Broker Held Liable for Failing to Obtain Insurance for Sub Under Wrap-Up Policy

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The U.S. Court of Appeals for the 5th Circuit has held that an insurance broker was liable to a participant in a wrap-up insurance program for negligent failure to procure insurance even though the broker and participant were not in privity of contract.

The case arose out of construction of the Aladdin Hotel and Casino in Las Vegas. Fluor Daniel, Inc. contracted with Aladdin Gaming, LLC to redesign and rebuild the hotel and casino. Fluor retained Marsh USA, Inc. to serve as the insurance broker for the project and to administer the wrap-up insurance program, here an CCIP or contractor-controlled insurance program. (Wrap-up policies also are issued for OCIPs or owner-controlled insurance programs.)

The CCIP was to include commercial general liability insurance, excess liability insurance, professional liability insurance (PLI), pollution insurance and subcontractor default insurance. PLI polices insure against design errors and omissions. Fluor's contract with the owner required PLI for Fluor, the owner and related entities but not for subcontractors. When the PLI policy was issued by St. Paul Insurance, no subcontractors were listed as insureds.

Fluor entered into a subcontract with SMI Owen Steel Co., Inc. in which SMI agreed to design, engineer and install the project's structural steel and foundation. Marsh provided a CCIP manual stating that all tiers of subcontractors would be provided with PLI coverage.

SMI enrolled in the CCIP and properly completed all enrollment forms. Marsh noted that SMI had not requested PLI coverage in its enrollment forms, and SMI responded that it was not required to complete additional forms to obtain PLI coverage.

SMI's subcontract stated that design professional errors and omissions insurance was not provided under the CCIP. SMI did not make a bid deduction for CCIP-provided PLI coverage. SMI was required under its subcontract to provide evidence that its design consultant maintained PLI coverage and that SMI was named as an additional insured under that policy. SMI complied with this requirement, but its design consultant's PLI coverage only provided coverage to SMI for vicarious liability – that is, the policy did not provide PLI coverage to SMI for its own professional negligence unrelated to its consultant's scope of work.

Two months after SMI entered into the subcontract, Marsh sent Certificates of Insurance to SMI stating that it was an additional named insured on Fluor's PLI policy. A Marsh manager later told employees to stop sending certificates for PLI coverage to subs and to amend the Contractor Handbook. Even so, 10 months later Marsh sent SMI another insurance certificate stating that it had PLI coverage under the CCIP.

The certificates each stated that they were provided for information only and did not modify coverage provided in the policy. SMI contended that it detrimentally relied on Marsh to procure PLI coverage. But, Marsh never procured PLI coverage for SMI under the CCIP or from any other insurer.

The project ran behind schedule from its beginning, and several of SMI's subs defaulted. Aladdin filed arbitration claims against Fluor, which filed cross-claims against SMI for breach of contract, alleging

that SMI had "failed to perform its professional design and construction duties."

The PLI insurer under the CCIP did not defend SMI. SMI ultimately paid $1.25 million to settle with Fluor and the owner and released its $6.6 million claim for unpaid subcontract value.

SMI sued Marsh for negligent failure to procure insurance, as a third party beneficiary for breach of contract and for detrimental reliance/promissory estoppel. The case proceeded to trial, and the jury found in favor of SMI on all claims. SMI chose to recover under its negligence cause of action, and the District Court entered judgment in SMI's favor for $7.8 million. Marsh appealed to the 5th Circuit, which affirmed. *SMI v. Marsh USA, Inc.*, 520 F.3d 432 (5th Circuit 2008).

The 5th Circuit applied Nevada law in its ruling. It first noted that the Nevada Supreme Court had, in three cases, recognized causes of action against an insurance broker for negligence and breach of contract in failing to procure insurance.

Marsh argued that it could only be held liable if the policy would have provided coverage. Because the policy would have contained an insured-versus-insured exclusion barring SMI's claim, SMI would not have not been damaged and, therefore, could not prove causation.

The 5th Circuit rejected this argument on the basis of evidence showing: that the owner and Fluor initially had intended to provide subcontractor PLI coverage, that Marsh had sought PLI coverage for subs from St. Paul, that the scope of coverage was negotiable, that a Marsh representative had verbally assured SMI that it did not need to secure PLI coverage, that the policy issued by St. Paul deleted the insured-versus-insured exclusion, and that the Insurance Information Booklet, Contractor Handbook and two Certificates of Insurance issued by Marsha all stated that SMI had PLI coverage. The 5th Circuit held that the evidence was sufficient for PLI to prove causation.

Marsh also argued that the economic loss rule barred SMI's claims. The 5th Circuit rejected this argument: "We conclude that Nevada's economic loss doctrine does not bar negligence claims involving the violation of a professional, extra-contractual duty imposed by law." The 5th Circuit found that the Nevada Supreme Court had, in a prior case, imposed an independent duty of care on insurance brokers.

Because it affirmed SMI's negligence claim, the 5th Circuit found it unnecessary to address Marsh's arguments regarding SMI's third-party beneficiary and promissory estoppel claims.