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Brokers Catching Heat For Sandy Coverage Headaches In NJ

By Martin Bricketto

Law360, New York (July 03, 2013, 6:32 PM ET) -- Mounting lawsuits in New Jersey that blame insurance brokers for coverage gaps following Superstorm Sandy could motivate firms to cap their liability through agreements with insureds and better document interactions with customers to guard against negligence claims, attorneys said.

Following denials or smaller-than-expected payments from insurers on Sandy claims, businesses and other entities in storm-impacted areas have accused brokers and agents of botching the procurement of coverage for their properties, especially when it comes to flood risks.

"I anticipate that we're going to see a lot more of these types of suits," Lynda Bennett, chair of Lowenstein Sandler LLP's insurance coverage practice, told Law360 in June. "What happens is all of these claims are still being adjusted and handled by the carriers, and as the denials come in, now clients are evaluating whether there's a valid basis to go after the broker because the coverage they thought they had wasn't there."

A number of similar cases have already been filed in state court. The Raritan Yacht Club in a May 17 suit in Middlesex County accused insurance agent Exemplar International Inc. of failing to secure flood insurance for the club — or even suggest that it purchase such coverage — despite what should have been a deep familiarity with the group's facilities in Perth Amboy, N.J.

Generally, one underlying theme in such litigation is that the renewal process has become a rote exercise, according to Bennett.

"Clients' needs and risks change over time, we have found that brokers sometimes get complacent in the renewal process, particularly with long-standing clients, where the brokers no longer ask probing and detailed questions to learn how the business has changed and how the risks and exposures may have changed," Bennett said.

Also in May, an operator of Ethan Allen home furnishing stores sued its insurance broker, Capitol Risk Management Services Ltd., in Bergen County for alleged negligence in lining up coverage that the company says should have protected it from $1.5 million in damage caused by the storm.

One significant worry after Sandy was the forced shutdown of wastewater treatment facilities such as the Passaic Valley Sewerage Commission, which was flooded with 200 million gallons of seawater. Now, the PVSC is at the center of a contractor's lawsuit in Middlesex County that accuses C&H Agency Inc. of failing to secure proper coverage for a commission project and exposing the company to more than $1 million in storm damages.

Brokers also face litigation in New Jersey federal court. Based in Point Pleasant Beach, N.J., the Residences at Bay Point Condominium Association Inc. sued Standard Fire Insurance Co. in April for allegedly refusing to provide fair compensation for Sandy damages. However, the housing complex contends that, if Standard isn't liable, the court should find that broker Chernoff Diamond & Co. LLC ran afoul of its contract to procure adequate flood insurance, according to the suit.

Choice of law can be a critical issue in such suits, according to Robert D. Chesler, a shareholder with Anderson Kill & Olick PC.

In New York, a plaintiff trying to argue that a broker had to do more than just secure requested, available coverage must show a "special relationship," and courts there haven't sorted out what that means, he said. Plaintiffs face an easier standard in New Jersey, where brokers are considered fiduciaries who owe certain duties to their clients, according to Chesler.

To win a suit in New Jersey, plaintiffs will have to show a breach of duty, Chesler said.

"Normally an insurance broker makes promises as to what he's providing: 'I will give you the best coverage, I will look at the options and tell you what you need,'" he said. "In those situations where a broker misses something obvious like flood coverage, he is opened up to liability."

Also, plaintiffs must establish that the coverage at issue was available on the market, which could be a difficult hurdle when it comes to flood insurance, according to James W. Carbin, a partner with Duane Morris LLP. The threat of flooding for properties outside of traditional flood zones could also be a factor, he said, noting the risk assessments that brokers perform.

"In that risk assessment, if the business is in a 500-year flood zone, that's a different risk than if it's in a 20-year flood zone. If it's in a 500-year flood zone, it's going to be that much more difficult to criticize the broker for the potential risk," Carbin said.

Additionally, businesses will have to show that they would have purchased the coverage if it was offered to them, according to Brian Osias, a partner at McCarter & English LLP.

"Those are the kinds of issues I think courts will be grappling with and giving more guidance on for the next storm," he said.

Whatever the outcome of the individual cases, the litigation may change the way that brokers do business in the state, according to some attorneys.

Larger companies in the past have been asked to sign broker agreements that spell out front-end, policy placement services, and smaller and midsize companies should watch for such requests going forward, according to Bennett. Many of those agreements can include indemnification language or limitation of liability terms that aren't favorable to insureds, she said.

Additionally, brokers asked numerous companies in the wake of Sandy to sign claims handling agreements that included liability limiting provisions, according to Bennett. Those provisions not only applied to the claims-handling services, but in some instances would have absolved the broker from any mistakes in the placement of the insured's coverage program, she said.

"It is important for policyholders to know that these agreements are negotiable and they should engage coverage counsel to assist them with those agreements," Bennett said.

Louis H. Kozloff, a partner with Nelson Levine de Luca & Hamilton LLC, said brokers could look to minimize their own risks by better documenting their communications with customers and taking new steps to outline their responsibilities, "so there's a level of understanding of what the producer's role is and what advice they're giving, and what decision the customer or policyholder is making based on that advice."

The Sandy experience could also spur more education for brokers, according to Chesler.

"I think the smaller brokers in particular need to get up to speed on all the new changes in the insurance products that are out there," he said.

For Carbin, Sandy didn't reveal any deficiencies in the insurance market or the way insurance is placed or acquired.

"Rather, it may have highlight to some companies the need to add flood insurance where they haven't thought about that before," he said.

--Additional reporting by Sean McLernon. Editing by Sarah Golin and Katherine Rautenberg.