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Broker Had No Duty to Monitor Solvency of Insurance Company After Policy Issued

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In a case of first impression, a California Court of Appeals declined to impose a duty upon an insurance broker to advise an insured that its liability carrier had been placed in conservatorship. Plaintiff was a subcontractor that was added as insured under an owner controlled insurance program (OCIP) liability policy. The policy provided 10 years of continuous coverage for liabilities arising out of a specific high-rise condominium project. Before the project was completed, the carrier was placed in conservatorship by the Illinois Department of Insurance. The carrier was not formally declared insolvent until after the project was completed.

The broker procured the policy at the request of the general contractor, not the subcontractor, but acted as the intermediary that provided the carrier with the additional insured enrollment identifying the subcontractor. The subcontractor argued that it was a known insured under the OCIP and thus a foreseeable victim of injury if it was not advised of the carrier's conservatorship.

Question Before the Court

Following is the issue considered by the court and how the court decided it.

Was the absence of an actual broker-client relationship fatal to the claim against the broker?

Yes. The general contractor alone had engaged the broker to purchase the policy. The Court of Appeal found that there would be serious public policy problems if California were to adopt a "new legal duty of notification of the carrier's conservation order and insolvency." The court noted that, even as to actual brokerage customers, liability is generally limited to errors in the policy procurement process. A duty to monitor a carrier's financial condition to a noncustomer additional insureds over an extended period would place an unreasonable burden on the brokerage profession. The court noted that, although many jurisdictions legally require brokers to provide such post-sale notices of insolvency, that obligation is typically imposed by statute. The court held that only the California legislature had the power to impose such a sweeping change in state law. Such a duty conflicted with California common law on the scope of a broker's duty.

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What the Court's Decision Means for Practitioners

Practitioners need to closely examine the state law that will control a dispute such as this. Whereas California courts have made an effort to clearly define a broker's duties after procurement of a policy, the law is less favorable in other states. As the Court observed, 10 states, including Florida and Michigan, and Puerto Rico have statutes requiring that insureds be notified of insurer insolvencies. In other states, such as Illinois and Texas, courts have ruled that a broker has a duty to advise an actual brokerage customer of a post-sale insolvency when it comes to the broker's attention. Thus, the question of whether private rights of action will be recognized in favor of noncustomer additional insureds remains open in many jurisdictions. This potential lack of uniformity is problematical for firms that service a national clientele.

Pacific Rim Mechanical Contractors, Inc. v. Aon Risk Insurance Services West, Inc., 2012 WL 62146 (Cal. App. 4 Dist Feb. 28, 2012)

For further information, please contact Edward F. Donohue or your regular Hinshaw attorney.

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Edward F. Donohue, III

Partner

415-263-8158