

INSURER'S LIABILITY FOR NEGLIGENT INSPECTIONS



by Gary Wickert

Many insurance companies along several lines of insurance routinely provide insurance inspections of their insureds' premises and operations (also known as field inspections or loss control surveys) for loss control, risk management, and underwriting purposes. In their unstoppable search for deep pockets and third parties, trial lawyers have for years been requiring insurers and defense counsel to respond to a vagary of legal theories of liability that challenge a common assumption in our industry – that an insurance company cannot be liable for injuries resulting from such inspections, if performed negligently. That assumption is not always correct.

Many people do not fully understand the importance of the insurance inspection and how it relates to the underwriting process. These inspections are often used to verify the insured not only exists at the address on the policy and that there are no liability or other hazards that exist on the property that could cause

the homeowner (personal lines, residential inspections), business owner (commercial lines, commercial inspections) and/or the insurance company unnecessary exposure. These inspections are used as an underwriting tool to minimize the potential of an insurance claim and to verify that the information collected at the time of application for the policy is correct. With increasing frequency, however, trial lawyers are attempting to make inspections conducted by workers' compensation carriers, general liability carriers and property insurers a basis for tort liability.

These loss control inspections are performed by either company-trained loss control inspectors or graduate engineers, and function much like a home inspection you might request before purchasing a home. The insurer wants to know if there are any problems, dangers, risks, or potential claims waiting to happen as a result of shoddy safety programs and careless operations on the part of the insured. The inspections vary greatly in scope and thoroughness. Some are quick and cursory confirmations of the existence of

certain safety equipment such as sprinklers, fire extinguishers, etc. Others are more involved and detailed, involving the technical aspects of large, complex manufacturing facilities. In addition to looking for potential problems and hazards, the inspections also serve to gauge an insured's attitude, cooperativeness, knowledge and commitment to loss prevention and control. A safe insured is often a better risk than an insured which is not safe.

Upon completion of an inspection, the inspector typically prepares a detailed report of his or her findings, including recommendations for how the insured might improve its safety, and occasionally making renewal of a policy contingent upon complying with a list of the inspector's recommendations. The inspector's activities are geared toward the business end of insurance underwriting, not necessarily to provide advice to insureds on their plant safety. Improved safety at the insured's location is usually just a by-product of their actual purpose – improving the profitability of the insurer's business. In short, they are self-serving and are not performed for the benefit of the insured or third parties, although such third-party benefits are an undeniable collateral benefit of the inspections. Most policies contain some sort of boilerplate admonishment regarding the extent and purpose of these inspections:

The Company shall be permitted but not obligated to inspect the Insured's property and operations at any reasonable time. Neither the right to make inspections nor the making thereof, nor any advice or report resulting therefrom shall constitute an undertaking on behalf of or for the benefit of the insured or others, to determine or warrant that such work places, operations, machinery or equipment are safe.

Even if the policy doesn't contain these disclaimers, the inspection report usually does. However, this does not deter trial lawyers from arguing that the insurance company has, by inspecting the premises, undertaken and assumed a duty to the insured and third parties on the premises of the insured or using the insured's equipment.

Any cause of action for negligent inspection must be based on § 324A of the Restatement (2d) of Torts:

§324A Liability to Third Person for Negligent Performance of Undertaking

One who undertakes, gratuitously or for consideration to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to protect his undertaking, if: (a) his failure to exercise reasonable care increases the risk of harm, or (b) he has undertaken to perform a duty owed by the other to the third person; or (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.

This Restatement is sometimes referred to the "Good Samaritan Rule." Most insurance inspections do not fall within this Restatement because the insurer does not "undertake" or assume responsibility to perform the inspection principally for the benefit of another. It is done as part of the insurer's underwriting process. *Smith v. Allendale Ins. Co.*, 303 N.W.2d 702 (Mich. 1981). Some courts, however, ignore the undertaking requirement and hold that reliance on an insurance company's inspection by either employee or employer is sufficient to sustain a tort claim by employee against company for negligent inspection. *Huggins v. Aetna Cas. & Sur. Co.*, 245 Ga. 248, 264 S.E.2d 191 (1980).



Other courts have determined that, depending on the facts, such inspections are necessarily undertakings for the benefit of the insured and any benefit derived by the insurer does not remove the inspection from the scope of § 324A. *Nelson v. Union Wire Rope Corp.*, 199 N.E.2d 769 (Ill. 1964) (applying Florida's workers' compensation law).

What sort of evidence would constitute evidence of an undertaking sufficient to place liability on the inspecting insurer? A New York case decided by Chief Justice Cardozo has indicated that if conduct has gone forward to such a stage that inaction would commonly result, not negatively merely in withholding a

benefit, but positively or actively in working an injury, there exists a relation out of which a duty to go forward arises. *Glanzer v. Shepard*, 135 N.E.2d 275 (N.Y. 1922). Admittedly, facts sufficient to create such a duty are rare, but they do exist. It is not enough that an insurance company has acted. In order to incur liability for negligent inspections, it must have undertaken to render services to another or that the insurer intended to render benefits for the benefit of another.

If, in the course of marketing or promoting itself and its inspection services, or in conjunction with the actual undertaking of the inspection itself, the insurer advertises

or represents that it will provide complete fire inspection services to alert the insured to fire hazards on the premises, its failure to detect and/or notify the insured of such hazards which thereafter result in a fire, could form the basis for liability on the part of the insurer. *Smith v. Allendale Mut. Ins. Co.*, supra. This line of reasoning has been followed, with detrimental results for the inspecting insurance company, in a number of cases. *Deines v. Vermeer Mfg. Co.*, 752 F.Supp. 989 (D. Kan. 2990). In *Deines*, the insurer's advertisements and coverage proposal to the insured implied benefits to the insured from the inspection and did not state that the services would relieve the insured of the burden of monitoring its own facilities.

The scope of the inspection might bear on whether a duty is owed to the insured or a third person. Likewise, the type of insurance at issue is also relevant. Courts draw sharp distinctions between third-party liability, workers' compensation, and first-party property insurance, with a tendency for workers' compensation carriers and boiler and machinery insurers to be liable more so than first-party carriers. *Leroy v. Hartford Steam Boiler Inspection and Ins. Co.*, 695 F.Supp. 1120 (D. Kan. 1988). This makes sense because workers' compensation insurance inspections would be more focused on personnel safety while first-party inspections are attuned more to preventing property loss.

If the insurer inspects specific dangerous machinery, such as in boiler and machinery inspections, the tendency is to place liability on the carrier's negligent acts. This is especially true if the insurer has the authority in a specific jurisdiction to shut down the insured's operations. *Seay v. Travelers Indemnity*, 730 S.W.2d 774 (Tex. Civ. App. 1987); *Van Winkle v. American Steam Boiler*, 52 N.J.L. 240, 23

Vroom 240, 19 A. 472 (1890).

In workers' compensation settings, an additional obstacle of the creative trial lawyer is the exclusivity rule, which holds that the employer is immune from suit by an injured employee. In most states, the workers' compensation insurer is granted the same immunity as its insured, allowing it to take advantage of the exclusive remedy rule as a defense.

Restatement § 324A also provides some indication that where the reliance of the insured, or of the third person, has induced the insured to forgo other remedies or precautions against such a risk, the harm results from the negligence as fully as if the actor had created the risk. In *Thompson v. Bohlken*, 312 N.W.2d 501 (Iowa 1981), the court stated:

Travelers [defendant insurer] also argues that it cannot be held under a duty of inspection under its insurance contract with [employer]. However, its liability for inspections does not arise from, nor is it circumscribed by, the contract of insurance; it arises ... from its undertaking the responsibility of making such inspections in such a manner as to increase the risk of harm or create reliance to another's detriment.

In order to create liability on the part of the inspection carrier, the negligent inspection must result either in an increase in the risk of harm, in an undertaking to perform a duty owed by another to a third person, or in reliance by the insured or the employee of the insured upon the undertaking. *Derosia v. Liberty Mut. Ins. Co.*, 583 A.2d 881, 886 (Vt. 1990).

In most cases, there will be no liability for an action brought against an insurer for

negligent inspection. This is because there is generally no duty under § 324A because the insurers do not normally agree to be, or by their actions voluntarily assume to be, responsible for the safety of the structure being inspected. *Gooch v. Bethel A.M.E. Church*, 792 P.2d 993, 998 (Kan. 1990). Generally speaking, insurers owe no duty of care to provide a reasonably safe workplace for the employees of their insured. *Commercial Union Ins. Co. v. DeShazo*, 845 So.2d 766 (Ala. 2002). However, where there is specific and dangerous property which is being inspected, the insurer has the authority to shut down the insured if it fails the inspection, the advertising of the inspection services raises the expectations of the insured as to the inspection as well as their reliance on the inspection, or there is some sort of other undertaking on which the insured relies, the occasional case may see liability attach for the negligent inspection conducted by the insurer. But those cases will be few and far between.

If you should have any questions regarding this article or subrogation in general, please feel free to contact Gary Wickert at 262-673-7850 or gwickert@mwl-law.com.

about the author

Gary Wickert is an insurance trial lawyer and is regarded as one of the world's leading experts on insurance subrogation. He is the author of several subrogation books and legal treatises and is a national and international speaker and lecturer on subrogation and motivational topics. Gary is also a published commercial fiction author and a politician in Wisconsin. After 15 years as the youngest managing partner in the history of the 30-lawyer Houston law firm of Hughes, Watters & Askanase, L.L.P., Gary returned to

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