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Insurance E&O Liability Arising from Superstorm Sandy

A Commentary by Kenneth M. Labbate & Carrie C. Turner of Mound Cotton Wollan & Greengrass
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Well, the rails are washed out north of town, We gotta head for higher ground. We can't come back till the water comes down, Five feet high and risin'.[1]

Superstorm Sandy's devastating clash with the Northeastern seaboard was likely only the first in a series of breakers arising from the storm. The insurance industry may find itself under water next. "[T]he most direct impact will be claims for property damage [due to flooding and power outages,] and business interruption made under homeowners and commercial first-party property policies."[2] Furthermore, damage caused by Superstorm Sandy's combination of wind, storm-surge flooding, rain, and snow will likely result in litigation between policyholders and insurers as to whether covered or non-covered events caused policyholders' damages.[3] Policyholders may discover that they are either inadequately insured or that their claims fall entirely outside the coverage provided by their policies.[4] In such cases, policyholders attempting to recoup significant losses will look to other sources for recovery and may file suits against their insurance brokers or agents,[5] claiming that the broker failed to procure the required insurance coverage.[6] Claims against brokers may stem from policyholders' complaints that policies had (1) insufficient limits; (2) insufficient sub-limits for flooding, named storm, or storm surges; (3) overly high deductibles; or (4) inadequate contingent coverage. As a result, insurance brokers, and correspondingly, insurance companies that underwrite errors and omissions ("E&O") liability insurance will most certainly face exposure to suits for breach of contract and/or negligence.[7]

The nature and scope of the broker's duties to the policyholder will be a significant issue.[8] Brokers are required to use reasonable skill and diligence in securing coverage.[9] However, where there is a special relationship between the broker and the customer at the time the broker procures coverage, the broker may owe the customer a heightened duty of care.[10] Thus, litigation may be focused upon whether or not a special relationship existed between brokers and customers. Furthermore, if the broker was acting as an agent of the insurer rather than as a general broker at the time of procurement, the broker's acts may be attributable to the insurer – another distinction policyholders may litigate.[1]

As the majority of litigation arising out of Superstorm Sandy will be filed in New York and New Jersey,[1] examining both states' precedent regarding a broker's duty of care to policyholders is worthwhile for both plaintiffs and potential E&O liability defendants.

New York

Under New York law, insurance agents and brokers have a duty to obtain requested coverage within a reasonable time or inform the customer of the agent's inability to do so.[13] However, "agents have no continuing duty to advise, guide, or direct a client to obtain additional coverage."[14] Therefore, under New York law, absent a specific request for coverage not already provided for in an insurance policy, agents have no common-law duty to advise a customer to procure additional coverage.[15] In order to prevail against a broker in New York, the policyholder must generally show that it requested a specific type of coverage that was available and that the broker failed to obtain that coverage.[16]

Alternatively, a policyholder can show that it had a special relationship with the broker that obligated the broker to advise the policyholder regarding available additional coverage absent the policyholder's request.[17] A special relationship may develop where (1) the agent receives compensation beyond that which he would receive for consultation other than the payment of premiums; (2) there was some interaction regarding a question of coverage where the insured relied upon the agent's expertise; (3) there is a course

of dealing over an extended period of time that objectively would put a reasonable insurance agent on notice that his advice was being sought and specifically relied upon.[18] Agents also may, by their conduct or by express or implied contract with customers, acquire duties in addition to their common-law duties.[19] Generally, New York courts consider the specific circumstances surrounding a broker-client relationship on a case-by-case basis to determine whether extra responsibilities for the broker should be recognized.[20]

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For instance, in *Radford v. Peerless Ins. Co. and Ladd's Agency, Inc.,* a plaintiff filed suit against her insurance broker for negligence, breach of contract, negligent misrepresentation, and breach of fiduciary duty arising from the agent's alleged failure to purchase a certain type of coverage on her behalf.[21] The court held that "liability for negligent misrepresentation has been imposed only on those persons who possess unique or specialized expertise, or who are in a special position of confidence and trust with the injured party such that reliance on the negligent misrepresentation is justified."[22] The court further held with regard to the breach of fiduciary duty and negligent misrepresentation claims that the agent had established that he did not have a special relationship with the insured party and did not owe her a fiduciary duty. The court additionally held that, because the plaintiff did not make a specific request for coverage beyond what the agent procured, a general request for additional coverage did not satisfy the requirement of a specific request for a certain type of coverage.

In a particularly relevant case, *Garnerville Holding Co., Inc. v. Kaye Ins. Assocs., Inc.*,[23] a policyholder sustained flood-related losses that exceeded the limits of its flood coverage under the policy procured by the insurance broker. The policyholder sued the broker in both tort and negligence, alleging that the broker failed to properly advise the policyholder as to how much flood coverage the policyholder should purchase. The court dismissed the action in its entirety, holding that "[n]o special relationship between the parties has been alleged that would support [the policyholder's] claim that [the] broker was under a common-law duty to advise [the policyholder] as to the amount of coverage it would be prudent to obtain and, in the absence of any allegation that [policyholder] specifically requested coverage in an amount greater than that obtained by [the broker] or that it was expressly or impliedly agreed that [the broker] would undertake to provide risk management services to [the policyholder], [the policyholder] has no cause of action against [the broker] for breach of contract." An appellate court reached a similar conclusion in *Tappan Wire & Cable, Inc. v. County of Rockland*, finding that an insurance broker had no duty to advise, guide or direct its client to obtain additional flood coverage, absent a showing of a special relationship.[24]

Several New York appellate courts have held that, once an insured party receives his policy, he is presumed to have read the policy and understood it and, therefore, is not justified in relying upon the broker's word that the policy included requested coverage. This precedent historically served to preclude or significantly limit actions against brokers.[25] New York appellate courts in each of the four departments have held that the presumption of having read the policy does not bar the insured from bringing a negligence action against the broker in certain exceptional circumstances, such as where a fiduciary or other special relationship existed between the broker and insured.[26]

Recently, however, in *American Bldg. Supply Corp. v. Petrocelli Group, Inc.*, the New York Court of Appeals held that, even when an insured party received the policy and held it without complaint, where "issues of fact exist as to whether [the insured] specifically requested coverage . . . and [the broker], being aware of such request, failed to procure the requested coverage," the insured could maintain actions for negligence and breach of contract against the broker.[27] The court further held that "[the insured's] failure to read and understand the policy should not be an absolute bar to recovery under the circumstances of this case."[28] It appears that agents and brokers cannot anticipate a summary disposition of cases against them where policyholders have received their policies without complaint. In *Petrocelli*, although the court attempted to limit its holding to the circumstances of the case, the Court of Appeals clearly has established a precedent under which it will be more challenging for agents and brokers to quickly dispose of cases through pre-answer motion practice or on summary judgment.[29]

New Jersey

New Jersey courts also hold that agents and brokers owe policyholders a basic duty of care. A broker's basic duties to a policyholder are to: (1) have the degree of skill and knowledge requisite to the calling; (2) exercise good faith and reasonable skill, care and diligence in obtaining insurance coverage for a customer; (3) possess reasonable knowledge of the types of policies, their different terms, and the coverage available in the area in which his principal seeks to be protected, and (4) procure the insurance or coverage the broker undertook to supply.[30] Failing to exercise diligence and care in these areas will result in liability for the broker.[31]

Aden v. Fortsh,[32] discussing a broker's duties to a policyholder, has been, and remains, the source of some confusion in New Jersey.[33] *Aden*, which limited its holding to the case before the court, considered whether the broker in that action could assert comparative negligence as a defense where the policyholder failed to read an insurance policy that contained an incorrect coverage limit.[34] The *Aden* court held that the contributory negligence defense was not available to the broker because the policyholder was entitled to rely on the broker's expertise in procuring an insurance policy. The court invoked the *Rider* duty of care standard in concluding that "a broker engaged to obtain insurance must exercise reasonable skill and 'is expected to possess reasonable knowledge of the types of policies, their different terms, and the coverage available in the area in which his principal seeks to be protected.'"[35] Because, during the course of its analysis, the court discussed the "special relationship" and "fiduciary relationship" between a broker and customer,[36] *Aden* has engendered subsequent questions as to whether brokers are, by default, fiduciaries of insured parties and owe to insured parties a fiduciary standard of care.

Triarsi v. BSC Group Servs., LLC directly addressed the question of whether, in New Jersey, a common-law cause of action for breach of fiduciary duty against a broker exists.[37] The *Triarsi* court held that, for brokers, "as a matter of law, there is actually a single duty and it is essentially one sounding in negligence."[38] The court further clarified that "an insurance broker who agrees to procure a specific insurance policy for another but fails to do so may be liable for damages resulting from such negligence. . . . A broker engaged to obtain insurance must exercise reasonable skill and 'is expected to possess reasonable knowledge of the types of policies, their different terms, and the coverage available in the area in which his principal seeks to be protected.'"[39] *Triarsi* seems to answer the question as to whether a broker has a fiduciary duty to the policyholder negatively – there is only one duty, a duty of professional care sounding in negligence, as defined by *Rider.*[40]

As in New York, New Jersey further provides that a "special relationship" can exist between a policyholder and broker resulting in a heightened duty of care on the part of the broker. In *Glezerman v. Columbian Mut. Life Ins. Co.*, the court held that "[a]n insurance agent may assume duties in addition to those normally associated with the agent-insured relationship, and New Jersey courts regularly review the record for evidence of greater responsibilities. . . . the [policyholder] must establish 'something more' than a broker-client relationship in order to impose a heightened standard of care on a broker."[41] The court further clarified that "a broker's liability has turned on whether the broker's conduct invited reliance, or the client's conduct exhibited or justified a claim of reliance."[42]

Conclusion

It is difficult to forecast how courts will work through the myriad questions that inevitably will arise out of the losses inflicted by Superstorm Sandy. The losses certainly will include claims filed by policyholders against the agents and brokers who procured coverage for insured parties, be it in a residential or commercial context. There is no question that brokers will find themselves attempting to answer questions regarding the extent of their duties to policyholders when policyholders, finding themselves uninsured or underinsured, file E&O liability claims post-Sandy. Defending these claims likely will present unique hurdles for some agents and brokers who, themselves, may reside in the very communities where losses occurred and have,

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themselves, suffered business losses – including, potentially, loss of records or electronic information usually relied upon to defend against claims brought by policyholders. Most agents and brokers have defined procedures that can be relied upon to defend against such claims. However, to the extent documentation or electronic data has been lost or compromised, establishing an otherwise solid defense regarding the nature and extent of coverage requested and agreed upon, and when and to what extent coverages were bound or terminated, may now prove difficult.

Footnotes

[1] Johnny Cash, "Five Feet High and Risin."

[2] Louis H. Kozloff and Kenneth S. Merber, *Insurance E&O Claims Arising from SuperStorm Sandy*, ADVISEN (Dec. 12, 2012).

[3] *Id.*

[4] *Id.*

[5] When acting on behalf of a policyholder, a broker and agent's duties are identical. Thus, throughout this article, the terms "agent" and "broker" should be understood as interchangeable.

[6] Kozloff and Merber, *supra* note 2.

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Murphy v. Kuhn*, 90 N.Y.2d 266, 270, 682 N.E.2d 972 (1997).

[11] Kozloff and Merber, *supra* note 2.

[12] Leslie Scism and Erik Holm, *After the Storm, Suits Roll in*, WALL STREET JOURNAL (Dec. 27, 2012), http://online.wsj.com/article/SB10001424127887324731304578193842931128354.html (last visited Apr. 19, 2013).

[13] *Murphy v. Kuhn*, 90 N.Y.2d at 270.

[14] *Id.*; *see also, Sawyer v. Rutecki,* 92 A.D.3d 1237, 937 N.Y.S.2d 811 (4th Dep't 2012) (brokers have no continuing duty to advise, guide or direct a client to obtain additional coverage above requested coverage).

[15] *Empire Indus. Corp. v. Ins. Co. of N. Am.,* 226 A.D.2d 580, 641 N.Y.S.2d 345 (2d Dep't 1996) ("At bar, the plaintiffs assert that they asked the defendant to obtain the 'best' available insurance coverage. However, since it is undisputed that the plaintiffs never requested underinsurance coverage, the defendant had no duty to recommend or procure that coverage"); *see also, Obamsawin v. Bailey, Haskall & LaLonde Agency,* 85 A.D.3d 1566, 1567, 924 N.Y.S.2d 878 (4th Dep't 2011) (dismissing where the defendant met its initial burden on a motion to dismiss by submitting evidence establishing that plaintiffs never made a specific request for additional coverage and that the services it provided to plaintiffs did not give rise to a special relationship); *Trans. High. Corp. v. Pollack Assocs., LLC,* 74 A.D.3d 489, 902 N.Y.S.2d 83 (1st Dep't 2010) (holding that there was no special relationship between a broker and insured party where the insured's interactions with brokers indicated that the insured was not relying on brokers' expertise, given that insured specifically requested the coverage in question, insured actively discussed with brokers the procurement, type, and amount of coverage, and insured actively reviewed the procured policy); *Kuhn*, 90 N.Y.2d at 270 (insurance agent and agency were not in a special relationship with insured and could not be held liable for failing to advise the insured of need for higher liability limits on a commercial automobile policy even though the relationship between the parties covered twelve years. The insured was merely a consumer of the agent, had never asked about increasing its limits, there was no indication of insured's relying on the agent's expertise and no basis for the insured's unfounded assumption that the policy had a $1 million liability limit); *Chaim v. Benedict,* 216 A.D.2d 347, 628 N.Y.S.2d 356 (2d Dep't 1995) ("while an insurance broker acting as an agent of its customer has a duty of reasonable care to the customer to obtain the requested coverage within a reasonable time after the request, or to inform the customer of the agent's inability to do so, the broker/agent owes no continuing duty to advise, guide, or direct the insured customer to obtain additional coverage.").

[16] *Hoffend & Sons, Inc. v. Rose & Kiernan, Inc.*, 7 N.Y.3d 152, 851 N.E.2d 1149 (2006).

[17] *Kuhn,* 90 N.Y.2d at 272.

[18] *Id.*

[19] *Id.* at 271.

[20] *Id.*

[21] 93 A.D.3d 1354, 1355, 941 N.Y.S.2d 430 (4th Dep't 2012) (citations and quotations omitted).

[22] *Id.*

[23] 309 A.D.2d 541, 765 N.Y.S.2d 317 (1st Dep't 2003) (citing *Murphy v Kuhn,* 90 N.Y.2d at 272-73).

[24] 305 A.D.2d 665, 761 N.Y.S.2d 237 (2d Dep't 2003).

[25] *See Motor Parkway Enters., Inc. v. Lloyd Keith Friedlander Partners, Ltd.,* 89 A.D.3d 1069, 933 N.Y.S.2d 586 (2d Dep't 2011); *Golub v. Tananbaum-Harber Co.*, 88 A.D.3d 622, 623, 931 N.Y.S.2d 308 (1st Dep't 2011); *Laconte v. Bashwinger Ins. Agency,* 305 A.D.2d

845, 846, 758 N.Y.S.2d 562 (3d Dep't 2003); *Chase's Cigar Store v. Stam Agency*, 281 A.D.2d 911, 722 N.Y.S.2d 320, 322 (4th Dep't 2011).

[26] See *Busker on the Roof Ltd. P'ship Co. v. Warrington*, 283 A.D.2d 376, 377, 725 N.Y.S.2d 45, 47 (1st Dep't 2001)

[27] 19 N.Y.3d 730, 737, 979 N.E.2d 1181 (2012).

[28] *Id.*

[29] *See also,* Norman H. Dachs and Jonathan A. Dachs, *Caveat Broker: Court of Appeals Clarifies Insured's Duty to Read the Policy,* NEW YORK LAW JOURNAL (Jan. 10, 2013).

[30] *Rider v. Lynch*, 42 N.J. 465, 476, 201 A.2d 561 (1964).

[31] *Id.*

[32] 169 N.J. 64, 776 A.2d 792 (2001).

[33] Christopher P. Leise, *Understanding an Insurance Broker's Duty of Care*, Jan. 10, 2012, http://www.whiteandwilliams.com/resources-alerts-Understanding-an-Insurance-Brokers-Duty-of-Care.html.

[34] 169 N.J. 64.

[35] *Id.* at 76.

[36] *Id.*

[37] 422 N.J. Super. 104, 115, 27 A.3d 202, 208 (App. Div. 2011). Notably, this case was decided by an intermediate appellate court. *Aden* is a decision of New Jersey's highest appellate court. Therefore, it is not clear to what extent *Triarsi* limits the *Aden* court's holding.

[38] *Id.* (citing *Rider v. Lynch*, 42 N.J. at 476, for the definition of professional care).

[39] 422 N.J. Super. at 115-16.

[40] Leise, s*upra* note 23.

[41] 944 F.2d 146, 150-51 (3d Cir. 1991) (applying New Jersey law).

[42] *Id.* New Jersey courts have found insurance brokers liable for failing to procure sufficient insurance coverage in a wide variety of cases.

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