be disassociated from the character of the insurance "agent's" status in the business world — that of an expert. The extent of the "expert agent's" knowledge, either actual or as represented, would seem to be the primary determinant of what conduct may be labeled "reckless." As in *Hardt v. Brink*,[61] the measuring stick should be that degree of skill and care exercised by other "experts" in the community.

LICENSED INSURANCE SALESMAN

Because the court in *Anderson v. Knox*[62] suggested that the imposition of the professional fiduiciary duty on the insurance "agent" might

56. 297 F.2d 702 (9th Cir. 1961).

57. See PROSSER, TORTS 557 (2d ed. 1955), for a discussion of misrepresentation in sales talk.

58. PROSSER, TORTS 556 (2d ed. 1955).

59. Anderson v. Knox, 297 F.2d 702, 721 (9th Cir. 1961), citing RESTATEMENT, TORTS § 542 (1938).

60. Anderson v. Knox, 297 F.2d 702, 727 (9th Cir. 1961).

61. 192 F. Supp. 879 (W.D. Wash. 1961).

62. 297 F.2d 702, 706 n.4 (9th Cir. 1961). Compare this suggestion with the finding of

come from the licensing statutes, an evaluation of these statutes is in order. Licensing statutes have been enacted partly because of a feeling both within and without the insurance industry that the various states should assure the public of the professional competence of the insurance salesman.[63] Many of these licensing statutes provide that their primary purpose is to protect the interest of the insurer and the insurable interests of the public.[64]

While most states provide separate statutes for the licensing of "brokers" and for the licensing of "agents," the requirements imposed on members of both classes are substantially the same.[65] In the light of this similarity of requirements requisite to the procurement of a license, it is questionable whether one class should be held to a higher standard of conduct toward the insured. For this reason, it is submitted that the "agent" should not be permitted to defend his questioned conduct toward the insured by successfully asserting the agency theory.

In *Anderson v. Knox*[66] the court's reference to the possible role of the licensing statutes in the imposition of the professional fiduciary duty is derived from a statement in *Steadman v. McConnell*,[67] a decision upholding a license suspension. The *Steadman* case involved a fact situation very similar to the one in *Knox v. Anderson*.[68] A portion of the *Steadman* opinion reads as follows:

> The appellant was an experienced expert in the field; the insured a mere layman who was led to believe that the bank plan would meet certain expressed objectives. Certainly the relationship was a *fiduciary* one in which Mr. and Mrs. Stokes were entitled to believe appellant's material statements.[69] (Emphasis added.)

Because the court in the *Steadman* case imposed a fiduciary duty on the insurance "agent," there is reason to believe that such a duty may eventu-

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fact by the district court in Knox v. Anderson, 162 F. Supp. 338, 341 (D. Hawaii 1958): "That Defendant failed to disclose to Plaintiff certain material information and facts which were known or should have been known to Defendant and which Defendant was under a duty to disclose to Plaintiff because of the *relationship of trust and confidence* which existed between Plaintiff and Defendant and the superior knowledge of Defendant . . . ." (Emphasis added.)

It is submitted that the district court was prepared to impose the fiduciary duty, while the court of appeals preferred to leave it to licensing commissions.

63. KIMBALL, INSURANCE AND PUBLIC POLICY 120 (1960).

64. See, *e.g.*, ILL. ANN. STAT. ch. 73, § 1065.49(f) (Smith-Hurd Supp. 1961). This statute states that the insurance license may be revoked if the salesman "has not demonstrated trustworthiness and competency to transact business as insurance agent, broker or solicitor in such a manner as to safeguard the public." Under this statute all three classes of salesmen are subjected to the same standard of skill and conduct.

65. *Compare* ANN. IND. STAT. tit. 39, § 4503 (Burns 1952), *with* tit. 39, § 4603; *compare* OHIO REV. CODE § 3905.01 (Supp. 1962), *with* § 3905.18 (Supp. 1962).

66. 297 F.2d 702, 706 n.4 (9th Cir. 1961).

67. 149 Cal. App. 2d 334, 308 P.2d 361 (1957).

68. 159 F. Supp. 795 (D. Hawaii 1958).

69. Steadman v. McConnell, 149 Cal. App. 2d 334, 340, 308 P.2d 361, 365 (1957).