the ProfessionalLine

Volume 10 • Issue 2 • September 2010

A Hinshaw & Culbertson LLP publication devoted to professional liability issues

The Impact of *Crawford v. Weather Shield Manufacturing, Inc.* on MGA, Producer and Agency Agreements

Joseph J. De Hope, Jr.
Hinshaw & Culbertson LLP

MGA, Producer and Agency agreements often require one or both parties to them to indemnify the other. Sometimes these agreements refer to defense costs and other times to defense obligations. This article addresses the statutory duty to defend, under California indemnity law, insurance coverage issues arising from that defense obligation, the practical use and effect of indemnity clauses in these agreements and suggestions for addressing the duty to defend.

A. STATUTORY DUTY TO DEFEND – CALIFORNIA CIVIL CODE SECTION 2778

The California Supreme Court determined, in *Crawford v. Weather Shield Manufacturing, Inc.*, 44 Cal. 4th 541 (2008), that a contractual indemnitor incurred a duty to defend the indemnitee at the time the indemnitee tendered its defense to the indemnitor. The Court considered the duty of a subcontractor to defend a developer. More recently, this rule was followed in *UDC-Universal Development, L.P. v. CH2M Hill*, 181 Cal. App. 4th 10 (2010). Both courts found an immediate duty to defend, despite ultimate jury determinations that the indemnitor had not been negligent.

The Court in *Crawford* considered subcontracts that contained a provision under which each subcontractor/designer agreed:

> (1) to indemnify and save [Peters] harmless against all claims for damages to persons or to property and claims for loss, damage and/or theft of homeowner's personal property growing out of the execution of the work, and (2) at his own expense to defend any suit or action brought against [Peters] founded upon the claim of such damage or loss or theft. . . .

The court in *UDC* considered the following language:

> Consultant [CH2M Hill] shall indemnify and hold Owner, Developer, and their respective officers, directors, employees and agents free and harmless from and against any and all claims, liens, demands, damages, injuries, liabilities, losses and expenses of any kind, including reasonable fees of attorneys, accountants, appraisers and expert witnesses, to the extent they arise out of or are in any way connected with any negligent act or omission by Consultant, its agents, employees or guests, whether such claims, liens, demands, damages, losses or expenses are based upon a contract, or for personal injury, death or property damage or upon any other legal or equitable theory whatsoever. Consultant agrees, at his own expense and upon written request by Developer or Owner of the Subject Property, to defend any suit, action or demand brought against Developer or Owner on any claim or demand covered herein. Notwithstanding the above, Consultant shall not be required to indemnify Developer or Owner from loss or liability to the extent such loss or liability arises from the gross negligence or willful misconduct by Developer, Owner, or agents, servants or independent contractors who are directly responsible to Developer or Owner, or for defects in design furnished by such person."

The Supreme Court held:

> Finally, California Civil Code Section 2778, unchanged since 1872, sets forth general rules for the interpretation of indemnity contracts, "unless a contrary intention appears." **If not forbidden by other, more specific statutes, the obligations set forth in Section 2778 thus are deemed included in every indemnity agreement unless the parties indicate otherwise.**
>
> In this regard, the statute first provides that a promise of *indemnity* against claims, demands or liability "embraces the costs of defense against such claims, demands, or liability" insofar as such costs are incurred reasonably and in good faith. (California Civil Code Section 2778(3), italics added.) Second, **the section specifies that the indemnitor "is bound, on request of the [indemnitee], *to defend* actions or proceedings brought against the [indemnitee] in respect to the matters embraced by the indemnity,"** though the indemnitee may choose to conduct the defense. (California Civil Code Section 2778(4), italics added.) Third, the statute declares that if the indemnitor declines the indemnitee's tender of defense, "a recovery against the [indemnitee] suffered by him in good faith, is conclusive in his favor against the [indemnitor]." (California Civil Code Section 2778(5).) On the other hand, if the indemnitor got no reasonable notice of the action, or was not allowed to control the indemnitee's defense, recovery by the third party against the indemnitee is only presumptive evidence against the indemnitor. (California Civil Code Section 2778(6).) (Emphasis added)

While the *Crawford* Court based its decision on both the indemnity agreement and the statutory rules, the *UDC* court made clear that the duty to defend was statutorily based and not dependent upon *Crawford*. Therefore, *Crawford* applied to contracts written before the Supreme Court issued its decision.

These cases dealt with indemnity contracts used in development and construction projects. The impact of these cases upon design professionals has been thoroughly considered in "The Duty To Defend Under Non-Insurance Indemnity Agreements: *Crawford v. Weather Shield Manufacturing, Inc.* and Its Troubling Con-Sequences For Design Professionals," 50 Santa Clara L. Rev. 825, Gilson S. Riecken. This article addresses the potential impact of *Crawford* on MGA and Producer agreements under California law. The potential exists that the *Crawford* analysis may be applied in other states. The article sets forth, in Appendix B, statutes and case law from other states. The author suggests that courts in other jurisdictions could find a similar, independent defense obligation lurking within every indemnity agreement.

The *Crawford* analysis is not limited to construction disputes. The statute is not limited to construction disputes. The court noted:

> By virtue of these statutory provisions, the case law has long confirmed that, **unless the parties' agreement expressly provides otherwise, a contractual indemnitor has the obligation, upon proper tender by the indemnitee, to accept and assume the indemnitee's active defense against claims encompassed by the indemnity provision**. Where the indemnitor has breached this obligation, an indemnitee who was thereby forced, against its wishes, to defend itself is entitled to reimbursement of the costs of doing so. (Emphasis added)

Crawford and *UDC* establish that the duty to defend exists from the time the defense is tendered. In contrast, the duty to indemnify cannot and does not arise until liability is established. Thus, the duty to defend cannot be dependent upon the ultimate liability determination.

"The Crawford and UDC decisions establish that the duty to defend exists from the time the defense is tendered. In contrast, the duty to indemnify cannot and does not arise until liability is established. Thus, the duty to defend cannot be dependent upon the ultimate liability determination."

There are numerous MGA, Producer and Agency agreements on the internet. Sample provisions include the following indemnification clauses:

> 1. Broker agrees to indemnify, and save harmless the Agency and any of its employees or agents from and against any and all claims arising out of or relating to any act or failure to act upon the part of Broker which results in any claim which arises against the Agency, whether said claim is well founded or not. Broker agrees to promptly notify the Agency of any claim, demand, action or cause of action in which the Agency is named, and Broker agrees to indemnify and save the Agency harmless from any loss, expense, demand, action or cause of action, including but not limited to, expenses of investigation, witnesses, court cost, or attorneys' fees, arising from or related to any act or failure to act upon the part of the Broker, whether well founded or not.
>
> 2. MGA shall indemnify, defend and hold Producer harmless against all liability which Producer may become obligated to pay to any party, and indemnify Producer for attorney's fees and costs of suit, if the MGA would have been legally liable even in the absence of this Agreement.
>
> Producer shall indemnify, defend and hold MGA harmless against all liability which MGA may become obligated to pay to any party, and indemnify MGA for attorney's fees and costs of suit, if the Producer would have been legally liable even in the absence of this Agreement.

continued on back page

Chair, Professional Liability Group:
Marissa I. Delinks

Executive Editor:
David L. Winnett

Managing Editor:
Jill Buresh Nail

Recent Court Rulings

Accountants

In Pari Delicto Defense May Be Asserted by Auditors That Have Acted in Good Faith in Dealing With the Corporation's Agents

***Official Committee of Unsecured Creditors of Allegheny Health Education and Research Foundation v. PriceWaterHouseCoopers, LLP*, 989 A.2d 313 (Pa. 2010), 2010 WL 522830**

The Pennsylvania Supreme Court recently analyzed the circumstances under which an auditor may assert the *in pari delicto* defense. *Official Committee of Unsecured Creditors of Allegheny Health Education and Research Foundation v. PricewaterhouseCoopers, LLP*, 989 A.2d 313 (Pa. 2010) (*AHERF v. PwC*). The decision presents a thorough analysis of the defense as it applies to claims against accountants.

The *in pari delicto* defense stems from an equitable doctrine, "*in pari delicto potior est conditio defendentis* [,] meaning in a case of equal or mutual fault the position of the defending party is the stronger one." In suits arising out of financial statement engagements, the client may have culpability if its employees provide the accountant with fraudulent or misstated information. The defense, when successful, imputes the employee's wrongdoing to the client and bars the suit against the accountant. It "serves the public interest by relieving courts from lending their offices to mediating disputes among wrongdoers, as well as by deterring illegal conduct."

In recent years, several decisions addressing the *in pari delicto* defense in claims against accountants have narrowly construed the defense, limiting the ability of accountants to avail of it or, in some cases, precluding accountants from asserting the defense altogether. In 2006, the New Jersey Supreme Court held that an auditor sued for negligently failing to detect fraud on the part of its client's officers was precluded from availing itself of the defense. *NCP Litigation Trust v. KPMG LLP*, 901 A.2d 871.

In construing the defense more broadly, the *AHERP v. PwC* decision represents a departure from these cases. In *AHERP*, the Pennsylvania Supreme Court held that:

- there is no bright line rule precluding the auditor of a bankrupt corporation from raising the *in pari delicto* defense;
- the wrongdoing of a client corporation's employees will not be imputed to the corporation where an auditor has dealt in bad faith or colluded with the client corporation's employees;
- an auditor that has colluded with the client corporation's employees to misstate the corporation's financial condition may not avail of the *in pari delicto* defense.

Much of the decision is devoted to discussing the public policy rationale for the *in pari delicto* defense. The Supreme Court discussed *Cenco Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir. 1982), a seminal *in pari delicto* decision. In *Cenco*, the U.S. Court of Appeals for the Seventh Circuit endorsed a broad application of the defense in suits arising out an auditor's failure to detect management fraud. The court reasoned that broad application of the defense would encourage independent directors and shareholders to actively monitor the decisions of management. The Pennsylvania Supreme Court disagreed with *Cenco* "in terms of the degree to which the decision, in an auditor-liability context, prioritizes the policy of incentivizing internal corporate monitoring over the objectives of the traditional schemes governing liability in contract and in tort, including fair compensation and deterrence of wrongdoing."

As *AHERF* demonstrates, whether the *in pari delicto* defense will prevail is a fact-intensive analysis. AHERF was a nonprofit that ran hospitals, medical schools and doctors' practices. In the 1980s and 1990s, it carried out an expansion program that ultimately failed and led to its bankruptcy. The AHERF creditors' committee sued a number of AHERF officers and insiders as well as Pricewaterhouse Coopers (PwC), the successor to AHERF's auditor, Coopers & Lybrand. The creditors' committee alleged that the auditors had colluded with high-level AHERF officers to fraudulently misstate AHERF's financial condition. According to the creditors' committee, the plan was to create the impression that management's expansion program was succeeding in spite of what the auditors and officers knew—that AHERF was insolvent, with the insolvency growing as a result of the "ruinous" expansion program.

PwC moved for summary judgment, raising the *in pari delicto* defense. It argued that the officers had participated in the fraud, supplying the auditors with false financial statements in the first instance. The district court granted PwC's motion, holding that the officers' fraudulent conduct was imputed to AHERF because it was committed in the course of the officers' employment and for the benefit of AHERF. The benefit to AHERF, the district court reasoned, was that the misstated financial statement permitted AHERF to make additional acquisitions, increase its assets and add revenue streams.

The district court rejected the creditors' committee's adverse interest argument. The adverse interest argument is an exception to the general rule of imputation which provides that an agent's knowledge will not be imputed to the corporation where the agent is acting adversely to the corporation's interests and in furtherance of the agent's interests. The district court narrowly construed the adverse interest exception, holding that it applies only "if the corporation 're-ceived no benefit' from the officers' improper conduct."

On appeal, the U.S. Court of Appeals for the Third Circuit certified two questions for the Pennsylvania Supreme Court's consideration:

> 1. What is the proper test under Pennsylvania law for determining whether an agent's fraud should be imputed to the principal when it is an allegedly non-innocent third-party that seeks to invoke the law of imputation in order to shield itself from liability?
>
> 2. Does the doctrine of *in pari delicto* prevent a corporation from recovering against its accountants for a breach of contract, professional negligence, or aiding and abetting a breach of fiduciary duty, if those accountants conspired with officers of the corporation to misstate the corporation's finances to the corporation's ultimate detriment?

In analyzing whether an auditor will be entitled to avail of the *in pari delicto* defense, the court emphasized that the starting point is whether the auditor acted in good faith. Where an auditor acts in good faith (i.e., is not actively colluding with the corporation's officers to carry out the fraud) but is nevertheless negligent, the auditor may avail of the *in pari delicto* defense. The court stated, "[o]n balance, we believe the best course is for Pennsylvania common law to continue to recognize the availability of the *in pari delicto* defense (upon appropriate and sufficient pleadings and proffers), via the necessary imputation, in the negligent-auditor context." Conversely, the court noted that the *in pari delicto* defense is unavailable to the auditor found to have participated in the corporation's fraud. The court held that, "[t]he outrageous misconduct asserted on the part of AHERF officers obviously distinguishes this type of case from garden-variety contract and tort claims in which the defense should not be available. To prevent abuses, courts obviously must be judicious in screening cases in which *in pari delicto* is asserted."

The court also rejected the district court's narrow interpretation of the adverse interest exception, holding as a matter of law that a corporation could never benefit from misstated financial information because it was always in the corporation's interest to have accurate financial information. The court held,

> Nevertheless, in the collusion scenario-as a matter of law-we regard it to be in the best interests of a corporation for the governing structure to have accurate (or at the very least honest) financial information. Thus, like other courts, in settings involving auditors who have not proceeded in material good faith relative to a principal-corporation, we decline to consider a knowing, secretive, fraudulent misstatement of corporate financial information to be of benefit to a company.

Barry MacEntee
Chicago

Insurance Agents and Brokers

Insurance Agent's Duty Stops at Submitting Application; No Duty to Actually Obtain Coverage or Notify Clients of Denial of Coverage

***Cole v. Wellmark of South Dakota*, 776 N.W.2d 240 (S.D. 2009)**

The Della Tschetter Insurance Agency (Tschetter) submitted an application for health insurance for Dellas and Margie Cole (Coles) to Wellmark of South Dakota, Inc. (Wellmark). Tschetter told the Coles that Wellmark would probably consider their child's allergies to be a preexisting condition and place a rider (exclusion) on the coverage. The application contained, in bold print, the statement that the policy would not become effective until it was approved and the applicants were notified in writing. As the meeting with the Coles concluded, Tschetter advised them they were "all set" and "good to go."

Wellmark claimed that it sent a letter to the Coles stating that the company agreed to provide the health coverage so long as the Coles signed two riders. The letter allegedly stated that the policy would not take effect until the Coles signed the riders and returned them to Wellmark. Wellmark also claimed that it sent a rejection letter when the riders were not returned, and that it returned the premium.

A few days after the premium was allegedly returned, the Coles' daughter injured her knee. The cost of the resulting medical care came to $20,000. The Coles contended that they were never informed that the Wellmark policy was not in effect.

The Coles sued Tschetter alleging a duty to provide the requested health coverage and a duty to advise if the requested coverage was not obtained. The Supreme Court of South Dakota ruled that there was no coverage as the application made it clear that there was none until Wellmark affirmatively advised the Coles that coverage was in effect. The Court stated the general duty was for an insurance agent to use reasonable diligence to get the specified insurance and to seasonably notify the applicant if the agent could not obtain the insurance.

The Supreme Court found that the applicants had not asked Tschetter to monitor the progress of the application or to provide further services if Wellmark did not accept the application. Tschetter had provided information about several insurers to the Coles and also suggested that COBRA coverage might be best under the circumstances. The Coles never asked Tschetter to review their health history and make a recommendation of a particular insurer, but instead decided upon the insurer based upon their ability to designate the starting date for the coverage.

The Supreme Court concluded that Tschetter had met its obligations by submitting a properly completed application. Tschetter could not and did not promise that the insurance would be accepted, and the application notified the Coles that Wellmark would make the final decision to accept or reject the application. The Court also found no duty to actually obtain the coverage or to notify the Coles that the coverage was not provided because the application expressly stated that Wellmark would be communicating with the Coles rather than Tschetter.

The opinion suggests that Tschetter did not receive copies of the letters that Wellmark claimed it had sent to the Coles. It also alludes to a claim

Case Summaries & Conclusions

by Tschetter that it called the Coles and left a telephone message for them to return the riders. Because the Supreme Court found no duty to make the call, it did not consider the sufficiency of the notice.

The Supreme Court rejected a fiduciary duty theory, stating that the general rule is that most arms-length commercial or business transactions do not create a fiduciary relationship. Because there was no indication that the Coles had "any weakness of age, of mental strength, business intelligence, knowledge of the facts involved, or other conditions, giving to one an advantage over the other" there was no fiduciary relationship.

The Supreme Court ruled that the statements that the Coles were "all set" and "good to go" were either mere expressions of opinion or they related to the completion of the application and were not a statement that coverage would take effect. Summary judgment in Tschetter's favor was affirmed.

Joseph J. De Hope, Jr.
San Francisco

Architects and Engineers

Accepted Work Doctrine May Not Be a Defense Where Work Does Not Comply With Design Plans or Code

Hollis & Spann, Inc. v. Hopkins, 686 S.E.2d 817 (Ga. 2009), 301 Ga. App. 29 (2009)

A hotel guest sued an independent contractor for bodily injuries sustained in a fall while using a handicap access ramp. Plaintiff alleged that while the ramp design complied with the accessibility requirements of the Americans with Disabilities Act (ADA) and the Georgia Code, the ramp as constructed did not.

The contractor built the ramp according to specifications of the original design plan. However, the city inspector rejected the ramp as originally constructed, stating that the center slope was too steep, and instructing the contractor to rebuild the ramp to reduce its slope to comply with the applicable code requirements. The reconstructed ramp was wider and had a more gradual slope. Although the contractor did not inspect or measure the ramp to ensure compliance with the regulatory requirements, the city inspector inspected and approved the reconstructed design.

The contractor moved for summary judgment, arguing that the "acceptance" or "accepted work" doctrine applied to preclude liability. Georgia's acceptance doctrine provides that a contractor is not liable for injuries resulting from defective design where: (1) the contractor does not hold itself out as an expert in the design work at issue; (2) the contractor is not negligent in performing its work; and (3) the contractor's work is approved and accepted by the owner. Exceptions to the accepted work doctrine apply where: (1) the contractor is negligent in the performance of its own work; (2) the work is a nuisance per se, that is, inherently or intrinsically dangerous; or (3) the work is so negligently defective so as to be imminently dangerous to third persons.

The trial court denied the contractor's motion for summary judgment. In affirming, the appellate court agreed with the trial court's finding that the contractor's failure to build the ramp's side flares according to slope specifications in the design plans was evidence of the contractor's negligent construction, creating an issue of material fact.

The appellate court also found that there was an issue of material fact as to whether the ramp was imminently dangerous. Specifically, the court stated that as an elderly person, plaintiff was within the class of persons intended to be protected by Georgia's accessibility regulations and that the ramp was intended for her use. Because there was also evidence that the ramp was negligently constructed, the appellate court found there to be an issue of material fact as to whether the ramp was imminently dangerous to third persons.

Renee Choy Ohlendorf
Los Angeles

Insurance Agents and Brokers

Court Finds No Error in Judge's Charging of Jury Only on Professional Negligence

Credit Suisse First Boston Mortgage Capital LLC vs. Philip Lehman Company Ltd. 2010 WL 816540 (Unpublished Decision of the Appellate Division of the Superior Court of New Jersey, March 10, 2010)

This opinion addresses the issue of causation relating to an insurance broker's failure to procure an insurance policy that was supposed to name plaintiff as an additional insured. Plaintiff Credit Suisse First Boston Mortgage Capital LLC (Credit Suisse) contacted defendant Philip Lehman Company Ltd. (Broker) to procure property liability and excess liability insurance coverage for a New Orleans hotel, the Crescent on Canal Hotel (Crescent), which was owned by Credit Suisse. Credit Suisse requested that the Crescent be listed on the policy as a named insured and that Credit Suisse be named as additional insured along with its property management company. The Broker contacted National Security Underwriters Inc. (NSU), a specialty insurance wholesaler for hotels and the hospitality industry. NSU underwriters had no direct contact with plaintiff, and acted only on the basis of information provided by the Broker. The Broker completed the application, which failed to note the request that Credit Suisse and/or the management company be named as additional insureds.

Based on the insurance application, NSU underwriters sent the Broker a quote listing Crescent as the named insured on the proposed policy with primary, excess and umbrella coverage. Credit Suisse and the management company were not listed as named or additional insureds on the application, binder, order to bind or the insurance policies.

The NSU underwriter advised the Broker that the Broker was authorized to issue any certificates of insurance needed to confirm the insurance obtained for Crescent. The Broker sent to NSU a certificate of liability insurance that listed Credit Suisse and the management company as additional insureds. The certificate was then forwarded on to Credit Suisse and the management company.

Pursuant to NSU's underwriting procedures, insurance brokers were required to make written requests for specific endorsements naming the entities as insureds or additional insureds. Such written requests would then be forwarded to the insurers to decide whether a specific endorsement would be issued. The Broker made no written request for a specific endorsement listing Credit Suisse or the management company as additional insureds. As a result, the only documents listing those entities as additional insureds were the certificates of liability insurance prepared by the Broker, which stated: "This certificate is issued as a matter of information only and confers no rights up the certificate holder. The certificate does not amend, extend or alter the coverage afforded by the policies below."

The policies were issued by St. Paul Fire & Marine but it did not contain an additional insured Endorsement. Nor did they name Credit Suisse or the management company as additional insureds.

In August 2002 a class action suit was filed against the Crescent and Credit Suisse by the employees and guests of the hotel. St. Paul agreed to defend Crescent but denied coverage to Credit Suisse. Prior to resolving the coverage dispute, Credit Suisse and Crescent settled the class action suit with Credit Suisse paying $3,850,000. The settlement agreement released St. Paul from all "future actions claims, rights, lawsuits, suits, causes of action, obligations, debts, demands or liability of any kind."

Less than six months later, Credit Suisse and the Crescent sued the Broker, alleging professional negligence, breach of fiduciary duty and breach of contract. The Broker filed a third-party complaint against NSU underwriters. A jury trial commenced finding that the Broker had been negligent, but that his negligence was not the proximate cause of plaintiffs' alleged injuries.

The St. Paul policy contained a "Describe Person or Organization Endorsement" (DPOE), which was a blanket endorsement providing coverage to any organization falling within its description. Due to its affiliation with the Crescent and the scope of the property management agreement, there was little question that St. Paul was obligated to defend and indemnify Credit Suisse. As such, there should have been coverage for it under St. Paul's policy. The jurors were instructed that the Broker could be liable if he secured coverage inferior to that requested by Credit Suisse and if he failed to advise Credit Suisse regarding the availability of coverage upon an insurer's declination. The court of appeal noted that Credit Suisse, as a plaintiff, was a sophisticated commercial entity with more than adequate means to ascertain their rights and liabilities before surrendering millions of dollars when faced with litigation. As a result, Credit Suisse's decision to settle without suing St. Paul—because of allegedly inadequate response provided by the Broker about the scope of the policy—was highly questionable. Credit Suisse acknowledged that it had not even examined the terms of the insurance policy before settling the underlying suit. Equally curious was plaintiff's decision to release St. Paul from liability apparently without receiving any consideration when the underlying class action settlement were consummated.

Importantly, plaintiffs asserted that although both the professional negligence claim and the breach of fiduciary duty claim were asserted against the Broker, the judge erred in charging the jury only on plaintiffs professional negligence claim. The court found that the breach of fiduciary duty claim was overlapping and redundant and dismissed the fiduciary duty claim. The court of appeals did not deal with whether the court had correctly dismissed the fiduciary duty claim because the alleged error was not capable of producing an unjust result in light of the jury's finding that the Broker was negligent. The court noted that, assuming that the jury would have appreciated any distinction between a fiduciary standard and a professional negligence standard, the fact that the jury found the Broker negligent rendered the question irrelevant. Once the jury found that the Broker breached a fiduciary duty, it was next required to determine whether the Broker's wrongful conduct proximately caused the injury. The charge on proximate causation regardless of whether the Broker was found negligent or to have breached its fiduciary duty would have been the same. As a result, any error that the judge may have committed in refusing to provide a jury instruction regarding the Broker's fiduciary duty was inconsequential. The jury's finding in favor of the Broker was affirmed.

Joseph J. De Hope, Jr.
San Francisco
William Yu
Chicago

Real Estate

Plaintiffs in Fraud and Negligent Misrepresentation Suit Against Real Estate Agent Must Plead Facts With Sufficient Specificity as to Agent's Knowledge of the Falsity of His Alleged Misrepresentations, Plaintiffs' Reasonable Reliance on Alleged Representations, and Agent's Duty to Plaintiffs

Colasacco v. Robert E. Lawrence Real Estate, et al., 890 N.Y.S.2d 114 (2nd Dept. 2009)

Plaintiffs met with defendant Christopher DiCorato (DiCorato), a real estate agent and employee of defendant Robert E. Lawrence Real Estate, to view a vacant parcel of property. During that meeting, DiCorato walked the property with plaintiffs, showed plaintiffs the

continued on back page

the Professional Line

The Impact of *Crawford v. Weather Shield Manufacturing, Inc.* on MGA, Producer and Agency Agreements

continued from front cover

3. The MGA agrees to indemnify and hold harmless Agent and its officers, employees and agents from any liability, damage or claims, including the cost of defense, asserted against Agent based upon alleged acts or omissions of Agent if same resulted solely and directly from strict adherence by Agent to instructions or procedures established by the MGA and were not the result of Agent's independent acts or omissions.

Similarly, the Agent and the Agency agree to indemnify and hold the MGA, the company, board members, shareholders and officers harmless from any and all claims and damages including but not limited to cost of defense, resulting directly or indirectly from Agent's violation of any insurance law or insurance department regulation, order, ruling or decisions and/or any breach of Agent's obligations under this Agreement.

4. Producer and MGA agree to indemnify and hold each other harmless from any and all expenses, costs, and attorney or counsel fees; for any cause of action, loss or damage arising from fraudulent or unauthorized acts or neglect by MGA or Producer or their agents, solicitors or employees.

5. Each party agrees to indemnify and hold harmless the other, its/his/hers officers, agents and employees from any and all damages, judgments, claims, suits, attorneys fees, court costs and investigation expenses arising out of any conduct of, and caused by, the errors, omissions or negligent, dishonest or intentional acts of the other.

6. You (Producer) shall indemnify and hold us (MGA) harmless for any liability, loss, damage, judgment, action, expense, or attorney's fees we sustain due to any representations, acts or omissions on your part or your failure to comply with terms of this Agreement. This includes but is not limited to your failure to promptly forward applications and premiums or to comply with restrictions on your binding authority as set forth in our underwriting guidelines. This indemnification shall apply to any judicial, arbitration or administrative proceeding and shall survive the termination of this Agreement.

One of these agreements expressly agrees to defend while the others speak of indemnifying or holding harmless for defense costs. The clause that expressly agrees to defend (2) will be enforced. As noted above, the indemnity agreements in *Crawford* and *UDC* included duties to defend. California Civil Code Section 2778 also imposes a duty to defend when the agreement includes such a duty.

The other clauses (1, 3-6) do not impose a specific duty to defend. Section 2778, as interpreted in *Crawford* and *UDC*, imposes a duty to defend upon request when the indemnity agreement includes the duty to indemnify for defense costs. Thus, it is likely that the indemnitor in these clauses has the obligation to defend the indemnitee even though the clauses are only phrased as indemnification for attorneys' fees or defense costs.

These clauses create defense obligations from the time of the tender of defense because each of them refers either to a duty to defend (2), attorneys' fees (4, 5 and 6) or claims (1 and 3). These references make it clear that obligations under the clauses exist prior to the liability determination. Further, the claims clauses (1 and 3) refer to alleged wrongdoing or claims that may not be well founded, thus demonstrating that the duties arise based upon the allegations rather than a finding of liability.

B. INSURANCE COVERAGE ISSUES RELATING TO THE DEFENSE OBLIGATION

If a claim is made to an insurance agent or broker for defense and indemnity, the agent or broker is likely to tender the claim to his or her professional liability insurer. The E&O insurer will likely have the duty to defend the agent/broker and to indemnify for covered losses. The E&O insurer is likely, however, to point out that the indemnitee is not an insured and is not entitled to a defense. Assuming this to be true for the purpose of this article, the insurer may still consider providing that defense because California Civil Code Section 2778 expressly provides, "If, after request, the person indemnifying neglects to defend the person indemnified, a recovery against the latter suffered by him in good faith, is conclusive in his favor against the former."

If the defense costs would be damages under the policy and if the award against the indemnitee is binding upon the indemnitor, the insurer for the indemnitor may consider it wise to defend the indemnitee to protect the insurer's own interests. Consideration could be given to using one attorney to defend the indemnitor and the indemnitee if there is no conflict of interest.

If, however, the insurer does not agree to defend the indemnitee, the agent/broker who agreed to indemnify may have an obligation to defend the indemnitee. Obviously, this can be a significant cost.

Some E&O policies contain a contractual exclusion, similar to a CGL policy exclusion, that excludes coverage for liability of others assumed by the insured under a contract unless the insured would have had that liability in the absence of the contract. Generally, there is no duty to defend another in the absence of a contract. Insurers may assert this exclusion to avoid a duty to defend imposed either by the language of the indemnity agreement or the effect of Section 2778.

C. WAYS TO ADDRESS AND ELIMINATE THE DEFENSE OBLIGATION

The defense provisions in California Civil Code Section 2778 are not mandatory. The parties can agree that there is no duty to defend or that there is a right to defend but no duty to defend. *Gribaldo, Jacobs, Jones v. Agrippina Versicherunges*, 3 Cal. 3d 434 (1970).

Subcontractors in the residential construction industry were rescued by the legislature from these onerous indemnity clauses. California Civil Code Section 2782(c). To the extent that insurance agents and brokers contend they are unfairly compelled to indemnify others, they have the option of seeking a similar legislative remedy.

D. CONCLUSION

The courts in *Crawford* and *UDC* concluded that indemnity obligations generally include a defense obligation. The California Supreme Court recognized that not all indemnity agreements are insured. Insurance professionals should recognize that they may be assuming an uninsured defense obligation under an indemnity agreement. They may consider providing a copy of the indemnity agreement to their professional liability insurers to determine, in advance of a claim, whether insurance coverage is available for an indemnity defense.

Recent Court Rulings — Case Summaries & Conclusions

continued from page 3

boundary lines and markers on the property, and gave plaintiffs a property survey.

Plaintiffs thereafter purchased the property and constructed a residence on it. When plaintiffs went to sell the property, they learned that they had constructed the residence on a portion of property that was actually owned by one of their neighbors. Plaintiffs purchased that portion of property to resolve the issue, and thereafter sued defendants, alleging two causes of action for fraud and "mistake," which the court construed as negligent misrepresentation. Plaintiffs alleged that DiCorato had misrepresented the property's boundary lines, and that plaintiffs had relied upon his misrepresentations to their detriment.

Defendants filed a motion to dismiss the complaint, which was denied. The appellate court reversed upon the basis that plaintiffs had not adequately pled causes of action for fraud or negligent misrepresentation with the required specificity.

The court first recognized that the essential elements of a fraud claim include pleading specific facts regarding a defendant's knowledge of the falsity of his alleged misrepresentations, as well as a plaintiff's justifiable reliance on those misrepresentations. The court then held that plaintiffs had failed to allege that DiCorato knew that the alleged misrepresentations which he made to plaintiffs were false. The court further held that plaintiffs' reliance upon DiCorato's alleged misrepresentations regarding the property boundary was unreasonable as a matter of law, as plaintiffs had failed to plead that the boundary was within the exclusive knowledge of defendants. The court also noted that plaintiffs could have readily ascertained the property's boundaries through "the use of ordinary means."

The court further recognized that the elements of a negligent misrepresentation cause of action include a defendant's duty to use reasonable care to impart correct information to a plaintiff because of a special relationship between the defendant and the plaintiff, and the plaintiff's reasonable reliance upon that information. The court held that plaintiffs had failed to allege that defendants owed any duty to plaintiffs to provide them with correct information based upon a special relationship. The court further held that, similar to their fraud cause of action, plaintiffs had not pled sufficient facts to establish that their reliance upon DiCorato's alleged misrepresentations was reasonable.

Joseph J. De Hope, Jr.
San Francisco

William Yu
Chicago

Hinshaw & Culbertson LLP
222 North LaSalle Street
Suite 300
Chicago, Illinois 60601
312-704-3000
info@hinshawlaw.com
www.hinshawlaw.com

Editorial Contributors:

Chair, Professional Liability Group
Marissa I. Delinks
Boston, Massachusetts
617-213-7000
mdelinks@hinshawlaw.com

Executive Editor:
David L. Winnett
San Francisco, California
415-362-6000
dwinnett@hinshawlaw.com

Managing Editor:
Jill Buresh Nail
San Francisco, California
415-362-6000
jnail@hinshawlaw.com

Contributors:

Joseph J. De Hope, Jr.

Barry MacEntee

Renee Choy Ohlendorf

William Yu

This newsletter is prepared by Hinshaw & Culbertson LLP to provide information on recent legal developments of interest to our readers. This publication is not intended to provide legal advice for a specific situation or to create an attorney-client relationship. We would be pleased to provide such legal assistance as you require on these and other subjects if you contact an editor of this publication or the firm.

The Professional Line is published by Hinshaw & Culbertson LLP. Hinshaw is a national law firm with approximately 500 lawyers in 24 offices. We offer a full-service practice, with an emphasis in litigation, business law and corporate transactions, environmental, intellectual property, labor and employment law, professional liability defense, estate planning and taxation matters.

Our attorneys provide services to a range of for-profit and not-for-profit clients in industries that include alarm and security services, construction, financial services, health care, hospitality, insurance, legal, manufacturing, real estate, retail and transportation. Our clients also include government agencies, municipalities and schools.

Hinshaw was founded in 1934. The firm is headquartered in Chicago, and maintains offices in 12 states: Arizona, California, Florida, Illinois, Indiana, Massachusetts, Minnesota, Missouri, New York, Oregon, Rhode Island and Wisconsin.

Copyright © 2010 Hinshaw & Culbertson LLP, all rights reserved. No articles may be reprinted without the written permission of Hinshaw & Culbertson LLP, except that permission is hereby granted to subscriber law firms or companies to photocopy solely for internal use by their attorneys and staff.