Agents E&O Standard of Care Project

New Jersey Survey

To gain a deeper understanding of the differing agent duties and standard of care by state, the Big "I" Professional Liability Program and Swiss Re Corporate Solutions surveyed their panel counsel attorneys. Each attorney was asked to draft a brief synopsis outlining the agents' standard of care in their state. They were also asked to identify and include a short summary of the landmark cases. In addition, many of the summaries include sample case studies emphasizing how legal duties and issues with standard of care effected the outcome. Finally, recent trends in errors in the state may also be included.

This risk management information is a value-added service of the Big "I" Professional Liability Program and Swiss Re Corporate Solutions. For more risk management information and tools visit www.iiaba.net/EOHappens. On the specific topic of agents' standard of care check out this article from the Hassett Law firm, our E&O seminar module, and this risk management webinar.

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STANDARD OF CARE PROJECT – STATE OF NEW JERSEY

1. Overview.

In New Jersey, an insurance producer is obligated to exercise reasonable skill and is expected to possess reasonable knowledge of the terms and conditions of policies that are available to satisfy his client's objective, reasonable expectations of coverage against foreseeable risks of loss. Where the producer neglects to procure the insurance reasonably expected or where the policy is materially deficient, the producer may become liable for his failure to exercise the requisite degree of skill. The Supreme Court of New Jersey has addressed the duties and obligations of an insurance producer and those holdings have formed the customary and generally accepted practice in New Jersey. See e.g., Aden v. Fortsh, 169 N.J. 64 (2001); Rider v. Lynch, 42 N.J. 465, 476 (1964).

The question of whether a duty exists is a matter of law properly decided by the court, not the jury, and is largely a question of fairness or policy. Wang v. Allstate Ins. Co., 125 N.J. 2, 15 (1991); Strachan v. John F. Kennedy Mem'l Hosp., 109 N.J. 523, 529 (1988). "The inquiry involves a weighing of the relationship of the parties, the nature of the risk, and the public interest in the proposed solutions." Kelly v. Gwinnell, 96 N.J. 538, 544 (1984);

accord Goldberg v. Housing Auth. of Newark, 38 N.J. 578, 583 (1962). The Supreme Court defined the precise scope of an insurance producer's duty in Rider v. Lynch, supra, where it explained:

> One who holds himself out to the public as an insurance broker is required to have the degree of skill and knowledge requisite to the calling. When engaged by a member of the public to obtain insurance, the law holds him to the exercise of good faith and reasonable skill, care and diligence in the execution of the commission. He 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. If he neglects to procure the insurance or if the policy is void or materially deficient or does not provide the coverage he undertook to supply, because of his failure to exercise the requisite skill or diligence, he becomes liable to his principal for the loss sustained thereby.
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> [42 N.J. at 476.]

Distilled to its essence, the obligations of an agent/broker are (1) to procure the insurance; (2) to secure a policy that is neither void nor materially deficient; and (3) to provide the coverage he or she undertook to supply. Ibid. If an agent or broker fails to exercise the requisite skill and diligence when fulfilling those obligations, then there is a breach of the duty of care, and liability arises. Ibid.

Under certain circumstances, an agent or broker may assume additional duties beyond those outlined in Rider v. Lynch. In those cases, the court will look to determine whether there was "something more" than a broker-client relationship in order to impose a heightened standard of care on the broker. Such a duty arises when there is a "special relationship" between the insurance agent and the client which indicates reliance by the client on the agent. See e.g. Wang v. Allstate Ins. Co., 125 N.J. 2, 15 (1991); Sobotor v. Prudential Property & Casualty Ins. Co., 200 N.J. Super. 333 (App. Div. 1984); Glezerman v. Columbian Mut. Life Ins. Co., 944 F.2d 146, 150-51 (3d Cir. 1991). The application of this "special relationship" test appears to be

somewhat subjective, with the Sobotor court finding that an insured's request for the "best available" coverage was sufficient to impose this heightened duty.

2. Brief Summary of Landmark New Jersey Cases.

a. Rider v. Lynch, 42 N.J. 465 (1964). In Rider, an eighteen year old with a limited ability to read English told a broker that she needed auto insurance for a car owned by her fiancé who gave her permission to use the car while he was out of state. The broker issued a non-owner's insurance policy to her but failed to explain that the policy covered only automobiles not regularly used by the insured. The New Jersey Supreme Court reversed a dismissal in the broker's favor, concluding that it was a factual question whether the broker breached his duty of care. Importantly, the Court noted that the failure of the insured to read the policy could not be used by the broker to support a defense of contributory negligence, ruling that the insured was "entitled to rely upon and believe that the broker had fulfilled his undertaking to provide the coverage impliedly agreed upon." That holding has been reaffirmed by the New Jersey Supreme Court in Aden v. Forth, 169 N.J. 64 (2001).

b. Wang v. Allstate Ins. Co., 125 N.J. 2 (1991). In Wang, the plaintiff insured was injured when her car hit a tree after two dogs ran into the roadway in front of her. Wang sued the dogs' owners. Both dogs' owners had personal liability coverage of $25,000, which had not been increased since the 1960's (for one dog owner) and the 1970's (for the other dog owner). The injured plaintiff took a consent judgment against each dog owner for $600,000 and then pursued the claim against the carriers and the insurance brokers. Wang claimed that the broker had a "duty to periodically and regularly advise" the client to increase the limits on their insurance coverage. The Court decided

that there was no such duty owed by the broker to the client. However, the Court made that ruling because it determined that there was no allegation of a "special relationship" between the broker and the client. Presumably, had a "special relationship" been alleged by the plaintiff, this case would not have been dismissed. The New Jersey Supreme Court also suggested that such a duty could be imposed by the legislature if it chose to do so.

c. ARC Family, LLC v. Ralph Panes, Associates, Inc., A-5411-05T2 (App. Div. April 24, 2008), certif. denied 196 N.J. 598 (2008). In this unreported Appellate Division case, the Court addressed an issue that arises frequently in broker cases, namely whether a broker has a duty to recommend specific property limits to a client. In that case, which involved a commercial condominium building, the Appellate Division ruled that the broker generally has no duty to establish the replacement value of property, except that, once the broker agrees to determine a replacement value, he has assumed a duty to procure adequate coverage. Given that many brokers use property value estimators as part of the application process, it may be that this exception swallows the rule. It has yet to be decided whether the Ralph Panes holding applies in a residential, as compared to commercial, context.

Case Study #1– Non-Owned Auto Coverage For Tiling Company

a. **Line of coverage involved-** Automobile insurance.

b. **Position of person in the agency involved -** Principal.

c. **Personal or Commercial Lines.** Personal.

d. **Type of Coverage involved-** non-owned auto coverage.

e. **Procedural or knowledge-based error.** Procedural.

f. **Claimant Allegation.** Insured claims broker did not offer non-owned auto coverage.

g. **Settlement or Trial.** Broker granted summary judgment. Affirmed on appeal.

h. **Description of alleged error.** Insured claims broker never explained or offered non-owned auto coverage to a tile contractor whose employees used their own vehicles for work.

i. **Tip to Avoid Claim.** Proper documentation can get frivolous claims dismissed before trial. The two letters sent by the broker directly led to the judgment in the broker's favor. Had the broker made a file note reflecting the oral conversation, the defense would have been even stronger.

In this case, the broker procured insurance coverage for the owners of a tile company. The company's owners owned two vans that were placed on a personal policy obtained through a different agent. The broker, who procured a CGL policy for the tile company, wrote two letters to the insured suggesting the availability of non-owned automobile coverage, one of which referenced an earlier phone call on the subject. The letters told the insured that they needed to make sure that their auto policy had non-owned coverage and suggested that, if not, it could be added to the CGL policy. The broker requested that he be given a copy of the auto policy procured through the other agent, but the insured did not provide it. The insured denied

receiving the letters and further asserted that the letters were insufficient to explain what "non-owned automobile coverage" was.

After an auto accident between a young woman and the tile company's employee who was driving his own car, the young woman obtained a judgment in the amount of $675,000 against the tile company. On summary judgment motions, the trial judge limited the case to the sole fact of whether or not the broker sent the letters in question, ruling that, if the letters were sent, the broker satisfied its obligation. To expedite the appeal, plaintiff stipulated that the letters were sent and, on appeal, the Appellate Division ruled that the letters were sufficient to satisfy the broker's duty owed.

The broker did a good job of documenting that he discussed a potential issue (the non-owned auto coverage) with the insured, though the broker apparently had a verbal conversation with the insured on the same topic but failed to document that phone call.

Case Study #2 – Fire In A Mansion

a. **Line of coverage involved –** CGL policy and contractor's supplemental coverage umbrella.
b. **Position of person in the agency involved** - Principal.
c. **Personal or Commercial Lines.** Commercial.
d. **Type of Coverage involved.** Liability and excess coverage for a contractor.
e. **Procedural or knowledge-based error.** Procedural.
f. **Claimant Allegation.** Plaintiff insured claims the broker filled out the insurance applications without his input. The carrier attempted to disclaim for material misrepresentations in the policy.
g. **Settlement or Trial.** Settlement.
h. **Description of alleged error.** The insurance applications contained a number of incorrect statements. The insured claims the information was input by the broker without the contractor's involvement.
i. **Tip to Avoid Claim.** Always make the insured sign the insurance application.

In this case, a fire occurred in a $15 million mansion in Colts Neck, New Jersey, at a point when the home was 85% completed. The homeowners sued a number of parties, including the contractor, who was the primary defendant. The contractor's CGL carrier and its umbrella carrier both disclaimed based on alleged misrepresentations in the insurance applications.

The alleged misrepresentation that started the carriers' inquiry was whether the contractor was in fact a "general contractor" or a "construction manager," the latter of which might be denied coverage under the professional services exclusion in the policy. The differences between a general contractor and a construction manager "at risk" are very hard to pinpoint. But

during the course of the 20 depositions that occurred, the carriers pointed out a number of different miss-statements in the insurance applications, none of which had anything to do with the fire itself but some of which might have been considered "material" which would enable the carrier to rescind the policy. During the course of depositions of the carrier's underwriters, it became clear that the underwriters themselves could not provide definitions of "general contractors" and "construction managers" that did not significantly overlap. The carrier's underwriting guidelines – which it did not provide to its wholesale or retail brokers – contained a definition of general contractor that was drafted based upon internet research conducted by the head underwriter.

Ultimately, the case settled at mediation at a point all parties had cross-motions for summary judgment pending on the construction manager/general contractor issue.

Had the broker required the client to sign the application, the claim would have been much harder to pursue against the broker. And if the broker was uncertain about a definition (such as, for example the definition of the term construction manager used in the application), the broker should have asked the wholesale broker for clarification (in writing).

Case Study #3– New Jersey Contractor Doing Work In New York

a. **Line of coverage involved –** contractor's CGL policy.

b. **Position of person in the agency involved** – Principal.

c. **Personal or Commercial Lines.** Commercial.

d. **Type of Coverage involved.** CGL policy for contractor.

e. **Procedural or knowledge-based error.** Procedural.

f. **Claimant Allegation.** Contractor had a $1 million CGL policy. The policy had a "sub-limit" of $15,000 for any work performed in New York (due to New York's unfavorable statutory law). The insured said it was unaware of the sublimit. Also, the broker issued an insurance certificate for a New York job that showed only the policy limit, not the sublimit.

g. **Settlement or Trial.** Settlement by the insurer, the broker was dismissed.

h. **Description of alleged error.** Failure to notify insured of sublimit, improperly sending certificate that showed incorrect policy limits for New York.

i. **Tip to Avoid Claim.** Document any particularly unfavorable terms or exclusions in a cover letter and/or have the insured counter-sign the endorsement page for the exclusion.

In this case, a man working on a construction site in New York fell off scaffolding and was seriously injured. He sued the project owner, the general contractor and the subcontractor. The subcontractor, a New Jersey framing contractor, had a $1 million CGL policy. But the policy had a $15,000 sublimit for any construction work performed in New York.

The subcontractor did a small amount of work in New York, a fact of which the broker was apparently aware. In fact, the broker sent Certificates of Insurance to a number of New York owners, which was further proof that the broker was aware the insured was doing work in

New York. The insured subcontractor says it was never told about the sub-limit. And the broker also sent certificates of insurance to the general contractor and project owner which referenced the $1 million limit, not the $15,000 sublimit. To make matters worse, when the carrier instituted the $15,000 sublimit in 2004, the carrier sent a notice to its brokers advising of the change and specifically reminded them not to issue certificates for New York jobs unless the certificates referenced the $15,000 sublimit. It appears the broker dropped the ball on this issue.

But when it instituted the $15,000 sub-limit, the carrier failed to give timely and proper notice of the change to its insured's, including the subcontractor. And New Jersey law renders ineffective any changes to policies for which the insured is not given proper notice. As a result, after the insurance company underwriting executives were deposed, the insurance company agreed to cover the claim up to the full $1 million policy limit.

The broker dodged a bullet as the result of the carrier's miss-step. If the broker did in fact tell the subcontractor of the $15,000 limit, and the subcontractor still wanted the policy, the broker should have documented such a risky decision by the insured either in a letter to the insured or, even better, by having the insured counter-sign the endorsement that contained the sub-limit.

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