RECENT DEVELOPMENTS AFFECTING PROFESSIONALS', OFFICERS', AND DIRECTORS' LIABILITY

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I. DEVELOPMENTS IN LEGAL MALPRACTICE

Many of the basic principles governing legal malpractice actions are established and familiar. But there is sometimes fundamental disagreement concerning how those principles are to be interpreted and how they should be applied in practice.

A. *Causation*

In *Iacono v. Hicken*,[1] the Court of Appeals of Utah, in a divided opinion, held that expert testimony is not necessary to decide whether the failure to make certain arguments on summary judgment in the underlying case caused plaintiff to lose the summary judgment motion. Instead, when causation turns on a legal issue, as in the summary judgment context, causation must be decided by the court as a matter of law. The underlying case (also referred to by the court of appeals as the Trust Case) concerned a trust established by the client's father, which he amended to give her the lion's share of his estate. The client's siblings filed suit, claiming that the amendment was invalid because the trust was irrevocable under Utah law. The siblings brought, and won, a motion for summary judgment, forcing the client to reach a settlement that evidently left her with little or nothing from the estate.

In her subsequent legal malpractice action against her attorney, the client alleged that the attorney failed to assert any defenses to summary judgment. At the bench trial in the legal malpractice case, the client introduced testimony from a trusts and estate expert, who opined on the standard of care and causation. As to causation, the expert testified that the attorney's failure to cite three particular cases on Utah trusts law was an error that deprived plaintiff of "a good shot of prevailing" on summary judgment.[2] The trial court reviewed and analyzed these cases, concluding that it was "impossible to predict what [the Trust Case judge] or any other

1. 265 P.3d 116 (Utah Ct. App. 2011).
2. *Id.* at 120.

objective trial court or even the Utah Supreme Court would or should have ruled in the [Trust] case in light of the holdings" of the three cases identified by the client's experts. The trial court discounted the expert's opinion on causation because the expert was not a litigator and because he admitted that there was no way of knowing if the Trust Case judge would have ruled differently.[3]

On appeal, the client argued that the attorney defendant was required to offer expert testimony to rebut the causation testimony of the plaintiff's expert. The client also argued that the trial court erred because it discounted the causation testimony of the expert and did not rely upon the expert's analysis of the three cases. A panel of the Court of Appeals of Utah affirmed the district court's ruling in a splintered decision.[4]

The concurrence, stating the opinion of the court, held that because a summary judgment motion is decided as a matter of law, it is also a question of law whether the failure to advance certain legal arguments at summary judgment caused the client to lose the motion.[5] The court held that "[d]eciding questions of law," such as whether certain arguments would have caused the client to prevail on summary judgment, "is the role of a judge, not a witness, even—as in this case—a highly qualified legal specialist."[6] Accordingly, where causation turns on a point of law, expert testimony is superfluous, and a court can decide the question on summary judgment.

The lead opinion, which was the minority statement on this issue, took a less definitive position on proof of causation and concluded that the attorney was not required to present rebuttal expert testimony on causation because the burden was on the client—not the defendant attorney—to establish causation.[7] The minority view also concluded that the trial court was not obliged to credit the expert's testimony, which the trial court considered unhelpful.[8]

Turning to the issue of whether causation had been established, the appellate court affirmed and found that causation could not be established because, under Utah law, it was not clear whether the trust was amendable. Because the law was unclear, it was not established that the failure to make certain arguments on summary judgment caused the client to lose the motion. The concurrence, however, disagreed with this rationale for affirming the lower court's causation determination.[9] The concur-

3. *Id.* at 126.
4. *Id.* at 130–31.
5. *Id.* at 131.
6. *Id.*
7. *Id.* at 125.
8. *Id.* at 125–26.
9. *Id.* at 131.

rence reasoned that because causation in the context of a motion for summary judgment is a question of law, the legal malpractice court *must* decide the underlying legal issue and cannot decide causation in favor of the attorney on the ground that the state of the law was undecided or unclear.[10] The concurrence did, however, argue that the uncertainty in the law *could* be relevant on the issue of standard of care: if a point of law is unsettled or debatable, the failure to construct a legal argument based on such unsettled points may not violate the applicable standard of care.[11]

The nature of causation in legal malpractice cases was also addressed in the past year by the Oregon Court of Appeals in *Watson v. Meltzer*,[12] which concerned a legal malpractice claim arising from allegedly negligent advice in the context of a business transaction. The issue on appeal was whether the trial court's jury instruction on causation was erroneous. Among other facets of the instruction, the client objected to the portion of the trial court's instruction that the jury was to consider what "would have" happened with respect to the underlying transaction had the attorney not been negligent. The proper instruction, according to the client, was what "should have happened."

The court rejected this argument, noting the distinction between cases that turn on issues of law and those that depend on disputed questions of fact.[13] If the "outcome of the earlier case hinged on an issue of law," it is the court rather than the jury that must determine causation. In that instance, the court must determine "what should have been the result of the earlier case."[14] By contrast, where the underlying matter depends on a factual dispute, causation is considered by the jury, which is tasked with determining what *would have* happened were it not for the attorney's negligence.[15] The court held that because it was a factual issue whether the attorney's negligence caused the client's loss in the business transaction, the trial court correctly instructed the jury that it was to determine what "would have" occurred (rather than what "should have occurred") but for the attorney's negligence.[16]

The court also rejected the client's argument that the case-within-a-case method was inappropriate where the underlying representation concerns a business transaction, rather than litigation. Although the term "case-within-a-case" is not apt in the transactional context, a plaintiff

10. *Id.*
11. *Id.*
12. 270 P.3d 289 (Or. Ct. App. 2011).
13. *Id.* at 294.
14. *Id.*
15. *Id.*
16. *Id.* at 295.

asserting a transactional legal malpractice claim must still show that he or she would not have suffered the injuries alleged in the absence of the attorney's negligence. The court disagreed with the suggestion that "transactional legal malpractice is qualitatively different" from litigation malpractice, necessitating a more forgiving standard of causation.[17]

B. *Statute of Limitations*

As with causation, courts are sometimes fundamentally divided on how statutes of limitation should be applied. In *Powell v. Rion*,[18] a panel of the Court of Appeals of Ohio was divided on whether a former criminal defendant's legal malpractice claims accrued when he filed a bar complaint or when he later learned of the grounds on which he ultimately filed suit. The client pled guilty to voyeurism and was registered (erroneously, as he later learned) as a sex offender. Because of his status as a registered sex offender, the client lost his position with the U. S. Air Force.

The client filed a grievance with the Dayton Bar Association, complaining that his lawyers did not tell him the state might withdraw a plea deal, which the client wanted to accept. The client also said he did not learn until the day of trial that he would have to register as a sex offender. He also claimed his lawyers failed to warn him that he might lose his job.

These were not the grounds on which the client later sued. At the time of the grievance, the client did not know that he was actually exempt from sex offender registration requirements, that he should never have registered in the first place, and that he would have to wait fifteen years to get his conviction expunged.

After the client learned he was exempt from registration and that he had to wait fifteen years to get the conviction expunged, he sued his criminal defense attorneys, claiming they incorrectly advised him that his guilty plea required him to register as a sex offender and alleging that they failed to alert the sentencing court that he was exempt from registration.

The applicable statute of limitations was one year. The client filed his grievance with the Dayton Bar Association more than one year before filing suit. He learned about the exemption from registration and the rules concerning expungement, though, less than one year before suit.

The appellate panel was divided on whether the cause of action accrued (1) when the client filed the grievance; or (2) when he learned the information forming the basis of his legal malpractice complaint against his attorneys. The majority held that the cause of action did not accrue until the client learned of the grounds for suit. The majority reasoned that

17. *Id.*
18. 972 N.E.2d 159 (Ohio Ct. App. 2012).

when the client filed his grievance, he had no reason to know he was exempt from registration.[19] In other words, there was a genuine issue "whether he was or should have been aware that any injury he did sustain was the result of faulty legal advice as opposed to bad communication by his lawyers and an unfortunate, but unavoidable, outcome of his criminal charges."[20]

The dissent, however, concluded that the cause of action *did* accrue when the client filed the grievance because he knew his attorneys had erred by failing to tell him the state might withdraw the plea deal and that this misstep caused him harm.[21] The fact that there may have been other acts of alleged malpractice by the attorneys, according to the dissent, did not defer accrual of the claim. The conduct known at the time of the grievance imposed upon the client "the duty of pursuing his possible remedies, which would have revealed a theory of legal malpractice in addition to the theory of which he was already aware."[22]

As the discussion above indicates, the division in the *Rion* court was not the result of disagreements over the proper interpretation of the factual details in the record, so much as a disagreement concerning the standards by which accrual of a claim is to be evaluated. The majority recognized that a client may learn about errors too unrelated to the cause of action to trigger the statute of limitations. The dissent believed that if the client learns an attorney has caused harm, the client has a duty to inquire further, which may yield new and different theories of liability.

II. DEVELOPMENTS IN ACCOUNTING MALPRACTICE

A. *Liability to Third Parties*

In a case arising from the Bernie Madoff scandal, the Second Circuit dismissed negligence and fraud claims against PricewaterhouseCoopers (PWC) filed by an individual who had invested $60 million in Greenwich Sentry, LP, a feeder fund into Bernard L. Madoff Investment Securities, LLC.[23] As auditor of the feeder fund, PWC issued unqualified reports attesting to the accuracy of the fund's financial statements both before and during plaintiff's investment. Although plaintiff lacked standing to bring a claim based on his decision to remain invested in the company, which was derivative in nature, he had standing to claim that PWC's negligence

19. *Id.* at 166.
20. *Id.* at167.
21. *Id.* at 168.
22. *Id.*
23. Stephenson v. PricewaterhouseCoopers, LLP, No. 11-1204-cv, 2012 WL 1764191, at *1 (2d Cir. May 18, 2012).

induced him to invest in the feeder fund.[24] Nevertheless, the complaint failed to show that PWC owed plaintiff a duty as a potential investor in the fund. To prevail on a negligence claim against an accountant in the absence of a contractual engagement, a plaintiff must show (1) the accountant was aware that the audit reports would be used for a particular purpose, (2) some known person was intended to rely, and (3) the accountant understood the third party would rely.[25] Because plaintiff was nothing more than a prospective limited partner, he was not a known party to PWC prior to his investment in the feeder fund and could not maintain a claim against PWC under an inducement-to-invest theory.[26]

The New Jersey Supreme Court reversed a $38 million verdict for plaintiff in *Cast Art Industries, LLC v. KPMG, LLP*, an accounting malpractice action filed against the auditor of Papel Giftware.[27] KPMG was in the process of auditing Papel's 1998 and 1999 financial statements when Cast Art Industries expressed an interest in a merger.[28] To obtain a $22 million loan for the merger, Cast Art submitted to its lender Papel's most recent audited financial statements, which contained KPMG's opinion that it had substantial doubt as to whether Papel could continue as a going concern. After the merger, Cast Art became aware of numerous accounting irregularities overstating Papel's revenue, and an overwhelming debt load caused Cast Art to fail. The court's decision hinged on a New Jersey statute addressing accountants' liability to third parties.[29] Under the New Jersey statute, an accountant can be liable to third parties if the accountant: (1) "knew at the time of the engagement" that the services rendered would be made available to the claimant, who was specifically identified to the accountant; (2) knew the claimant intended to rely on the accountant's services; and (3) directly expressed to the claimant, by words or conduct, the accountant's understanding of the claimant's intended reliance.[30] Cast Art urged the court to interpret the first requirement "knew at the time of the engagement" as "knew at any time during the period of the engagement," but the court adopted KPMG's preferred reading, "knew at the outset of the engagement."[31] In this case, KPMG did not know when it agreed to perform the audit that its work would play a role in a subsequent merger between its client and Cast Art. Thus, Cast Art could not satisfy the statutory requirements, and KPMG was entitled to judgment in its favor.[32]

24. *Id.* at *2.
25. *Id.*
26. *Id.* at *3.
27. 36 A.3d 1049, 1050–51 (N.J. 2012).
28. *Cast Art Indus.*, 36 A.3d at 1051–52.
29. N.J. STAT. ANN. § 2A:53A-25(b)(2).
30. *Cast Art Indus.*, 36 A.3d at 1056.
31. *Id.* at 1057.
32. *Id.* at 1060.

In the Southern District of New York, investors in Adelphia Communications alleged Deloitte & Touche, LLP negligently audited Adelphia's financial statements for the years 1999, 2000, and the first three-quarters of 2001.[33] The investors alleged that Deloitte "knew and intended that its reports concerning Adelphia's financial statements would be distributed to prospective purchasers of the Bonds" and that the purchasers would rely on the reports in making their decision to invest. However, plaintiffs did not plead "specific circumstances" showing that Deloitte had undertaken to influence and inform prospective investors, as opposed to merely knowing that some individuals might possibly rely on the reports.[34] In addition, allegations that Deloitte failed to comply with GAAS and GAAP and breached duties of reasonable care "knowingly, wantonly, recklessly, or at least negligently" were "far too conclusory" to satisfy the pleading requirements of Federal Rule of Civil Procedure 9(b).[35]

In *Bank of America, N.A. v. Knight*, a lender brought an action against a borrower limited liability company, its directors, officers, managing members, and auditors alleging that individual defendants looted the company and diverted assets to other entities.[36] The auditor defendant moved to dismiss the claims asserted against it for negligence and aiding and abetting breach of fiduciary duty. To state a negligence claim against an accountant under the Illinois Public Accounting Act, a plaintiff must allege that it was a "primary purpose" of the accountant-client relationship to benefit the third party, such that the client intended to benefit the third party and the accountant had knowledge of the intent.[37] Other than a formulaic recitation of these elements, the lender's allegations suggested the auditor generally knew its client would distribute the audited financial statements to various lenders, but there were no allegations of affirmative action by the auditor showing it had knowledge of an intent to influence this particular lender. The court therefore dismissed both the professional negligence claim and the duplicative aiding and abetting claim.[38]

B. *Causation*

The District Court for the Southern District of New York dismissed an accounting malpractice action filed against an auditor of CPS Group, Inc. (CPS) for failure to state a claim.[39] After CPS defaulted on its debt

33. *In re* Adelphia Commc'ns Corp. Secs. & Derivative Litig., No. 03 MDL 1529 (LMM), 2011 WL 5337149, at *1 (S.D.N.Y. Nov. 4, 2011).
34. *Id.* at *2.
35. *Id.* at *3.
36. No. 11 C 0303, 2012 WL 2368458, at * 1 (N.D. Ill. June 20, 2012).
37. *Id.* at *7.
38. *Id.* at *10.
39. Paladini v. Capossela, Cohen, LLC, No. 11 Civ. 2252(LAP), 2012 WL 3834655, at *1 (S.D.N.Y. Aug. 15, 2012).

and filed for bankruptcy, the lender sued CPS's former chief executive officer (CEO), who had guaranteed its two loans. The CEO then sued the accountants, claiming an erroneous audit in early 2008 failed to uncover numerous accounting errors from 2007, which led CPS to default on the two loans, inflated distributions to a co-founder, and eventually caused CPS's bankruptcy. The court held that CPS could not have caused the injuries claimed by plaintiff, i.e., the two loans and distribution, because they occurred before the audit.[40] Accordingly, plaintiff could not have relied on the audit when he decided to secure the loans, approve the distribution, or release another guarantor from his obligation.[41]

In *Cory v. Whisman, Grygiel & Giodano, P.A.*, the majority shareholder of a corporation sued its former accountants for malpractice, claiming they failed to inform him they had not completed and filed his individual tax return for 2002, which resulted in the filing of a substitute return by the IRS.[42] The shareholder's alleged damages included tax liability assessed as a result of the substitute return, interest, and penalties for untimeliness. On summary judgment, the accounting firm argued the shareholder could not establish proximate cause because he could not show (1) at the time he discovered the late return, it was too late to challenge the tax liability, and (2) that such a challenge would have been successful if timely.[43] The court denied summary judgment.[44] Whether or not a challenge would have been futile, the shareholder was in a weaker position with respect to challenging the tax liability than if the accountants had informed him promptly that they did not file the tax return.[45]

In a New York case, the plaintiff stated a malpractice claim against an accounting firm by alleging the firm failed to inform him of a possible tax election which would have allowed a larger write-off on securities trading losses. The complaint alleged that the election issue had been encompassed in the parties' engagement agreement.[46] Given the parties' accountant-client relationship, the scope of the accountants' duty was no narrower than their agreement, and may have been broader based on professional accounting standards.[47] Thus, the complaint presented a question as to whether the accountants' failure to raise the election issue was a deviation from professional standards and adequately pleaded proximate cause.[48]

40. *Id.* at *3.
41. *Id.* Duplicative claims for negligent misrepresentation, indemnification, and breach of fiduciary duty failed for the same reason. *Id.* at *5–6.
42. No. WMN-06-2694, 2012 WL 1632729, at *1 (D. Md. May 8, 2012).
43. *Id.* at *4.
44. *Id.* at *7.
45. *Id.* at *5.
46. Berg v. Eisner, LLP, 941 N.Y.S.2d 616, 617 (N.Y. App. Div. 2012).
47. *Id.*
48. *Id.*

C. *In Pari Delicto Defense*

In the Seventh Circuit, a trustee for a group of mutual funds filed suit against the funds' auditors, alleging their accountants failed to discover the funds were invested in a Ponzi scheme.[49] The district court dismissed the trustee's complaint based on the in pari delicto doctrine—the idea that the losses will rest wherever they fall when the plaintiff and defendant are equally at fault—because the founder of the mutual funds was convicted of fraud for his involvement in the Ponzi scheme.[50] The trustee argued that even though Illinois state law permitted an auditor to assert an in pari delicto defense against a receiver, the defense should never be available against a bankruptcy trustee in federal court. The appellate court rejected this argument and instead held that in pari delicto is a permissible defense against a trustee so long as the law whose jurisdiction creates the claim permits such a defense outside of bankruptcy.[51]

D. *Securities Fraud*

Former shareholders of China Integrated Energy filed a putative securities fraud class action against the company's auditor, claiming it violated § 11 of the Securities Act.[52] Section 11 provides a private right of action for purchasers of a security if the issuer published a registration statement in connection with the security that contained "an untrue statement of a material fact" or omitted a material fact that should have been included to make the statement not misleading.[53] Accountants are liable under § 11 only for those matters which they prepared or certified.[54] Here, plaintiffs stated a claim under § 11 where they alleged the accountants failed to notice discrepancies between the revenues and net income of the company's Chinese SAIC filings versus its SEC filings, negligently failed to audit the company's 2009 financial statements in a reasonable manner, failed to follow PCAOB standards, and consented to the inclusion of the false financial statements in the company's registration statement.[55]

E. *Statute of Limitations*

In *Bank of America v. Knight*,[56] auditor defendants argued the lender's claims were barred by a two-year statute of limitation set forth in the

49. Peterson v. McGladrey & Pullen, LLP, 676 F.3d 594, 595–96 (7th Cir. 2012).
50. *Id.* at 596.
51. *Id.* at 598–99.
52. Brown v. China Integrated Energy, Inc., No. CV 11-02559 MM, 2012 WL 1129909 (C.D. Cal. Apr. 2, 2012).
53. *Id.* at *3.
54. *Id.*
55. *Id.* at *4.
56. No. 11 C 0303, 2012 WL 2368458, at *5 (N.D. Ill. June 20, 2012).

Illinois Public Accounting Act.[57] They argued that the statute of limitations began to run when their client defaulted on over $35 million in loan obligations, at which point the plaintiff lender was on notice of a need to investigate the default and any potential causes of action. It was not clear from the face of the complaint if the lender knew it had an injury or cause of action against the auditors at the point of default, as the lender believed it was fully secured based on the information in the borrower's audited financial statements.[58] Although there was a point at which the lender had sufficient information concerning its injury and the cause of that injury, the complaint did not reveal when that actually occurred, and thus the court did not dismiss lender's professional negligence claim as untimely.[59]

In *Czajkowski v. Haskell & White, LLP*, a former CEO sued the accountants who audited his company's financial statements in 2001 and 2002, alleging they failed to disclose information they discovered about the nonpayment of payroll taxes caused by the misconduct of the company's former chief financial officer.[60] Between 2006 and 2009, the CEO was personally assessed over $500,000 in unpaid federal income taxes and penalties and settled the company's tax liabilities for over $340,000. When the accountant defendants moved to dismiss the negligence claims as barred by the two-year statute of limitations, the CEO argued his claims did not accrue until 2008, when he gained access to the accountants' workpapers identifying payroll tax liability and arrearages. The court rejected this argument, finding that the CEO had not exercised diligence in investigating the accountants' work, and his knowledge of the company's 2002 tax liability and his own personal liability would have aroused the suspicions of a reasonable person under the circumstances.[61] Thus, the claims were time barred.[62]

The Court of Appeals of Washington reversed summary judgment to an accounting firm defendant in *Murphey v. Grass*.[63] The Washington State Department of Revenue issued an assessment of approximately $70,000 against plaintiff and his two businesses in 2006, after completing a two-year audit, largely for unpaid retail and sales and use taxes. Plaintiff spent the next few years appealing the assessment and in 2009 sued the accounting firm responsible for the companies' bookkeeping and tax return preparation. The firm moved for summary judgment, arguing the lawsuit was barred by

57. 735 Ill. Comp. Stat. § 5/13-214.2(a).
58. *Id.* at *6.
59. *Id.*
60. 144 Cal. Rptr. 3d 522, 524 (Cal. Ct. App. July 18, 2012).
61. *Id.* at 178–79.
62. *Id.* at 179.
63. Murphey v. Grass, 267 P.3d 376 (Wash. Ct. App. 2011).

the three-year statute of limitations. The parties essentially agreed that the claim accrued when the Department of Revenue issued its "final assessment," but they disagreed as to when that occurred given plaintiff's lengthy appeal. The court held that a claim alleging negligent preparation of state tax returns accrues when the taxpayer incurs actual and appreciable harm, that is, when the Washington State Department of Revenue has issued its final assessment and can proceed to collect it.[64] By statute, the assessment was not final until the conclusion of any internal review by the department. In this case, plaintiff's claims were not time barred because the assessments did not become final, binding, and "due for payment" until 2009.[65]

In *Mayfield v. Heiman*, the beneficiary plaintiffs filed an action for breach of fiduciary duty and breach of trust against an accounting firm for alleged mismanagement of a family trust created by their father, who was singer and record producer Curtis Mayfield, Jr.[66] The beneficiaries claimed the accountant breached duties by entering into a loan transaction on behalf of the trust that, by all signs, would cause the trust to lose millions in exchange for a commission of $541,000.[67] The beneficiaries argued their claim did not accrue until 2004, when the trust had to repay the loan with payments that exceeded the loan proceeds. However, both the trial court and appellate court agreed that because the loan transaction closed on May 4, 2000, and because the beneficiaries did not file suit until January 2007, they were outside the six-year statute of limitation for any claims premised on the loan transaction.[68]

F. *Arbitration*

In *Taylor v. Ernst & Young, LLP*,[69] the liquidator of an insolvent insurer filed negligence and preference claims against the insurer's auditor, alleging that the auditor failed to use appropriate accounting standards. On appeal, the issue was whether the superintendant of insurance, in her capacity as liquidator for the insurer, should be bound by an arbitration agreement.[70] The Ohio Supreme Court held that the liquidator is not bound by an arbitration agreement when her claims do not arise out of the contract containing the clause. Here, the auditor could not enforce the arbitration clause in its engagement letter for either the negligence or preference claims of the liquidator, as neither claim arose from the engagement letter.[71]

64. *Id.* at 378–80.
65. *Id.* at 382.
66. 730 S.E.2d 685, 687 (Ga. Ct. App. 2012).
67. *Id.* at 689.
68. *Id.* at 690–91.
69. 958 N.E.2d 1203, 1206 (Ohio 2011).
70. *Id.* at 1206.
71. *Id.* at 1214–17.

III. DEVELOPMENTS IN DIRECTORS' AND OFFICERS' LIABILITY

A. *Conflicts of Interest and Fairness*

The Delaware Court of Chancery Court and the Delaware Supreme Court have in 2012 actively and ominously addressed conflicts of interest in change of ownership transactions in several high-profile, high-dollar cases. Two cases of particular interest underscore the importance of thorough disclosure of conflicts and the use of more than artificial constructs to confine those conflicts.

1. *In re El Paso Corporation Shareholder Litigation*: Undisclosed Conflicts

"Disturbing" and "troubling" was how the Delaware Chancery Court characterized the undisclosed conflicts of interest of El Paso Corporation's CEO and the partly undisclosed and inadequately quelled conflicts of its adviser, Goldman Sachs.[72] Despite its expressed deep concern, the court "reluctantly" denied the shareholder plaintiffs' motion for a preliminary injunction, where they asked the court to stop the merger between El Paso and Kinder Morgan (KM) and to let El Paso "shop" the business.[73] The court found that course of action would sanction El Paso's breach of the merger agreement while simultaneously either forcing KM to accept unbargained-for terms or risk letting KM out of the agreement. Nonetheless, the court's scathing address of undisclosed conflicts and finding that plaintiffs had a reasonable probability of success on a breach of fiduciary claim make the opinion instructive.

Shortly after El Paso Corporation announced its intent to spin off its exploration and production business (E&P), Kinder Morgan indicated it was interested in buying El Paso outright, using a sale of the E&P business to finance the purchase. El Paso's CEO was "the key negotiator," taking sole responsibility for negotiations with KM on behalf of the board, but concealed from the board his interest in an undisclosed potential management buyout of the E&P business.[74] The court concluded that El Paso's CEO, while having a duty to "squeeze the last drop of the lemon out for El Paso's stockholders," allegedly had "a motive to keep juice in the lemon that he could use to make a financial Collins for himself and his fellow managers interested in pursuing an MBO of the E&P business."[75]

72. *In re* El Paso Corp. Shareholder Litig., 41 A.3d 432, 435, 450 (Del. Ch. 2012).
73. *Id.* at 449–52. The court also suggested that an injunction might not ultimately benefit the shareholders and that the current deal, although perhaps not the best terms that could have been, was still at a premium to market. *Id.* at 434–35.
74. *Id.* at 433–34.
75. *Id.* at 444.

The court noted that El Paso's CEO kept that motive secret, negotiated the merger, and then approached Kinder Morgan's CEO on two occasions to try to interest him in the idea. In other words, when El Paso's CEO was supposed to be getting the maximum price from Kinder Morgan, he actually had an interest in not doing that.[76] The clandestine nature of the CEO's conflict made all the difference in the court's view that the less-than-aggressive negotiations and failure to shop the business to the market were not just questionable business judgment (not reviewable by the court), but a failure in loyalty.[77]

The court found El Paso's long-time adviser, Goldman Sachs, had conflicts both undisclosed and disclosed and which were, in all events, ineffectively "cabined." Goldman owned 19 percent of KM ($4 billion worth) and had two Goldman principals on KM's board. To manage the conflict, El Paso engaged Morgan Stanley to handle negotiations with KM. However, the court concluded Goldman's self-interested influence was not effectively curtailed for several reasons: (1) Goldman remained the adviser on the spin-off (the only practical alternative the company entertained), (2) Morgan Stanley's fee was entirely contingent on completion of the merger, and (3) Goldman asked for a $20 million fee for the merger and "sought credit as an advisor in the press release announcing the [m]erger."[78] The judge cynically commented:

> At this stage, I am unwilling to view Goldman as exemplifying an Emersonian non-foolishly inconsistent approach to greed, one that involves seeking lucre in a conflicted situation while simultaneously putting the chance for greater lucre out of its "collective" mind. At this stage, I cannot readily accept the notion that Goldman would not seek to maximize the value of its multi-billion dollar investment in Kinder Morgan at the expense of El Paso, but, at the same time, be so keen on obtaining an investment banking fee in the tens of millions.[79]

Once again, however, the court found the one undisclosed conflict particularly troubling: "[h]eightening these suspicions is the fact that Goldman's lead banker failed to disclose his own personal ownership of approximately $340,000 in Kinder Morgan stock, a very troubling failure that tends to undercut the credibility of his testimony and of the strategic

76. *Id.* at 434. The court could not dismiss the inference of self-interested motive, noting that "[the CEO] did not tell anyone but his management confreres that he was contemplating an MBO because he knew that would have posed all kinds of questions about the negotiations with Kinder Morgan and how they were to be conducted. Thus, he decided to keep quiet about it and approach his negotiating counterpart Rich Kinder late in the process, after the basic deal terms were set, to maximize the chance that Kinder would be receptive." *Id.* at 444.

77. *Id.* at 437–39.

78. *Id.* at 440, 443 ($20 million fee), 446 (sought credit).

79. *Id.* at 446.

advice he gave."[80] The court was persuaded of "questionable aspects to Goldman's valuation of the spin-off."[81]

In sum, where the court was inclined to see El Paso's choices as "the sort of reasonable, if arguable, ones that must be made in a world of uncertainty," it ultimately concluded those choices "must be viewed more skeptically" because of the concealed nature of the financial *motives* adverse to the stockholders.[82] "This kind of furtive behavior engenders legitimate concern and distrust."[83]

2. *Americas Mining Corporation v. Theriault*: Shifting Burden of Proving Fairness

The Delaware Supreme Court affirmed a whopping $2 billion Chancery Court judgment in favor of a minority shareholder, holding that the company overpaid in the purchase of a large business from its controlling stockholder, that the deal was unfair, and that the affiliate directors breached their duty of loyalty.[84] The Delaware Supreme Court in its lengthy en banc opinion significantly and explicitly addressed the burden of persuasion on the issue of the entire fairness of a self-interested transaction. In deals that involve self-dealing by a controlling shareholder, defendants can shift the burden of proving fairness by showing either (1) that the transaction was approved by "a well-functioning committee of independent directors" or (2) that the transaction was approved by "an informed vote" of a majority of the minority shareholders."[85] The court in *Americas Mining* made clear that practitioners and fiduciaries cannot guarantee that burden-shifting benefit by simply putting a committee in place. Where defendants are relying upon the use of an independent committee or an informed vote of the minority shareholders and it is not *clear* to the court prior to trial whether the independent committee was "well-functioning" or the minority shareholder vote was informed, the burden of proving the transaction's fairness remains on the defense.[86]

In reviewing the decision *not* to shift the burden of persuasion on the issue of fairness to the plaintiff (or decide the burden issue at all pretrial),

80. *Id.* at 442.
81. *Id.* at 441.
82. *Id.* at 434.
83. *Id.* at 447.
84. Americas Mining Corp v. Theriault, 51 A.3d 1213, 1218–19 (Del. 2012) (The $2 billion in damages awarded were a measure of the difference between what was paid for the large business, Minera, and what the court determined it was worth.).
85. *Id.* at 1240 (citing Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994)).
86. *Id.* at 1243 ("We hold prospectively that, if the record does not permit a pretrial determination that the defendants are entitled to a burden shift, the burden of persuasion will remain with the defendants throughout the trial to demonstrate the entire fairness of the interested transaction").

the Delaware Supreme Court examined the question of whether the committee in place was a well-functioning independent committee. The transaction involved the company (then Southern Peru) purchasing from its controlling shareholder (Grupo Mexico) a company controlled and almost entirely owned by Grupo Mexico (Minera); there was an exchange of stock—trading financially sound, "market tested" Southern Peru stock for financially struggling, privately held Minera stock. The company appointed a special committee to consider the transaction, but three of the four appointees, including the committee's chairman, were board members appointed by the majority stockholder, Grupo Mexico. The fourth committee member represented a large founding stockholder company that wanted to monetize its holdings in Southern Peru and get out. While the special committee was negotiating terms with Grupo Mexico, the founding stockholder committee member was negotiating registration rights from Grupo Mexico, needed because of the volume restrictions imposed on affiliates of an issuer. After its lengthy discussion of the tortured, seemingly one-sided negotiations, the court concluded it "had little doubt that [the founding stockholder's] own predicament as a stockholder dependent on Grupo Mexico's whim as a controller for registration rights influenced how [the committee member] approached the situation" and that it was subject to Grupo Mexico's domination.[87] Even though the conflicted committee member abstained from the final vote, his involvement throughout the negotiation of the deal contributed to the finding that the committee was not effective.

The court found that the special committee justified paying a higher price through "a series of economic contortions" including a devaluation of Southern Peru's own stock from its market price. At bottom, the court concluded that the special committee's "cramped perspective resulted in a strange deal dynamic" in which the committee "lost sight of market reality in an attempt to rationalize doing a deal of the kind the majority stockholder proposed . . . a game of controlled mindset twister" that resulted in giving away "over $3 billion worth of actual cash value in exchange for something worth demonstrably less . . . without using any of its contractual leverage to stop the deal or renegotiate its terms."[88]

Although the committee in *Americas Mining* was found not to be well functioning, the court did reaffirm that judicial review of the fairness of a transaction will be "significantly influenced" by the work of a "properly functioning special committee of independent directors," thus incentivizing the use of fair dealing processes.[89]

87. *Id.* at 1230.
88. *Id.* at 1248.
89. *Id.* at 1244.

B. *Derivative Suit Dismissal Under Rule 23.1*

According to the Delaware Court of Chancery in *Louisiana Municipal Police Employees' Retirement System v. Pyott*,[90] a dismissal with prejudice of a shareholder suit pursuant to Federal Rule of Civil Procedure 23.1 for failure to establish that a demand is excused is *not* necessarily preclusive of other shareholder suits with the same or similar claims. Recognizing that "[a] growing body of precedent holds that a Rule 23.1 dismissal has preclusive effect on other derivative complaints," the court declined to follow that trend.[91]

The court disagreed with the trending rationale that all shareholders suing derivatively are doing so in the name of the company and thus are in privity with one another. Rather, the court concluded that other stockholders are not in privity with shareholders against whom a Rule 23.1 dismissal has been granted because Delaware law says a derivative plaintiff has no authority to sue in the name of the corporation until a Rule 23.1 motion has been *denied* (i.e., there has been "a finding of demand excusal or wrongful refusal").[92] In effect, the court reasoned that a shareholder dismissed under Rule 23.1 is a shareholder who never acted on behalf of the company in the first place, and therefore could not be in privity with other derivative plaintiffs.

The message of *Pyott* is that for Delaware corporations, dismissal with prejudice of a shareholder derivative suit pursuant to Rule 23.1 for failure to demonstrate demand futility will not have preclusive effect or preclude other shareholders from trying again, perhaps with more specific or well-developed pleadings.[93]

C. *Fiduciary Duties of LLC Managers Under Delaware State Law*

Where the LLC agreement is silent as to limitations on an LLC manager's duties, Delaware law will imply the existence of fiduciary duties of the same sort and scope as in the corporate context, according to the Chancery Court opinion in *Auriga Capital Corporation v. Gatz Properties, LLC*.[94] The court reasoned that fiduciary duties should be the default and read into the LLC context as they are into the corporate context. The court grounded its decision in § 18-1104 of the Delaware LLC Act, which pro-

90. 46 A.3d 313 (Del. Ch. 2012).

91. The court cited a litany of opinions from different jurisdictions including the First Circuit and federal district courts in Nevada, New Jersey, Texas, California, and New York. *Pyott*, 46 A.3d at 323 & n.1.

92. *Id.* at 323, 327–28.

93. In its forty-two page opinion, the court held an extended discussion of the detrimental effects of fast filing and extolled the virtues of shareholders using §220 of Delaware General Corporation Law to request company books and records before filing. *Pyott*, 46. A.3d at 335–50. The court concluded that "fast-filing generates dismissals." *Id.* at 344.

94. 40 A.3d 839, 849–59 (Del. Ch. 2011).

vides that "[i]n any case not provided for in this chapter, the rules of law and equity . . . shall govern."[95] Linking the statute's call for the rules of equity to the need for full corporate fiduciary duties, the court stated that "[e]quity distinguishes fiduciary relationships from straightforward commercial arrangements where there is no expectation that one party will act in the interests of the other."[96] Although the court recognized that members of an LLC can contractually waive all fiduciary duties owed to them by the manager (except for the implied contractual covenant of good faith and fair dealing), it reasoned from the general provision of § 18-1104, legislative history, equity, and policy that fiduciary duties should and will otherwise be implied.[97]

D. *Liability for Causing a Company to Act Illegally*

In two opinions with opposite outcomes, the Delaware Court of Chancery further refined and suggested boundaries for liability in cases involving allegations that a board systematically fails to exercise oversight by fostering an adversarial relationship with government regulators.

In the case of *In re Goldman Sachs Group, Inc. Shareholder Litigation*,[98] the court clarified that one illegal act does not make a case for failure to exercise oversight and drew a line between acts that are actually illegal and acts that are merely morally repugnant or that might damage a corporation's reputation. The shareholders alleged that management was engaging in "disloyal and unethical trading practices" by continuing to sell mortgage-related products to its clients while profiting from the decline of the mortgage market (taking the short side of securitized mortgages while simultaneously long on or selling long positions on the underlying assets). Specifically, shareholders alleged that Goldman's "trading practices have subjected the Firm to civil liability, via, *inter alia*, an SEC investigation and lawsuit."[99] The court found, however, that only one of the three transactions described in the complaint resulted in liability.[100] The court concluded that that transaction was "unique" because the complaint did not plead enough specifics concerning the other two transactions to show they were similar to the illegal transaction.

95. *Id.* at 849–50 (quoting DEL. CODE ANN. tit 6, § 18-1104 (2012)).
96. *Id.* at 850.
97. *Id.* at 851, 852 n.46 (citing DEL. CODE ANN. tit 6, § 18-1101(c) (2012), which permits full contractual exculpation for breaches of fiduciary and contractual duties, except for the implied contractual covenant of good faith and fair dealing and citing the Chancery Court opinion in *Fisk Ventures, LLC v. Segal*, 2008 WL 1961156 (Del. Ch. May 7, 2007) where the court found based on the LLC agreement that the members had waived all fiduciary duties except those contractually provided.)
98. C.A. No. 5215-VCG, 2011 WL 4826104 (Del. Ch. Oct. 12, 2011).
99. *Id.* at *21.
100. *Id.* This involved the Abacus transactions, where Goldman settled fraud charges brought by the SEC against Goldman and one of its vice presidents.

And one transaction on its own "cannot demonstrate the willful ignorance of 'red flags'" necessary to state a claim for systematic failures of oversight.[101] Moreover, the court in *Goldman* found that as to trading practices that are risky and may damage the company's reputation, "[i]f an actionable duty to monitor business risk exists, it cannot encompass any substantive evaluation by a court of a board's determination of the appropriate amount of risk."[102]

Contrastingly, the Chancery Court in *Louisiana Municipal Police Employees' Retirement System v. Pyott* found the shareholders pleaded a nonexculpated breach of the duty of loyalty for causing the company to act illegally.[103] As in *Goldman Sachs*, government allegations of illegal conduct caused loss to the company in one rather large public incident. Nonetheless, the court pointed strongly to one distinguishing factor in the pleadings, stating that unlike the many similar complaints for systematic failure to monitor under *Caremark* that courts have dismissed, the complaint before it supported the allegations with references to internal company books and records.[104] Plaintiffs alleged a sufficient pattern of conduct at the board level, including continued approval of plans that anticipated regulatory violations even after receiving many warnings and a particular incident of regulatory intervention sufficient to withstand dismissal.[105] So, while allegations of one bout with the law will not rise to the level of a claim for failure to monitor, allegations of a specific pattern of behavior related to repeated illegal behavior will, even where that behavior has not systematically been prosecuted.

IV. DEVELOPMENTS IN AGENT/BROKER MALPRACTICE

It is well settled that insurance brokers and agents generally owe policyholders a duty of care stemming from the principal-agent relationship.[106] Although some jurisdictions characterize the relationship between the parties as a fiduciary one,[107] most jurisdictions limit the duty of care imposed upon brokers and agents to obtaining the insurance that the policy-

101. *Id.*

102. *Id.* at *22 (quoted language); *see also id.* at *20 ("reputational risk exists in any business decision").

103. *Pyott*, 46 A.3d at 323.

104. *Id.* at 353.

105. *Id.* at 355–56 (the directors approved multiple iterations of the company's strategic plan that anticipated improper marketing of an off-label use, monitored the sales growth that implied improper marketing, learned of a particular incident of regulatory interference, and then approved yet another plan that contemplated improper marketing).

106. *See, e.g.*, Emerson Elec. Co. v. Marsh & McClennan Cos., 362 S.W.3d 7, 12 (Mo. 2012).

107. *See, e.g.*, *id.* at 9 (while acting as the agent of the insured, broker "has a fiduciary duty to perform its duties with reasonable care, skill and diligence").

holder requested, unless the broker or agent agrees to undertake additional responsibilities. Recently, however, two state supreme courts have arguably expanded the traditional duties owed by agents and brokers.

A. *Duty of Loyalty*

In *Emerson Electric. Co. v. Marsh & McClennan Cos.*,[108] the Missouri Supreme Court recognized that, in addition to the long-established duty of care, insurance agents owe policyholders at least a narrow duty of loyalty. In *Emerson*, the broker received contingent commissions from certain insurance companies. A contingent commission is an added financial incentive, on top of a transaction-specific commission, for steering a larger volume of business to a particular insurance company. The broker also collected premiums on behalf of the policyholder and deposited those premiums in an interest bearing account. The broker retained the interest earned on the premiums before they ultimately were paid to the insurance company. The broker failed to disclose either of these added benefits to the policyholder.[109]

Upon discovering that the broker was receiving contingent commissions and retaining interest earned on premiums, the policyholder sued the broker, claiming that it breached its fiduciary duty, duty of loyalty, and duty of care. The broker, in turn, argued that it owed the policyholder only a fiduciary duty of care and not a duty of loyalty. It did not breach this duty, the broker argued, because the contingent commissions were authorized by statute and, when it collected premiums, it was acting on behalf of the insurer, not the policyholder. The Supreme Court of Missouri agreed with the policyholder that a broker owes a duty of loyalty to its clients but nonetheless held that the broker did not breach that duty solely by accepting contingent commissions or retaining interest earned on premiums.[110]

The court began its analysis by setting out the long-established law in Missouri that a broker "represents the insured and, unless otherwise shown by the evidence, is to be regarded as the agent of the insured."[111] A consequence of this agency relationship is that the broker, like all other agents, "is a fiduciary with respect to matters within the scope of his agency."[112] The scope of the broker's agency "normally is limited to procuring the insurance requested by the insured."[113] The broker's duty, however, does not include an obligation "to advise the insured on its

108. *Id.*
109. *Id.* at 9.
110. *Id.*
111. *Id.* at 12.
112. *Id.* at 12–13 (quoting Bunting v. Koehr, 865 S.W.2d 351, 353 (Mo. 1993) (en banc)).
113. *Id.* at 13.

insurance needs or on the availability of particular coverage, unless they specifically agree to do so."[114]

The broker's status as an agent, the policyholder argued, created not just a fiduciary duty of care but also a duty of loyalty. According to the policyholder, this duty followed "from the very nature of being an agent because it is a basic principle of the law of agency that an agent 'has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship.' "[115] The court agreed, holding that "a duty of loyalty running from the agent to the principal is inherent in the nature of the principal-agent relationship."[116] Accordingly, under Missouri law, the court held that brokers owe policyholders a basic duty of loyalty.

While recognizing that a duty of loyalty exists, the *Emerson* court was quick to qualify its scope. The duty of loyalty, the court held, would not subsume the older rule that brokers did not "have a duty to inform the insured how much insurance it needs [or] to search out the best insurance for it."[117] Following earlier Missouri precedent, the court rejected a rule imposing "a duty to give advice or recommend insurance," because such a duty "would in effect make agents and brokers into financial counselors or guardians of insureds and require them to have unreasonable knowledge of their insured's needs and of the marketplace."[118] The court thus rejected the policyholder's argument that the broker's duty of loyalty included a duty to obtain insurance at the lowest possible price. Such a duty, the court explained, goes too far and would require too much from a broker, whose basic duties are "to exercise reasonable care, skill and diligence in procuring insurance" and to "exercise good faith," consistent with its duty of loyalty.[119]

Further clarifying the scope of the duty of loyalty, the *Emerson* court held that, like the fiduciary duty of care, "the duty of loyalty necessarily extends only to matters undertaken by the broker within the scope of the agency."[120] This limitation, the court emphasized, "is particularly important because a broker is not always an agent of the insured, and indeed its commissions customarily are paid by the insurer."[121] Ordinarily, when collecting premiums, the broker is acting on behalf of the insurer. Accordingly, the court held that the broker did not breach its

114. *Id.*
115. *Id.* (quoting RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006)).
116. *Id.*
117. *Id.* at 14.
118. *Id.*
119. *Id.* at 15.
120. *Id.* at 16.
121. *Id.*

duty of loyalty to the policyholder by retaining the interest earned on the policyholder's premiums, as collecting premiums was not within the scope of the broker's agency relationship with the policyholder.

The duty of loyalty was limited not only by these common law considerations, according to the Missouri Supreme Court, but was also limited by statute. Specifically, under a Missouri statute, a broker is authorized expressly to collect commissions from an insurer.[122] This statute "does not distinguish between contingent and other commissions."[123] Accordingly, the court held that it was not a breach of the duty of loyalty to accept a contingent commission. Furthermore, because contingent commissions are authorized by statute, the broker has no duty to disclose these commissions to the policyholder "any more than it would have a duty to disclose other statutorily authorized aspects of its financial arrangements."[124]

Having held that the broker's duty of loyalty does not necessarily include "a duty to disclose the receipt of premium interest or contingent commissions" nor "a duty to obtain the lowest possible cost insurance," the *Emerson* court concluded by holding that "such additional duties may be assumed by brokers."[125] Importantly, the broker could assume these additional duties "either by contract, course of conduct . . . or a combination of both. . . ."[126] The court thus held that, while the broker did not breach its duty of loyalty by receiving contingent commissions or by retaining interest on premiums, there remained issues of fact to be resolved concerning whether the broker assumed and breached additional duties to the policyholder. Accordingly, the court remanded the case back to the trial court to resolve these factual issues.

B. *Duty Owed to Intended Beneficiary*

In *Pitts v. Farm Bureau Life Ins. Co.*,[127] the Iowa Supreme Court recently held that the duty of care is owed not only to the policyholder, but also to an intended beneficiary of a life insurance policy, at least under certain circumstances. In *Pitts*, the policyholder obtained a life insurance policy through the defendant insurance agent in 1989. According to a domestic relations court order, the policyholder was required to maintain $35,000 in life insurance for the benefit of his daughter while his child support obligation was ongoing, which would end in April 2005. In 1993, the policyholder got remarried and, subsequently, he and his new wife met with

122. Mo. Rev. Stat. § 375.116.
123. *Emerson*, 362 S.W.3d at 18.
124. *Id.* at 19.
125. *Id.*
126. *Id.*
127. 818 N.W.2d 91 (Iowa 2012).

the insurance agent to obtain insurance that would both satisfy the policyholder's child support obligations and provide for his new wife in the event of his death.

Ultimately, he purchased a policy that designated his daughter as the beneficiary of the first $50,000 of proceeds and designated his wife as the beneficiary of the balance. Then, in 1995, the policyholder changed his policy so that his daughter received the first $35,000 of the proceeds and his wife the balance. A third written change of beneficiary was made in 1996, but those changes were illegible. No further written changes were made. The policyholder's wife, however, alleged that when his support obligations ended in 2005, the policyholder had requested that the agent change the beneficiary designation so that his daughter was no longer the primary beneficiary. According to the policyholder's wife, the agent told her and her husband on multiple occasions that she was the sole beneficiary of the life insurance proceeds.[128]

The policyholder passed away in 2007. At the time, the policyholder's wife and her parents met with the agent. The agent allegedly told her again that she was the sole beneficiary on the policy. Moments later, however, after receiving a telephone call, the agent advised the policyholder's wife that the policyholder's daughter would still receive the first $35,000 of the proceeds. The policyholder's wife filed suit against the agent, asserting claims for negligence and negligent misrepresentation.

The trial court awarded summary judgment to the agent, finding that the policyholder's "oral statements were insufficient to impose a duty on [the agent] to change the beneficiary of the policy."[129] The court, however, found that the scope of the appeal was not so narrow. Rather, the issues before the court were (1) whether the agent was negligent in responding (or failing to respond) to the policyholder's request to change the beneficiary, if such a request was indeed made, and (2) whether the agent made negligent misrepresentations subsequent to that request.[130]

The agent argued, among other things, that he could not be liable for any purported breach of duty because the agent owed a duty of care to the policyholder only and did not owe any duties to his wife.[131] The Iowa Supreme Court, however, disagreed.

The court first rejected the agent's argument that because she was not actually designated as the beneficiary for the first $35,000 in proceeds, the policyholder's wife could not demonstrate that she was the *intended* beneficiary, finding that the argument made by the plaintiff was that the pol-

128. *Id.* at 106.
129. *Id.* at 97.
130. *Id.*
131. *Id.* at 97–98.

icyholder's intention was frustrated due to the negligence of the agent.[132] The court found compelling that plaintiff brought her claim not solely premised upon her status as a "family member" of the decedent but instead as a particular person whom the insured intended to benefit.[133]

The court found the rationale for such a rule in the case before it to be analogous: the primary function of the instrument is to benefit the intended beneficiary; damage to third parties such as plaintiff was foreseeable; the decedent's estate may not have an incentive or standing to bring the action; and, if no claim could be maintained, the very purpose in hiring the agent could be frustrated.[134] Accordingly, the court held that "an insurance agent owes a duty to the intended beneficiary of a life insurance policy in limited circumstances"—specifically, where plaintiff can establish the elements of negligence, can show that she was the "direct, intended, and specifically identifiable beneficiary," and can produce written evidence from the instrument that indicates that she is the intended beneficiary.[135]

With regard to plaintiff's negligent misrepresentation claim, the court likewise found that plaintiff could maintain such a claim against the insurance agent. The court determined that insurance brokers and agents are in the business of supplying information to third parties and, as such, could be liable for negligent misrepresentations to third parties such as plaintiff.[136] The information allegedly provided was given in the course of the agent's business and for the benefit of third parties. Accordingly, the court reversed the trial court's grant of summary judgment to the agent on this claim.

C. *Broker's Authority*

In *Gateway Hotel Holdings, Inc. v. Chapman-Sander, Inc.*,[137] the Missouri Court of Appeals held that a broker does not have authority to make counteroffers on behalf of the insurer when the broker is acting on behalf of the policyholder. In *Gateway*, the policyholder was a boxing promoter, staging a match at a hotel. The promoter agreed to obtain insurance for the match and to provide an ambulance on standby at the hotel during the event. It was the promoter's understanding that he was obtaining insurance for, among other things, any injuries suffered by the boxers fighting

132. *Id.* at 100.

133. The court analogized the situation to cases where a beneficiary sues a lawyer who negligently drafts a will and who owes a duty of care not only to his client, but also to the "direct, intended, and specifically identifiable" beneficiaries as expressed in the will. *Id.* at 101.

134. *Id.* at 101–02.

135. *Id.* at 106.

136. *Id.* at 111–13.

137. No. ED 97066, 2012 WL 2913793 (Mo. Ct. App. July 10, 2012).

in the match. The policy procured by the broker, however, contained an athletic participants exclusion, meaning such injuries were not covered. A specimen policy, containing the exclusion, was provided by the broker to the promoter.

At the event, one of the boxers was seriously injured. The promoter failed to have an ambulance at the hotel during the event, exacerbating the boxer's injuries. The boxer sued the hotel for his injuries, winning a verdict of near $14 million. The hotel, in turn, brought claims against the promoter for contribution, indemnity, and breach of contract for causing the boxer's injuries. As part of a settlement reached between the parties, the promoter assigned his claims against the broker to the hotel, which then brought claims for breach of contract and negligence against the broker.[138]

The broker argued that, even if the promoter made an offer to purchase coverage for the boxer's injuries, the specimen policy provided to the promoter constituted a counteroffer, which the promoter accepted. The court rejected this argument, holding that the broker was "an agent of [the promoter], not the insurance company, and, as such, did not have the authority to make a counteroffer."[139] Rather, it was the broker's "duty to procure the coverage requested."[140] "An agent or broker who unjustifiably and through his fault or neglect fails to obtain the requested insurance," the court concluded, "will be held liable for any damages resulting from such failure."[141] Accordingly, the broker could be liable to the hotel (as assignee of the promoter's claims) for failing to procure insurance covering injuries to the boxers.

138. *Id.* at *2.
139. *Id.* at *5.
140. *Id.*
141. *Id.* at *6.