Broker Liability in the Wake of COVID-19 Coverage Litigation

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Background

Insurance intermediaries, known as brokers when employed by an insured, have often been joined as co-defendants in insurance coverage litigation. Although the policyholder and broker participate in a sales transaction, the prevailing rule is that the broker's duty is defined by tort law, not contract law. In New Jersey, for example, the broker owes a duty to its client to act with reasonable skill and diligence in the performance of its services as a broker. *Brill v. Guardian Life Ins. Co. of America*, 142 N.J. 520, 542 (1995).

Some of the first COVID-19 related declaratory-judgment actions concerning property policies have followed claim denials for loss of business income and extra expense. The industry standard commercial property forms issued by the Insurance Services Office (ISO) provide coverage for loss of business income (business interruption); however, the availability of indemnification is predicated on direct physical loss or damage to property at the covered premises. Insurers have also invoked policy exclusions for losses caused by virus or disease, pollution, ordinance or law, and acts or decisions. Although these provisions might appear to erect substantial barriers to a recovery for economic losses, the multi-billion dollar value of the insurance claims has led to prompt and aggressive filings by counsel for policyholders. Several prominent chefs have even teamed with a Louisiana firm to file high-profile lawsuits for business interruption losses in every state against carriers who deny the claims.

Policyholders and counsel are also pushing for payment under the civil authority policy term that provides coverage for loss of business income due to a governmental order impeding or preventing access to the insured's property. Civil authority coverage requires that property damage to "other property" caused the business income loss. Counsel for insureds have argued that COVID-19 constitutes damage to "public space" and therefore meets the predicate of property damage to other property. Should courts accept this argument, typical coverage forms limit the time of recovery from 30 days to 60 days. In other words, the loss calculation will limit recovery for loss of business income incurred over a finite time, not the current multi-month shutdown in many states.

State legislatures across the country have introduced bills intended to influence the outcome of the coverage battle by compelling insurers to pay COVID-19-related business interruption claims. *See, i.e.*, Pennsylvania Senate Bill S.B. 1114; New York Assembly Bill A10226; and Louisiana Senate Bill 477. If any of these bills are passed, the insurance industry will likely mount a vigorous constitutional challenge. As one prominent insurance commentator has written. "So much remains unknown about the eventual impact of COVID-19 on health, the economy, and just about every aspect of business and society. This includes insurance coverage."

Theories of Broker Liability

If carriers choose to fight, which is likely, and if they prevail or limit recovery to a civil-authority loss payment, insureds might turn to claims against brokers involved in the placement of the policy. Attorneys for policyholders will argue that the broker should have procured a policy without the virus exclusion or a policy with a form that did not condition business interruption coverage on physical damage to insured property. Claimants might allege the broker erred by failing to recommend higher limits. If, on the other hand, insureds are able to succeed on their business interruption claims, some of the approximately two-thirds of small businesses without business interruption insurance may sue their brokers for not recommending or offering business interruption coverage. As for damages, insureds will aver the breach of their brokers' duty caused damages for losses not covered by the policy.

Because broker-negligence claims often sound in tort, the plaintiff will bear the burden to establish duty, breach of duty, and causation as well as damages. Counsel must therefore consider whether applicable law provides that a broker in an "arms-length" transaction has a duty to assess or comment on the "adequacy" of coverage.

Duties of Insurance Producers

As recognized by Thomas Ahart, former president of the Independent Insurance Agents and Brokers of America, the predominant industry practice is to report all claims, even potential claims, when requested to do so by the client, to all potentially liable carriers. There is some reason to believe that brokers are not universally following this widely adopted regulatory requirement and industry standard when presented with potential COVID-19 business interruption claims.

In California, the Insurance Commissioner included agents and brokers in a notice concerning proper adjustment practices for COVID-19 business interruption claims. The notice references "numerous complaints" to the Department that certain "insurers, agents [and] brokers" were attempting to dissuade policyholders from making pandemic-related business interruption claims. The notice therefore directs that agents, brokers, and insurance companies "accept, forward, acknowledge, and fairly investigate all business interruption insurance claims submitted by businesses." *Id.* Brokers who fail to comply with the claim-reporting industry standard can face liability if that breach provides an insurer with a reason to deny coverage.

Policyholders will also search for theories that brokers breached duties during the process of soliciting, quoting and binding coverage. In this regard, the threshold question is whether the state treats an insurance broker as an order taker or an advisor with heightened duties to assess exposures and make recommendations about a client's needs. Courts answering this question have come to different conclusions. In some states, courts focus on the transaction, not the relationship, and identify the duty with an assist from contract law. In New York, which takes this approach, insurance agents have no continuing duty to advise, guide or direct a client to obtain additional coverage. The obligation is generally defined by the customer's request for coverage. *M&E Mfg. Co., Inc. v. Frank H. Reis, Inc.*, 692 N.Y.S. 2d 191, 193 (App. Div. 1999). Texas takes a similar approach. *McCall v. Marshall*, 398 S.W.2d 106, 109 (Tex. 1965).

Other states expand a broker's duty but make a distinction between a policy which is materially deficient and a policy where coverage is allegedly inadequate. In Pennsylvania, a "plaintiff acquires a cause of action against his broker or agent where the broker neglects to procure insurance, or does not follow instructions, or if the policy is void or materially defective through the agent's fault." *Laventhol & Horwath v. Dependable Ins. Assocs.*, 579 A.2d 388, 391 (Pa. Super. Ct. 1990). Materially deficient means a broker should not propose or bind coverage that effectively leaves the policyholder uninsured for an exposure clearly inherent to the business. For example, a broker should not propose or bind coverage for a pool manufacturer that excludes liability coverage for bodily injuries arising from pool accidents. Recent decisions, however, hold that brokers in Pennsylvania do not have a duty to advise clients about their insurance needs or the adequacy of their coverage. *Gemini Ins. Co. v. Meyer Jabara Hotels, LLC*, — A.3d —; 2020 Pa.Super. LEXIS 277 (April 3, 2020); *Wisniski v. Brown & Brown Ins. Co. of PA*, 906 A.2d 571, 578 (Pa. Super. 2006).

Courts are unlikely to find that a broker placed a materially deficient policy for a restaurant or small business if the policy uses ISO forms that include a virus exclusion or require "physical damage" to trigger business interruption coverage. After all, these ISO forms with similar policy terms are sold to insureds across the United States. Nor could the broker have known, at the time of sale, that the restaurant would need a policy without the virus exclusion. It is widely understood that the 2020 pandemic is the first of its kind for close to 100 years. Tort duties are customarily formulated based on foreseeability, not hindsight.

Brokers in other states have an enhanced duty of care. In New Jersey, courts have held that insurance brokers have a fiduciary relationship with their clients. As such, "a broker is expected to [know] . . . the coverage available in the area in which his principal seeks to be protected." *Aiden v. Fortsh*, 776 A.2d 792, 801 (N.J. 2001) (citing *Rider v. Lynch*, 201 A.2d 561, 567 (N.J. 1964)). One case

held that "insurance intermediaries have a fiduciary duty to the client "to exercise good faith and reasonable skill in advising insureds." *Weinisch v. Sawyer*, 587 A.2d 615, 618 (N.J. 1991).

The extension of the duty to the realm of "advice" was recently illustrated in *Wakefern Food Court v. BWD Group, LLC*, 2020 N.J.Super. Unpub. LEXIS 630 (App. Div. April 8, 2020), where the Appellate Division affirmed a $10.9 million verdict against a broker on a flood-damage claim arising from Superstorm Sandy. *Id.* at *26. Wakefern alleged that its broker was negligent in presenting an alternative quote that included a two percent "named storm deductible." *Id.* at **6-8. The deductible led to a Sandy-damage recovery shortfall, and Wakefern sought that shortfall from its broker. *Id.* at **2, 8. The facts hinged on communications or advice by the broker at the time Wakefern elected to purchase a renewal policy with the NSD. The jury agreed, found for the insured on its breach of contract and negligence claims and the Appellate Division affirmed. *Id.* at **8-10. In an "order taker" state, it is unlikely that Wakefern's claims against its broker would have survived a motion for summary judgment.

Even states that hold brokers to an enhanced duty place limits on the obligation. In the absence of evidence of a special relationship or a specific undertaking, claims against brokers for failure to recommend "higher limits" have not fared well. In New Jersey, courts have found that neither a carrier nor its agents have a duty to advise an insured concerning a possible need for higher limits. *Wang v. Allstate Ins. Co.*, 592 A.2d 527, 532 (N.J. 1991). The holding in *Wang* has been applied to exculpate a producer acting not as an agent, but as the broker for the insured in the insurance transaction. *See C.S. Osborne & Co. v. Charter Oak Fire Ins. Co.*, 2017 NJ.Super. Unpub. LEXIS 1051 (App. Div.) The rule about coverage limits acknowledges that a commercial policyholder is in a much better position than its broker to know the value of business property and business earnings.

Business interruption coverage is subject to dollar limits stated in the policy declarations. If an insured obtains COVID-19-related coverage for a loss, it might still be underinsured due to the limits or due to the limited window of coverage under the civil authority provision. To pursue a claim against the broker for alleged inadequacy of limits, policyholders must establish something more than a standard client/broker interaction. This is often called a "special relationship."

Whether the broker has a duty to make assessments or make recommendations about a client's insurance needs often hinges on whether the client can establish that it formed a "special relationship" with its broker. *See, e.g., Triarsi v. BSC Group Services, LLC*, 27 A.3d 202, 209-10 (App. Div. 2011); *Yenchi v. Ameriprise Financial, Inc.*, 161 A.3d 811, 822-24 (Pa. 2017). The key to finding a special relationship is that the broker engaged in conduct which gives the client reason, over time, to rely on the broker to make recommendations or decisions about coverage or limits.

In *Glezerman v. Columbian Mutual Life Insurance Company*, 944 F.2d 146 (3d Cir. 1991), a widow was denied life insurance benefits because the policy lapsed for nonpayment. *Id.* at 149. The Third Circuit remanded for trial the widow's claim against her broker because she proffered proof that her broker had assumed responsibility, over time, to provide her with the last possible date she needed to make a premium payment on her life insurance policy. *Id.* at 155. The facts of *Glezerman* are unique, and it will seldom be the case that the interaction between a business owner and a broker will rise to the level of a "special relationship" because business owners typically reserve final insurance-purchasing decisions for themselves. *See, e.g., C.S. Osborne & Co.*, 2017 NJ.Super. Unpub. LEXIS 1051 at *16.

In some states, the rule of a broker's enhanced duty is referred to as a fiduciary or confidential relationship rather than a special relationship. In Pennsylvania, for example, such a confidential relationship can be shown by the insured's delegation of authority to the broker with "evidence the relationship goes beyond mere reliance on superior skill, and into a relationship characterized by overmastering influence on one side or weakness, dependence or trust justifiably reposed on the other." *Yenchi*, 161 A.3d at 820; *see Gemini*, 2020 Pa.Super. LEXIS 277 at **31-32.

Whether a broker owes a "fiduciary duty" to a client has been much discussed. However, at least in New Jersey, the appellate court has held that brokers, while in a fiduciary relationship, are not fiduciaries who owe a duty of utmost good faith to the client. *See Triarsi*, 27 A.3d at 208-09. Rather, even in an enhanced duty state such as New Jersey, brokers owe a duty of good faith and reasonable skill in advising clients.

CONCLUSION

It is reasonable to expect that most lawsuits against brokers will arise under the adequacy of commercial property business interruption coverage. Assuming an arms-length relationship, a written offer and clear evidence of a business accepting the offer, we anticipate that brokers will be able to mount strong defenses to any such claims.

Will other policies, such as event cancellation coverage, work their way into COVID-19-related discussions of broker liability? Industry expert Thomas Ahart expects a rise in employment-related claims and in director and officer claims, which might be covered under Employment Practices Liability I (EPLI) and Directors and Officers (D&O) liability policies. Will brokers be targets if commercial insureds do not maintain such coverage? Under any COVID-19-related broker claim, will the defendant be allowed to argue that payments under programs such as the Coronavirus Aid Relief and Economic Security Act (CARES Act) must be an offset to a business' loss of income damage calculation? These questions about broker liability can be added to the unknowns in the wake of the COVID-19 pandemic.

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As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates here.

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