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NEWSLETTER

Preparation of Experience Rating Reports Constitutes Professional Activity of Insurance Broker Under E&O Policy

September/October 2005

In an unpublished decision, the California Court of Appeal, applying California law, has held that an insurance broker's negligent preparation of experience rating reports for use by a liability insurer in calculating premiums constitutes a covered "professional activity" under an E&O policy. *Certain Underwriters at Lloyd's London v. Truck Ins. Exch.,* 2005 WL 1971153 (Cal. App. Aug. 17, 2005).

The E&O insurer issued a claims-made policy to an insurance broker. The E&O policy provided coverage for amounts the broker became liable to pay as damages by reason of any negligent act, error or omission committed or alleged to have been committed "which arise out of the conduct of the Assured's professional activities as Insurance Brokers, Insurance Agents or General Insurance agents." During the policy period, a hospital malpractice insurer sued the broker for negligence and breach of implied contract. The hospital malpractice insurer alleged that the broker had supplied it with erroneous "experience rating reports" regarding the loss experiences of insured hospitals (who were clients of the broker), causing the hospital liability insurer to charge its insureds lower premiums than it should have based on their loss experiences. The E&O insurer reserved its rights under the E&O policy based, *inter alia*, on its assertion that the provision of experience rating reports might not be the activities of an insurance broker, insurance agent or general insurance agent, as required for coverage. Judgment in the underlying suit was entered in favor of the hospital liability insurer. In the ensuing declaratory judgment action, the trial court held that the broker was acting both as an insurance broker and insurance agent within the context of the E&O policy, and therefore ordered the E&O insurer to pay the judgment awarded to the hospital liability insurer.

The appellate court rejected the E&O insurer's argument that preparation of experience rating reports was merely an administrative function rather than a "professional activity." The court noted that the broker calculated and submitted experience rating ratios on behalf of the hospitals in the course of obtaining insurance for them from the hospital liability insurer. Therefore, the court concluded, the broker was acting in its professional capacity as an insurance broker when it submitted the erroneous reports. The appellate court also rejected the E&O insurer's argument that the broker could not be acting as an "insurance broker" under the E&O policy because it was found to have breached a duty of care to the hospital liability insurer rather than the broker's hospital clients. The court determined that these duties are not mutually exclusive and that, in

the course of obtaining insurance to meet its clients' needs, the broker had voluntarily assumed a duty to the hospital liability insurer to exercise reasonable care in preparing the experience rating reports.

The appellate court further rejected the E&O insurer's argument that it could rescind the E&O policy because the broker failed to disclose in its application, in response to a question asking whether the broker was aware of any circumstances that might result in a claim being made against it, that (1) the broker's professional activities as an insurance broker included preparing experience rating reports, (2) the hospital liability insurer had filed a cross-complaint against the broker in an action the broker described in the application as a request by the broker for preliminary injunction and (3) the broker knew errors in the experience rating reports had caused the hospital liability insurer damages. The court concluded that none of these allegations constituted material omissions. The court found that the broker's failure to describe its activities was not even an omission because the question at issue only sought information about potential claims, not a comprehensive list of the broker's services. Likewise, the court determined that the failure to identify the cross-complaint, which did not allege errors in the experience rating reports, was not an omission. The broker disclosed the caption of the matter, including the case number, the court noted, and the cross-complaint was a present, rather than potential, claim. Finally, the court determined that the broker's failure to disclose its experience rating report errors was not a material omission because the hospital liability insurer had not, at the time of the application, demanded any payment from the broker, and had taken no other action on the issue for more than a year. The court found that it was reasonable under those circumstances for the broker to conclude that the hospital liability insurer did not intend to pursue a claim regarding the errors.

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