A Trap for the Unwary: Two-Year Statute of Limitations for Actions Against Insurance Brokers

Increasingly, insurance brokers are being dragged into insurance coverage disputes between insurance carriers and insureds. However, an insured’s claim against its broker is typically a side-show to the insured’s coverage dispute with its insurer, which tends to take center-stage from the standpoint of the insured. This is especially true in the early stages of a coverage dispute, where the insured’s efforts are concentrated on policy interpretation and convincing the insurer that its position regarding coverage is incorrect. Typically those efforts are unavailing, and litigation of coverage issues ensues.

During this time, the insured may be unaware that its broker made an error or omission resulting in lack of insurance coverage. It could be a simple case of clerical error where the broker failed to procure an endorsement to a policy requested by the insured. It could be a more complicated question involving questions of professional judgment and allegations that the broker failed to advise the client of certain exclusions, or failed to offer the client broader insurance coverage. In either case, the negligence of the broker may not be apparent at the outset of the case, and even if the insured suspects negligence on the part of its broker, the details of that negligence are usually unknown when the coverage action is commenced. Typically, an insured will learn those details through discovery undertaken in the coverage action, and only then will the insured file a negligence action against its insurance broker.

At that point, however, it may be too late. 735 ILCS 5/13-214.4 provides:

All causes of action brought by any person or entity under any statute or any legal or equitable theory against an insurance producer, registered firm, or limited insurance representative concerning the sale, placement, procurement, renewal, cancellation of, or failure to procure any policy of insurance shall be brought within 2 years of the date the cause of action accrues.

The Supreme Court of Illinois has not yet decided when a cause of action against an insurance producer accrues. However, in Broadnax v. Morrow, 326 Ill. App. 3d 1074, 762 N.E.2d 1152 (4th Dist. 2002), the Illinois Appellate Court Fourth Judicial District considered the question, and held that a cause of action for negligent failure to procure insurance accrues when the insurer denies coverage of the insured’s claim for coverage under the policy. Broadnax, 762 N.E.2d at 1081.

Broadnax involved a plaintiff whose claim for fire loss under a first-party property insurance policy was denied based on the plaintiff’s failure to comply with a vacancy provision in the policy. Subsequently, the insurer filed a declaratory action and the plaintiff filed a counterclaim for breach of the insurance contract. The coverage issues were resolved in favor of the insurance carrier. After judgment was entered against the
plaintiff in the coverage action, and more than two years after the insurer had denied coverage, the plaintiff sued the insurance brokers who procured the policy for negligence. *Id.* at 1153-54.

The plaintiff argued that his brokers were negligent by obtaining an insurance policy containing an exclusion that did not allow for the premises to be vacant or unoccupied when the brokers knew or should have known that property would be in that condition. *Id.* at 1154. The brokers filed motions to dismiss based on the two year limitations period set out in §5/13-214.4. The trial court granted the brokers’ motions and the plaintiff appealed. *Id.*

On appeal, the plaintiff argued that the negligence cause of action against his brokers did not accrue until judgment was entered against the plaintiff in the coverage action against his insurer. *Id.* at 1155. Until he knew the outcome of the underlying coverage litigation, the plaintiff argued, any negligence claim against the brokers would be premature and frivolous. *Id.* at 1155, 1157-58. The appellate court disagreed and affirmed the trial court’s judgment. *Id.*

The appellate court recognized that there was no direct controlling authority, but looked to the discovery rule as applied in legal malpractice cases to determine the date when the plaintiff’s cause of action accrued. *Id.* at 1156 (citing Knox College v. Celotex Corp., 88 Ill. 2d 407, 414-15, 430 N.E.2d 976, 979 (1981)). Accordingly, the court held that the discovery rule delays commencement of the two-year statute of limitations set out in §5/13-213.4 until the plaintiff knows or reasonably should know of his injury and that it was wrongfully caused. *Id.* at 1156-57.

The court found “there was no doubt” that plaintiff knew of his injury, the denial of his insurance claim, on the date the insurance carrier first denied his claim. *Id.* at 1157. That conclusion left only the following question: at the time the insurance carrier denied the claim, should the plaintiff “reasonably have known that [the insurance brokers] might have been negligent in procuring the insurance policy that failed to meet [the plaintiff’s] needs and resulted in [the insurer’s] denial of his claim?” *Id.* The court explained that “a plaintiff need not be certain of defendant’s negligence before the statute [of limitations] is triggered,” rather the discovery rule focuses on “reasonableness.” *Id.*

Thus, the court concluded that the plaintiff should have reasonably known of the insurance brokers’ possible negligence when the insurance carrier denied his claim on the basis of the vacancy provision. At that point, the court explained, the plaintiff knew that the insurance policy, which had been procured by the insurance brokers, contained a vacancy provision which was the basis of the insurer’s denial. Given that knowledge, there were only two reasonable explanations for the insurer’s denial: (1) the insurer’s interpretation of the vacancy provision was incorrect; or (2) the insurance brokers obtained an insurance policy that failed to meet the needs of the plaintiff. *Id.* Thus, the court held that the plaintiff’s negligence action against the broker was barred by the two year statute of limitations. *Id.* at 1158.

In so holding, the court rejected the plaintiff’s assertion that it was premature and frivolous to file a negligence action against the brokers before the resolution of the coverage action between the plaintiff and the insurer. *Id.* at 1158. The court reasoned that Illinois civil procedure “allows a party to plead alternative theories of recovery where a party is in doubt as to who is responsible for his injury.” *Id.* Because the plaintiff knew that the brokers were possibly negligent when his insurer denied coverage, the plaintiff could have pleaded alternative theories of liability against the insurer and the broker. *Id.*

One dissenting justice agreed with the plaintiff arguments, reasoning that the majority’s rule required the plaintiff to assume that the coverage action would be resolved against him. *Id.* at 1158-59. “If the policy had been held to provide coverage,” the court reasoned, “any action against the agent for negligence in obtaining the policy would have been completely unnecessary. It could not be determined whether the agent was negligent until it was determined whether the vacancy provision controlled.” *Id.* at 1159. In the view of the dissent, “[p]arties should not be compelled to file anticipatory claims which may later prove to be unnecessary.” *Id.*

Admittedly, the dissent’s rationale in Broadnax has some appeal in terms of judicial efficiency. However, a more important concern is the prevention of stale claims, which is the primary purpose behind statute of limitations in the first place. Under the dissent’s approach, a claim against an insurance broker could be brought many years after the alleged error or omission occurred. For example, a personal injury lawsuit arising out of a claim potentially covered by a liability policy may not be filed until two years after the broker procured the policy. If coverage issues arise, a year or more could pass before the lawsuit is tendered to the insurer, a denial letter is issued, and a coverage action is commenced. The coverage action could take three or more years to resolve, and if it was resolved against the insured, then the insured would still have another two years to bring a lawsuit against his or her insurance broker. Allowing a plaintiff to sue a broker after so much time has passed since the alleged error or omission occurred is not a reasonable application of the discovery rule. It certainly would be unfair to insurance brokers defending E & O claims.

Moreover, while providing a more just rule for insurance brokers, the majority’s opinion in Broadnax does not create unreasonable burdens upon insureds. Upon denial of the insured’s claim, the insured is aware of the insurer’s grounds for the denial. All the insured’s attorney has to do is subpoena the broker’s file and take his or her deposition to determine if the broker’s error or omission caused the lack of coverage, and then decide if suit against the broker is warranted. Two years is more than enough time for a diligent attorney to complete those tasks.

Practical Advice

As in any case, it is important for defense attorneys to check the applicable statute of limitations at the outset of the case. This is especially true for attorneys defending E & O claims against insurance brokers, where the relatively short two-year limitations period may provide the broker with a “get-out-of-jail free card.” Unfortunately, it is unlikely that a complaint against an insurance broker will, on its face, be barred by the statute of limitations, i.e., the complaint will not indicate precisely when the insurer denied coverage. Consequently, the key to a quick resolution in favor of the broker is to secure a copy of the insurer’s letter to the insured denying coverage. If the broker does not have a copy of the denial letter, the broker’s attorney should immediately request a copy of the denial letter from the attorney representing the insured. If insured’s attorney resists informal discovery, a request for the denial letter should be made to the attorney representing the insurer who denied coverage. He or she is likely to be more cooperative in providing information and documentation regarding the denial of the insured’s claim. Once all the documentation is in order, the broker’s attorney should file a motion to dismiss pursuant to 735 ILCS 5/2-619(a), or a motion for summary judgment, with a supporting affidavit. The affidavit should have a copy of the letter from the insurance company denying coverage and indicate when it was sent to the insured. Again, the assistance of the attorney representing the insurer that denied coverage will be helpful in securing the affidavit of a person from the insurance company attesting to the fact that the denial letter was sent more than two years before the insured’s complaint against the insurance broker was filed.

About the Author

Matthew C. Koch is an associate in the Chicago law firm of Marwedel, Minichello & Reeb, P.C.. Mr. Koch received his undergraduate degree from Loyola University Chicago in 2001 and his law degree from Saint Louis University in 2004. He concentrates his practice in areas of insurance defense, insurance coverage, admiralty and maritime, transportation and commercial disputes.