Agents E&O Standard of Care Project

Delaware 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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THE DUTIES OF A DELAWARE INSURANCE PROFESSIONAL

Marc Casarino, Esquire of White and Williams LLP highlights key legal decisions defining the scope of duties owed by insurance professionals and offers insight for insurance professionals to best insulate themselves from breach of duty liability.

As counsel for Delaware insurance professionals, I frequently defend against allegations that an agent neglected to procure appropriate insurance coverage. Many such cases start with a phone call to an agent after a loss, similar to:

Client: Am I covered?

Agent: Sorry, but you are not covered for this loss.

Client: What?! How could you let this happen? You know what coverage I needed. Why didn't you do something?!

This exchange reflects the public's common misperception about the scope of duties owed by Delaware insurance professionals.

The scope of duties owed by insurance professionals is established by Delaware case law. Insurance professionals must use reasonable care, diligence, and judgment in procuring the insurance coverage requested by the insured.[1] That is, the insurance professional is obligated only to procure the insurance coverage requested by the insured.[2] There is no duty to evaluate an insured's risks or to advise as to specific insurance matters.[3] There is no duty to ferret out additional facts from the insured to analyze coverage needs.[4] And, the scope of duty is not expanded simply because there is a lengthy course of dealing with the insured or it is represented that coverage is adequate based on the information provided by the insured.[5]

On the other hand, Delaware case law imposes upon the insured the duty to give accurate and complete information to the insurance professional so that appropriate coverage can be placed.[6] It is presumed that a rational person would want to assure that appropriate coverage is acquired, and so an agent is entitled to accept without question the information provided by the client.[7] Once coverage is placed, the agent should transmit copies of the policy documents to the client. The client is tasked with reading the policy documents

[1] *Blanchfield v. State Farm Mut. Auto. Ins. Co.*, 511 A.2d 1044 (Del. 1986).
[2] *Sinex v. Wallis*, 611 A.2d 31 (Del. Super. 1991).
[3] *Id. See also Blanchfield*, 511 A.2d 1044 (Del. 1986).
[4] *Id.*
[5] *Id. See also Gifford v. McClafferty*, C.A. No. 06C-11-146, J. Slights (Del. Super. Feb. 6, 2007).
[6] *Id.*
[7] *Polly Drummond Thriftway, Inc. v. W.S. Borden Co.*, 95 F.Supp.2d 212 (D. Del. 2000).

upon receipt.[8] If there is an error in the coverage placed, the client is obligated to discover it in a timely manner.[9] Delaware Courts have consistently held that the statute of limitations on a claim for an agent's negligence begins to run upon receipt of the allegedly erroneous policy documents.[10] Often the error does not come to light until several years after coverage is placed, and multiple annual renewals have occurred. There is not a tolling of the statute of limitations under a time of discovery rule, and annual renewals repeating the initial coverage problem do not give rise to a new deadline to make a claim.[11]

An insurance professional may be held to a higher duty where it has a special relationship with the insured.[12] Whether a special relationship exists is a fact-intensive inquiry. By way of example, a special relationship may arise where the insurance professional markets itself as an expert or accepts compensation directly from the insured in exchange for coverage advice.[13] Insurance professionals should be cognizant not to engage in conduct that suggests a special relationship, unless that is what is intended.

The following examples from matters I have defended show these principles at work:

Example 1:

a. Line of coverage involved: Surplus Line

b. Position of person in the agency involved: Junior Agent

c. Personal or Commercial Lines: Commercial

d. Type of coverage involved: Bodily injury

e. Procedural or knowledge-based error: Procedural

f. Claimant Allegation: Failure to advise of coverage exclusion

g. Settlement or Trial: Neither – claim dropped voluntarily

h. Description of alleged error: Failure to advise of coverage exclusion

i. Tip to avoid claim: Document communication regarding notification of and potential import of coverage exclusions

[8] *Kaufman v. C.L. McCabe & Sons, Inc.*, 603 A.2d 831 (Del. 1992).
[9] *Id.*
[10] *Shenberger v. Williams Ins. Agency, Inc.*, C.A. No. S12C-03-001, J. Bradley (Del. Super. June 28, 2013); *Jadczak v. Assurant, Inc.*, 2009 WL 1277965 (Del. Super. Apr. 30, 2009); *Kaufman*, 603 A.2d 831 (Del. 1992).
[11] *Id.*
[12] *Sinex*, 611 A.2d 31 (Del. Super. 1991).
[13] *Id.*

j. Summary of the case: Agent procured coverage for a client who bought and rehabilitated neglected properties for rental and/or sale to low-income families. Agent met with client on numerous occasions to review its policy, and specifically discussed that there was an exclusion of coverage for injuries occasioned by contractors or subcontractors on the rehabilitation projects. This was significant, and hence highlighted by the agent, because the client relied exclusively upon contractors for the construction. The client was instructed to confirm that the contractors had sufficient insurance coverage, and that the client was an additional insured on all such policies. The client eventually formed its own contracting business as a separate entity, which was insured for injuries occasioned by its work or its subcontractor's work on the properties. Inexplicably, the client thereafter began a project under its original business entity rather than its contracting business entity. An employee of a contractor working on the project was rendered quadriplegic in a fall on the worksite. The carrier denied coverage based upon the contractor / subcontractor exclusion. The client had neglected to secure itself as an additional insured on its contractor's policy.

The client immediately blamed its agent for securing inadequate coverage and threatened legal action. The client argued that the agent knew the client's business and risks associated therewith, and so the agent should not have allowed the client to secure a policy with the exclusion in question. It was questionable whether the agent had conducted itself in a manner that created a special relationship requiring explicit consultation on the policy terms and conditions. Although the agent met with the client on numerous occasions, there was no record documenting the agent's discussions of the exclusion and related advice.

Eventually the client admitted that the agent had explained the exclusion in question and that the client understood that it was not covered for the underlying claim. If the client had not come clean, it would have been a long and expensive process to extricate the agent from this claim. This situation highlights the importance of properly documenting key client contact points, such as telephone calls or meetings with clients and delivery of policy documents. Proper documentation will permit the agent to better defend itself when a client develops post-loss amnesia about what it knew pre-loss.

Example 2:

a. Line of coverage involved: Surplus Line

b. Position of person in the agency involved: Junior and Senior Agent

c. Personal or Commercial Lines: Personal

d. Type of coverage involved: Property damage

e. Procedural or knowledge-based error: Procedural

f. Claimant Allegation: Failure to advise of coverage exclusion

g. Settlement or Trial: Neither – claim dismissed by court

h. Description of alleged error: Failure to advise of coverage exclusion

i. Tip to avoid claim: Document communication regarding notification of and potential import of coverage exclusions

j. Summary of the case: Agent procured property coverage for client's vacation rental house. The initial policy incorporated an exclusion of water damage coverage unless the client maintained heat in the residence or turned off the water supply. The third annual renewal of the policy modified the exclusion such that the water supply had to be turned off whenever the residence was unoccupied for more than 72 hours. The policy was renewed with the modified exclusion over a period of almost 10 years.

The agent forwarded the initial policy and water damage exclusion to the client, and thereafter had no further contact with the client. The insurance company sent annual renewal documents and premium bills directly to the client. The agent was copied with a summary version of policy documents. The agent was paid a commission by the insurance company. When the water damage exclusion was modified, the insurance company sent a notification to the client, and simultaneously suggested that the agent send its own notification to the client. The agent decided not to send its own notification to the client, relying instead on the notification provided by the insurance company.

The client did not turn off the water supply while the house sat vacant during the winter, and a frozen pipe burst causing extensive damage. The insurance company denied the claim based on the modified exclusion. The client sued the agent under a negligence and contract theory. The client argued that the agent's receipt of commissions based on the premiums paid by the client constituted compensation for the agent's advice thereby creating a contractual relationship. The client also argued that the agent breached the applicable standard of care by not itself advising the client of the exclusion when it was modified. In this regard, the client raised that the agent knew the residence was a seasonal rental that would be vacant for extended periods, which heightened the agent's obligation to counsel the client about the significance of an exclusion concerning absence from the property.

The court granted our motion to dismiss the lawsuit for several reasons. First, the receipt of commissions from premium payments does not constitute compensation giving rise to a special relationship requiring the agent to counsel the client. Second, it was demonstrated that the client received all policy documents in a timely manner. The court ratified the long-standing principle that the client was obligated to read and understand the policy documents upon receipt. Since the agent did not have a special relationship with the client, the agent was not obligated to explain the policy contents to the client. Third, the court rejected the client's argument that the exclusion in question was not customary in the industry, thereby negating the client's suggestion that the agent procured a "defective" policy. Fourth, the court rejected the client's argument that each annual renewal including the "defective" exclusion triggered a new statute of limitations. The court was not persuaded by the client's argument that it would have no reason to consider the exclusion problematic until a loss occurred. The court held that the client was

required to file suit within 3 years of the client's receipt of the exclusion, and so the lawsuit filed almost 10 years after the fact was untimely.

This case highlights the Hobson's choice faced by agents regarding notifying client's of potential coverage issues without inadvertently creating a special relationship. In this instance, a generic cover letter directing the client to review the policy renewal documents and identifying the modified exclusion likely would not have created a special relationship under Delaware law. However, these are fact-intensive situations and when uncertain how to proceed it is best for the agent to consult counsel familiar with these issues.

Example 3:

a. Line of coverage involved: Commercial Auto

b. Position of person in the agency involved: Junior and Senior Agent

c. Personal or Commercial Lines: Commercial

d. Type of coverage involved: Bodily Injury

e. Procedural or knowledge-based error: Procedural

f. Claimant Allegation: Erroneously placing personal vehicle on commercial auto policy

g. Settlement or Trial: Portion of claim dismissed by court, and remainder settled

h. Description of alleged error: Failure to properly insure vehicles

i. Tip to avoid claim: Attention to file management and document communication regarding client's coverage requests

j. Summary of the case: Agent had decades long relationship with the client, a small family owned business. Agent placed commercial auto coverage for the business vehicles and personal auto coverage for the business owner's family members. Historically the business owner bought all of the vehicles and leased some back to the business. The leased-back vehicles were placed on the commercial auto coverage with the full approval of the insurer. The business owner's teenage child developed a poor driving record, and the commercial auto insurer demanded that the child's vehicle be moved to a personal lines policy. The agent worked with the client to move the child's vehicle to a personal lines policy. Approximately one year thereafter, the business owner advised the agent that the child's vehicle was sold and that there was no replacement vehicle. The agent accepted that representation as true, and honored the client's request to cancel the personal lines policy for the child. Several weeks after the child's personal lines policy was canceled, the business owner advised that agent that he had purchased a new vehicle, was leasing it to the business, and requested that it be added to the schedule of vehicles on the commercial auto policy. The agent accepted the client's representations as true, and honored the request.

Unfortunately, the business owner was deceitful and had only co-signed for the vehicle, which was actually bought by the child for the child's exclusive personal use. The agent's file included few records documenting the various telephone conversations with the client, and the existing records were largely indecipherable markings and incomplete handwritten notes that left open a number of questions about what was actually discussed with the client. The lack of adequate documentation was compounded when inaccurate information was provided by the agent to the commercial auto insurer during an annual audit. The commercial auto insurer specifically asked whether the child's vehicle was still insured on a personal lines policy. The commercial side of the agent did not consult with the personal lines side of the agent, but rather inaccurately reported from memory that the child still owned a vehicle covered by a personal lines policy.

The child caused an accident that resulted in a death and catastrophic injuries to several surviving victims. Multiple lawsuits were filed against the business as the apparent owner of the vehicle and the child, who at the time of the accident was over 18 years old. When the commercial auto insurer discovered the circumstances surrounding the actual ownership of the vehicle and the deception surrounding the acquisition of its insurance, coverage was denied. This resulted in a second round of lawsuits, including claims by the injured parties against the agent for alleged collusion in fraudulently securing coverage for the child's vehicle. The client also sued the agent claiming that the agent neglected to properly advise about coverage for the subject vehicle.

We won dismissal of the injured parties' lawsuits against the agent. When dismissing those actions, the court affirmed that the agent had the right to rely upon the representations of the client regarding the ownership of the vehicle, and that the agent was not obligated to research the accuracy of the client's representations. The court further opined that even if the agent had breached a duty of care, only the client could make a claim based thereon. Since the injured parties were strangers to the relationship between the agent and client, those parties could not premise a claim upon the agent's alleged negligence in handling the client's affairs. While our motion to dismiss the client's lawsuit against the agent was pending, the commercial auto insurer settled all of the pending injury lawsuits. Thereafter, the commercial auto insurer sued the agent for violation of their agency contract based upon the alleged mishandling of the file and inaccurate reporting during the audit process. We reached a settlement with the commercial auto insurer on behalf of the agent, and the agent unfortunately lost that insurers' lucrative book of business as a result of this matter.

This case included the perfect storm of circumstances that will lead to claims against an agent. There was a dishonest client who schemed to acquire insurance on a vehicle because insuring it properly was cost-prohibitive. The agent did not properly or accurately document communications with the client. There was poor coordination between the agent's personal lines and commercial lines employees. And, at the penultimate opportunity to catch and correct its error, the agent guessed incorrectly about the

content of its file. Had the agent taken a few moments to review the file and identify the correct information for the commercial auto insurer's audit, the agent may have enjoyed a better outcome.

These examples demonstrate the importance of proper documentation when confronted with a claim for breach of duty. Agents should develop proper file maintenance procedures and periodically audit whether employees are consistently adhering to the procedures. Often the most seemingly mundane or innocuous record can later be an agent's damnation or salvation when confronted with a claim. Appropriate documentation of account events and attention to detail are paramount. While an agent cannot control whether a disgruntled client will make a claim, having the proper record support will go a long way to avoiding liability.

About the Author:

Marc Casarino is a partner in the Delaware office of White and Williams LLP. In over 15 years of complex litigation experience involving a myriad of insurance professional error and omission claims, he has been instrumental in developing Delaware precedent favoring insurance professionals. He can be reached at 302-467-4520 or casarinom@whiteandwilliams.com.