

RECENT DEVELOPMENTS AFFECTING
PROFESSIONALS', OFFICERS', AND DIRECTORS'
LIABILITY INSURANCE

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The first part of this article addresses developments in directors and officers insurance coverage over the past year, including the narrowing of the professional services exclusion in the context of service-related claims; the junction between cyber insurance and D&O insurance for responding to potential data breach claims or regulatory investigations; the wane of pre-merger challenges that may leave more D&O resources available for other claims against merging companies; and trends in coverage for governmental investigations. The second part turns to developments over the past year in the specific area of malpractice claims against accounting firms. These decisions have broad implications for professional insurance because they focus largely on the level of fault that a claimant must prove to establish claims against its accountant, which in turn may affect whether the professional may obtain insurance coverage for the claims or will be barred by a conduct-based exclusion. The third and final part discusses developments in the specific area of insurance broker and agent liability and considers varied topics, including when a “special” relationship exists between a policyholder and its agent or broker that imposes fiduciary or similar duties on the agent or broker, the application of the economic loss rule in broker liability cases, and the interplay of statutes of limitations with the policyholder’s duty to read its policy.

I. DIRECTORS AND OFFICERS LIABILITY

The D&O arena consistently generates changes and challenges for managements and their insurers, and this past year was no exception. This survey examines one significant change and three rising challenges deemed by the authors to be especially noteworthy: (1) disputes involving the scope of the professional services exclusion in D&O policies, (2) cyber disclosure obligations, (3) waning merger/acquisition lawsuits, and (4) coverage expectations for government investigations under D&O policies.

A. *Professional Services Exclusion*

This past year, federal courts in Maryland and Illinois furthered the trend of clarifying the narrow application of the professional services exclusion in D&O policies by highlighting the distinction between actual professional services and other acts that are merely related to the professional service. Insurers traditionally apply the professional services exclusion broadly as a means to avoid liability that could or should be covered under an errors and omissions insurance policy. On the other hand,

D&O insureds—with some support in the common law, including the two cases discussed below—apply a very narrow definition to the term professional service.

The first case for discussion is *Education Affiliates Inc. v. Federal Insurance Co.*,¹ in which a Maryland court rejected the insurer's broad application of the professional services exclusion in the context of a series of claims against for-profit post-secondary educational institutions. Policyholder Education Affiliates received a subpoena issued by the Florida attorney general's office, which subsequently became a complaint alleging that it used deceptive marketing and sales practices. Later, two groups of former students filed civil complaints alleging the insured's marketing and advertising contained false statements concerning accreditation, quality of education, cost, and job prospects following graduation.

The insurer denied coverage under a D&O policy issued to the insured due in part to the professional services exclusion, which provided that there is no coverage "for" any actual or alleged error, misstatement, act, etc. "in connection with the rendering of, or actual or alleged failure to render, any professional services for others by any person or entity otherwise entitled to coverage under this Coverage Section . . ."² The insured filed a declaratory judgment action in Maryland federal court challenging the denial.

The court ultimately found the professional services exclusion did not apply. The court cited to a Fourth Circuit case holding "practices that are 'common to most businesses' and do not require 'specialized knowledge separate and apart from that required in *any* business' are not professional services."³ Significantly, the *Education Affiliates* court pointed out that under the Fourth Circuit case, if routine services qualified as professional services, coverage "would be practically eviscerated."⁴

The *Education Affiliates* court agreed with the insured that the *marketing* of professional services does not constitute the *rendering* of professional services.⁵ Moreover, marketing is for the insured's own benefit, not the benefit of others, as required by the exclusion. The court stated "[t]he fact that the marketing relates to the professional services to be rendered to others cannot be said to conflate the two because, in light of the fact [the insured's] core business is the rendering of educative services to others, such conflation would provide an evisceration of coverage here."⁶

1. No. 15-CV-1624, 2016 WL 4059159 (D. Md. July 28, 2016).

2. *Id.* at *2.

3. *Id.* (quoting *Liberty Life Ins. Co. v. Travelers Indem. Co. of Ill.*, No. 98-1674, 1999 WL 417436, at *2 (4th Cir. May 5, 1999)).

4. *Id.* (citing *Liberty Life*, 1999 WL 417436, at *3).

5. *Id.* at *2.

6. *Id.*

For the professional services exclusion to apply under the *Education Affiliates* analysis, thus, the professional service itself, not other routine business or administrative activities that are ancillary to the professional service, must be at the root of the claim. Notably, the policy at issue in *Education Affiliates* did not use the more expansive “arising out of, related to, or in any way involving” language in its preamble, instead using the more limited “for.” Based on the court’s opinion, though, it does not appear that the decision turned on that distinction. Allowing a more expansive preamble to exclude the claim in that case would still run counter to the court’s coverage evisceration rationale—insureds that provide professional services would find it difficult to ever obtain coverage under a D&O policy if non-professional services connected to the professional service were excluded.

An Illinois federal court echoed the same sentiment in *Caveo, LLC v. Citizens Insurance Co. of America, Inc.*⁷ In that case, a consulting company was accused of using a competitor’s copyrighted material in a public webinar. The insurer asserted its professional services exclusion and denied coverage. The U.S. District Court for the Northern District of Illinois ruled against the insurer, finding “Caveo is not an advertising company; it is a consulting company. Its solicitation of customers [by participating in a webinar] . . . did not constitute the provision of a professional service.”⁸ Therefore, as in *Education Affiliates*, the court focused on the professional service offered by the insured and analyzed whether the alleged acts concerned the actual professional service or were merely an ancillary act.

Education Affiliates and *Caveo* highlight the continuing tension between insureds and insurers regarding the professional services exclusion. For now, it appears that only a claim that focuses more on the insured’s services and less on tasks incidental to that service will likely trigger the exclusion. Nonetheless, directors and officers should carefully review their entire policy, including the professional services exclusion, to see whether it might impede D&O coverage for claims related to the insured’s business operations. If so, other insurance options may be prudent to consider for responding to these risks.

B. *Cyber Disclosure Obligations and Liability*

As data breaches become more and more common across companies of all types and sizes, the line between cyber coverage and D&O coverage continues to blur. Although there are innumerable ways in which a claim could trigger both policies, one type of claim that has repeatedly threatened to rear its ugly head over the past several years are claims against

7. No. 15-CV-6200, 2016 WL 5477537 (N.D. Ill. Sept. 29, 2016).

8. *Id.* at *4 (citing *Standard Mut. Ins. Co. v Lay*, 2 N.E.3d 1253 (Ill. App. Ct. 2014)).

a company for failure to report “material” breaches or cyber incidents. The recent Yahoo breach may be the impetus for regulators to sharpen their focus on such failures to report. Currently, we think of disclosure obligations as being a “D&O” issue, while we see breaches as a “cyber” issue. Where do we park the hybrid?

The murky categorization of a failure to report claim for insurance purposes tracks the murkiness of the reporting obligation itself. The SEC Division of Corporate Finance issued its Disclosure Guidance on Cybersecurity on October 13, 2011, but this is neither an official rule nor guidance officially adopted by the SEC.⁹ Rather, it is simply a forceful suggestion for companies on how, when, and what to report to regulators when they experience a breach or cyber incident. Indeed, the Disclosure Guidance themselves recognize the Catch-22 inherent in disclosing information about cyber incidents. On the one hand, the Disclosure Guidance recommends that companies disclose to regulators certain risk factors associated with cyber incidents, which can include aspects of the business, outsourced functions, or prior cyber incidents that could give rise to material cybersecurity risks; risks related to cyber incidents that may remain undetected for long periods of time; and descriptions of relevant insurance. The Disclosure Guidance notes these disclosures are particularly important when they are the significant factors “that make an investment in the company speculative or risky.”¹⁰ On the other hand, “detailed disclosures could compromise cybersecurity efforts¹¹ . . . and we emphasize that disclosures of that nature are not required under the federal securities laws.”¹²

Perhaps recognizing it is difficult for a company to walk the thin line between whether a disclosure is “material” and whether the disclosure will impede the company’s own cybersecurity efforts (or law enforcement efforts in investigating a breach), the SEC has yet to bring a regulatory enforcement action against a company for failure to disclose a cyber incident.¹³ However, a regulatory enforcement action seems inevitable. At a recent cybersecurity conference, SEC Commissioner Luis Aguilar em-

9. SEC Division of Corporation Finance, *CF Disclosure Guidance: Topic No. 2*, Oct. 13, 2011, <https://www.sec.gov/divisions/corpfm/guidance/cfguidance-topic2.htm>.

10. *Id.*

11. It is not common for companies to file a disclosure with the SEC if a breach is deemed immaterial. For example, Sony never filed a notice with the SEC for its 2014 breach.

12. *CF Disclosure Guidance: Topic No. 2*, *supra* note 9.

13. Although this article focuses on potential SEC enforcement actions, the Federal Trade Commission notably brought suit against Wyndham Hotels and Resorts, alleging that Wyndham’s lack of cybersecurity was an unfair trade or business practice that exposed consumer payment information in a data breach. Wyndham agreed to settle the action in December 2015 with the proposed court order requiring Wyndham to submit to annual security audits for the next twenty years. See Fed. Trade Comm’n v. Wyndham Worldwide, 799 F.3d 236 (3d Cir. 2015); see also Press Release, Federal Trade Comm’n, Wyndham Settles FTC Charges It Unfairly Placed Consumers’ Payment Card Information At Risk,

phasized that in light of the frequency of cyber incidents involving companies of “all shapes and sizes,” “ensuring the adequacy of a company’s cybersecurity measures needs to be a critical part of a board of director’s risk oversight responsibilities.”¹⁴ The buzz in the legal community is that there will be an increase in class actions filed to address companies’ lack of disclosure for cyber incidents and the regulatory enforcement action floodgates may also soon open; at least one senator has called for an investigation of Yahoo after a September 2016 announcement of a massive data breach.¹⁵

The Yahoo breach may be the bellwether for regulatory investigation and follow-on insurance coverage disputes. The breach occurred in late 2014. Although it is not clear yet exactly when the breach was discovered, Yahoo officially announced the breach on September 22, 2016.¹⁶ Yahoo believes the attack was carried out by a state-sponsored actor, affecting at least 500 million accounts, and that the stolen account information may have included names, email addresses, telephone numbers, dates of birth, and encrypted passwords, but not unprotected passwords, payment card data, or bank account information.¹⁷

What makes the Yahoo breach the perfect test case for whether the SEC will file a regulatory action is the pending \$4.8 billion acquisition of Yahoo by Verizon.¹⁸ With the enormous deal on the horizon, and with even Verizon’s general counsel questioning whether the breach was a material event¹⁹ (implying that Yahoo failed to disclose the breach in order to allow the acquisition to go forward with Yahoo’s value inflated), it may raise red flags at the SEC. Yahoo is also already facing several class action lawsuits from consumers for failure to protect their data and information and particularly for taking so long to discover and disclose the breach.²⁰

Dec. 9, 2015, <https://www.ftc.gov/news-events/press-releases/2015/12/wyndham-settles-ftc-charges-it-unfairly-placed-consumers-payment>.

14. Kim Holmes, *Data Breach and Due Diligence: Why Boards Need to Get Involved with Cyber Insurance*, ID EXPERTS, Sept. 19, 2016, <https://www2.idexperts.com/blog/single/data-breach-due-diligence-why-boards-need-to-get-involved-cyber-insurance>.

15. *This Senator Is Calling for an Investigation of Yahoo’s Security Practices*, FORTUNE, Dec. 15, 2016 (citing Sen. Mark Warner (D-VA) “who called the hacks ‘deeply troubling’”).

16. Bob Lord, *An Important Message About Yahoo User Security*, YAHOO, Sept. 22, 2016, <https://yahoo.tumblr.com/post/150781911849/an-important-message-about-yahoo-user-security>.

17. *Id.*

18. Thomas Gryta & Deepa Seetharaman, *Verizon Puts Yahoo on Notice After Data Breach*, WALL ST. J., Oct. 13, 2016, <http://www.wsj.com/articles/verizon-sees-yahoo-data-breach-as-material-to-takeover-1476386718>.

19. *Id.*

20. Steven Trader, *Yahoo Battered With Class Action Over 2014 Data Breach*, LAW360, Sept. 23, 2016, <http://www.law360.com/articles/843922/yahoo-battered-with-class-actions-over-2014-data-breach>.

Yahoo does not seem to consider the data breach as “material” for potential investors because its September 9, 2016, SEC filing stated it was not aware of any third-parties alleging security breaches or “unauthorized access or unauthorized use” of personal information that could significantly impact its business.²¹ Specifically, Yahoo officials stated they consider the cyber incident to have been low risk, implying that the incident was not “material” for regulatory purposes because all stolen passwords were encrypted and because of the low likelihood that the supposed state-sponsored hacker would be interested in consumers’ financial data.²²

The Yahoo breach comes at a critical turning point in the insurance world as cyber breaches become more and more frequent, but regulators have yet to establish a pattern of filing enforcement actions for failure to disclose material information in connection with such cyber incidents. Whether spurred on by Yahoo or the next headline-grabbing breach, increased activity by the SEC and other regulators seems inevitable. Insurance coverage disputes are equally certain to follow. The sheer cost of responding to regulators, monitoring credit for affected customers, defending multiple litigations, and resolving liability claims could be mind-boggling and will spur insurers to evaluate all possible coverage and exclusionary arguments for data breach regulatory claims.

C. M&A Challenges on the Wane

Over the last decade, merger objection suits became an almost inherent part of doing business in the mergers and acquisitions world. Beginning in the mid-2000s, and peaking in 2013, shareholders challenged nearly every merger. Typically, shareholders would file suit shortly after the announcement of a merger, alleging a broad range of technical misgivings or breaches of fiduciary duties and attempting to enjoin the transaction. In an effort to move forward, the merger parties frequently settled such cases through what became known as disclosure-only settlements. These settlements arguably yielded little value to shareholders. The settlement consideration was typically limited to additional disclosure and proxy amendments. Financial consideration was generally limited to a fee awarded to plaintiffs’ counsel.

The recent decision by Delaware Chancellor Andre Bouchard in *In re Trulia, Inc. Stockholder Litigation*,²³ however, suggests that rampant merger objection suits may be on the way out. *Trulia* rejected a proposed disclosure-only settlement arising out of Zillow’s acquisition of Trulia. Chancellor Bouchard took the opportunity in his opinion to solidify a

21. Yahoo Schedule 14A, Exhibit A thereto, Paragraph 2.16(p) (Sept. 9, 2016), <https://investor.yahoo.net/secfiling.cfm?filingID=1193125-16-706578&CIK=1011006>.

22. Gryta & Seetharaman, *supra* note 18.

23. 129 A.3d 884 (Del. Ch. 2016).

seemingly growing trend in Delaware of discouraging disclosure-only settlements. The court identified a number of concerns generally with merger objection suits, which in the court's view "optimally should be adjudicated outside the context of a proposed settlement."²⁴ However, Chancellor Bouchard noted that should suits continue to be filed in search of disclosure-only settlements, practitioners should expect "increase[ed] vigilan[ce]" regarding the "reasonableness of the 'give' and 'get' of such settlements" and cautioned that supplemental disclosures associated with these settlements must "address a plainly material misrepresentation or omission."²⁵ In other words, absent a truly meaningful additional disclosure, the court was signaling the end of the award of significant plaintiffs' fees.

Many practitioners speculated that *Trulia* could have a dramatic impact on the rate merger challenges were filed.²⁶ That speculation was confirmed on August 2, 2016, when Cornerstone Research released the results of its shareholder litigation study. Merger litigation for deals valued over \$100 million had already fallen from 93 percent in 2014 to 84 percent in 2015.²⁷ However, that decline accelerated in the first half of 2016 following *Trulia* dropping to an eight-year low of 64 percent.²⁸

The reduction in filing rates was especially pronounced in Delaware. In the first three quarters of 2015, almost 61 percent of all deal challenges were filed in Delaware.²⁹ By the end of the first quarter 2016 following *Trulia*, that number plunged to 26 percent.³⁰ Delaware had shored up shareholder litigation at home; but had it simply compelled litigants to file their challenges elsewhere?³¹ The question (or concern) was, would other states follow Delaware's lead?

For now, other states appear to be more hospitable than Delaware to disclosure-only settlements,³² but that may be a short-lived distinction.

24. *Id.* at 887.

25. *Id.* at 898.

26. Kevin LaCroix, *Delaware Chancellor Rejects Disclosure-Only Settlement, Signals What's Next for Merger Objection Suits*, D&O DIARY, Jan. 26, 2016, <http://www.dandodiary.com/2016/01/articles/shareholders-derivative-litigation/delaware-chancellor-rejects-disclosure-only-settlement-signals-whats-next-for-merger-objection-suits/>.

27. *Shareholder Litigation Involving Acquisition of Public Companies: Review of 2015 and 1H 2016 M&A Litigation*, CORNERSTONE RESEARCH, at 1, <https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-2016>.

28. *Id.*

29. *Id.* at 3.

30. *Id.*

31. Kevin LaCroix, *Cornerstone Research: Since Trulia, Merger Objection Lawsuit Filings Have Plunged*, D&O DIARY, Aug. 2, 2016, <http://www.dandodiary.com/2016/08/articles/director-and-officer-liability/cornerstone-research-since-trulia-merger-objection-lawsuit-filings-have-plunged/>.

32. In its report, Cornerstone noted that "[e]arly anecdotal evidence indicates that it is possible" that other courts will continue to approve disclosure-only settlements. However, Cornerstone also noted this evidence was based upon "a small number of disclosure-only set-

There is some evidence of the creeping influence of the *Trulia* decision to other jurisdictions, most notably the *Hayes v. Walgreen Co. (In re Walgreen)* case in the Seventh Circuit.³³

In *Walgreen*, Judge Richard Posner of the Seventh Circuit issued a scathing opinion that cited heavily to *Trulia*, expounded upon it, and concluded that disclosure-only settlements are a “racket”:

The type of class action illustrated by this case—the class action that yields fees for class counsel and nothing for the class—is no better than a racket. It must end. No class action settlement that yields zero benefits for the class should be approved and a class action that seeks only worthless benefits for the class should be dismissed out of hand.³⁴

The *Walgreen* decision is not necessarily the death knell for disclosure-only settlements, but it shows that the *Trulia* analysis has been adopted outside of Delaware and could eventually become a majority rule, particularly when considering the influence and stature of Judge Posner, who already concurred.

If *Trulia* and *Walgreen* are the new normal, the number of merger lawsuits should continue to fall. Most corporations and their D&O insurers will likely applaud this result. Yet some commentators wonder if a world without disclosure-only settlements might prove worse—that disclosure-only settlements are a necessary evil that prevents post-merger litigation, which can drag on for years and prove much more costly.³⁵ So, which is it? Should the impending death of disclosure-only settlements be cheered or feared? At the end of the day, the result is not likely to be binary or mutually exclusive. As the Cornerstone study showed, *Trulia* and its progeny will likely contribute to the continued decline of merger challenge suits and thus a reduction in claims against corporate defendants and their insurers. This in turn may increase the rate of post-closure litigation because it will become increasingly difficult to reach an approved settlement prior to the finalization of a merger deal.

Ultimately, it remains to be seen whether decisions such as *Trulia* will truly be fiscally beneficial or require greater capital outlay from corporate defendants or their D&O insurers. But if the decline of disclosure-only settlements translates to a mere exchange of high-volume low severity claims (pre-merger settlements) for low-volume high severity claims

lements” approved after but reached before the *Trulia* decision was rendered. *Shareholder Litigation Involving Acquisition of Public Companies*, *supra* note 26.

33. 832 F.3d 718 (7th Cir. 2016).

34. *Id.* at 724 (citing *Robert F. Booth Trust v. Crowley*, 687 F.3d 314, 319 (7th Cir. 2012)).

35. Doug Greene, *The Decline of the Disclosure-Only Settlement: Will We Regret What We Wished For?*, D&O DIARY, Aug. 17, 2016, <http://www.dandodiscourse.com/2016/08/17/the-decline-of-the-disclosure-only-settlement-will-we-regret-what-we-wished-for/>.

(post-merger settlements), it is quite possible that the overall financial impact may be fairly muted. Only one thing is certain: disclosure-only settlements are on their way out and the frequency of merger challenges should continue to fall.

D. Coverage for Government Investigations

Another fruitful area of common dispute between D&O insurers and their insureds is whether and when the D&O policy should respond to a government investigation. Numerous courts have weighed in on the subject, although few, if any, majority rules have emerged. Perhaps the disputes continue due to the absence of such rules. Or perhaps they continue (and always will) because investigations are amorphous by nature, resistant to a four-corners comparison under the ubiquitous D&O coverage trigger of “a claim for a wrongful act.”

This article examines two recent decisions approaching coverage for regulatory and internal investigations in different ways. At first blush, the decision by the Ohio Court of Appeals in *Eighth Floor Promotions v. Cincinnati Insurance Cos.*³⁶ and the decision by the U.S. District Court for the District of Colorado in *Musclepharm Corp. v. Liberty Insurance Underwriters, Inc.*³⁷ are distinguishable. *Eighth Floor Promotions* focused on whether the internal investigation for which the policyholder sought coverage rose to the level of a “claim” under its policy. *Musclepharm*, in contrast, questioned whether a regulatory investigation accused the insured of a “wrongful act.” Viewed together, however, these two cases suggest that there may be a tangible distinction between *responding* to an investigation and *defending* against one and that only the latter category of investigations should be covered under D&O insurance.³⁸

By way of background, many courts have analyzed whether an investigation constitutes a “claim” as defined under the particular D&O policy, or, more specifically, whether an investigatory device in question (e.g., subpoena) is a “written demand for non-monetary relief.” These decisions go both ways.³⁹ Fewer courts have considered whether an investigation or an

36. No. 10-15-19, 2016 WL 5900078 (Ohio Ct. App. Oct. 11, 2016).

37. No. 15-CV-00555-REB-KMT, 2016 WL 4179784 (D. Colo. Aug. 4, 2016).

38. For purposes of this article, we ignore public company D&O policies that include “pre-claim inquiry” coverage, along with “investigation policies” now available in the market.

39. See, e.g., *Polychron v. Crum & Forster Ins. Cos.*, 916 F.2d 461, 463 (8th Cir. 1990); *Richardson Elecs., Ltd. v. Fed. Ins. Co.*, 120 F. Supp. 2d 698, 700-01 (N.D. Ill. 2000); *Dan Nelson Auto. Grp., Inc. v. Universal Underwriters Grp.*, 2008 WL 170084, at *5 (D.S.D. Jan. 15, 2008); *Joseph P. Bornstein, Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 828 F.2d 242, 244 (4th Cir. 1987); *MBIA Inc. v. Fed. Ins. Co.*, 652 F.3d 152, 159 (2d Cir. 2011); *Minuteman Int'l, Inc. v. Great Am. Ins. Co.*, 2004 WL 603482, at *3-4 (N.D. Ill. Mar. 22, 2004); *Agilis Benefits Servs. LLC v. Travelers Cas. & Sur. Co. of Am.*, 2010 WL 8573372, at *7 (E.D. Tex. Apr. 30, 2010); *Syracuse Univ. v. Nat'l Union Fire Ins.*

investigatory device alleges a wrongful act in the first place. Those that have, however, also have reached disparate results.⁴⁰ Putting both of these approaches into play, *Eighth Floor Promotions* analyzes whether an investigatory device (e.g., subpoena) was a claim, i.e., a written demand for non-monetary relief. *Musclepharm* focuses instead on whether the investigatory device alleged a wrongful act. A close look at the two decisions, however, shows that they simply attacked the same problem from two different angles.

In *Eighth Floor Promotions*, a software industry group issued a letter to the insured advising that the insured was using unlicensed or unauthorized copies of certain business software, compelling the insured to undertake an internal investigation to assess the infringing use. That is, the group offered the insured, in lieu of litigation, the opportunity to self-audit its computer systems to determine whether it held and was using the software. The D&O insurer denied coverage on the basis that the letter was not a claim, i.e., a written demand for relief, “because it only advised [the insured] that [the group] was investigating possible instances of copyright infringement and gave [the insured] an opportunity to conduct its own company-wide investigation to determine whether any copyright infringement had occurred.”⁴¹

The court concluded that the letter rose to the level of a claim—a written demand for relief—because the letter offered the insured a self-auditing option as an alternative to litigation and stated that “senior management [of the insured] may not have had an opportunity to investigate or consider *the ramifications of using unlicensed software*.”⁴² To the court, this showed the group had already determined that violations had occurred and that it was merely investigating the extent of such violations. Accordingly, the court found the letter was “for relief” (i.e., it was a claim) because it accused the insured of wrongdoing and sought to enforce a corresponding right through the threat of litigation.⁴³

In *Musclepharm*, the court never considered whether the SEC investigation at issue amounted to a claim. Instead, the court ended its inquiry when it concluded that the investigation did not allege a wrongful act, i.e., “any actual or alleged error, misstatement, misleading statement, act, omission, [etc.]”⁴⁴ The court based this conclusion on the fact that none of the SEC’s correspondence alleged, or “asserted to be true,” any-

Co. of Pittsburgh, PA, 2013 WL 3357812, at *3 (N.Y. Sup. Ct. Mar. 7, 2013); RSUI Indem. Co. v. Desai, 2014 WL 4347821, at *4 (M.D. Fla. Sept. 2, 2014).

40. See, e.g., *Syracuse Univ.*, 2013 WL 3357812, at *3; Nat’l Stock Exch. v. Fed. Ins. Co., 2007 WL 1030293 (N.D. Ill. Mar. 30, 2007); *Emp’rs Fire Ins. Co. v. ProMedica Health Sys.*, 524 F. App’x 241, 247 (6th Cir. 2013).

41. *Eighth Floor Promotions*, 2016 WL 5900078, at *8.

42. *Id.* at *9 (emphasis in original)

43. *Id.*

44. *Musclepharm*, 2016 WL 4179784, at *6.

thing.⁴⁵ The SEC's initial voluntary disclosure letter stated the inquiry "should not be construed as an indication that the [SEC] or its staff believes any violation of law has occurred," and a subsequent SEC order stated only that the SEC had information that "*if true* tends to show" various "*possible* violation[s]" of the securities laws which "*may have*" occurred.⁴⁶ To the court, the insured was not being accused of anything.

Neither *Eighth Floor Promotions* nor *Musclepharm* truly broke any new ground. What makes the cases worthy of discussion is how the courts tackled the same coverage dispute under two policy provisions by focusing on the same key inquiry—is the investigating body accusing the insured of wrongdoing, or is it simply trying to determine whether any wrongdoing has occurred?

Given the broad array of matters that fall within the ambit "investigations," it is highly unlikely the courts will ever create a rigid rule, such as "a subpoena for documents as part of an investigation is (never/always) a written demand for non-monetary relief and/or for a wrongful act." In the absence of such a rule, the collective focus of *Eighth Floor Promotions* and *Musclepharm* courts may be the single best predictor of coverage for investigations: is the insured *really* being accused of something?

II. DEVELOPMENTS IN ACCOUNTING MALPRACTICE

This part of the article turns to recent developments related to insurance coverage for accounting malpractice claims and the substantive defenses that accounting professionals may pursue in the underlying claims against them to maximize the coverage available. The first part highlights how a limits reinstatement endorsement to a malpractice policy may not operate as the policyholder intended. The second part addresses the "equal fault" defense, under which an accounting professional argues that its corporate client engaged in conduct that would make it inequitable to hold the accounting professional liable for misstatements in its accounting opinions that relied on that conduct. The third part discusses the viability of the "ongoing representation" rule, which tolls the statute of limitations for malpractice claims against an accounting professional as long as the accountant maintains a professional relationship with the claimant. Both of these defenses, in turn, may affect the insurance coverage available to the accounting professionals, as well as to their clients that may be seeking to pin their own corporate financial misrepresentations on their accountants.

45. *Id.* at *4–6.

46. *Id.* at *4 (emphasis in original).

A. *Accounting Malpractice Insurance: Reinstatement Endorsement, A Cautionary Tale*

Reinstatement endorsements, which purport to reinstate the limits of a malpractice policy upon the exhaustion of that policy or other coverage, or after the policyholder incurs a specific amount of loss on its own, can provide a great source of extra malpractice coverage to professionals and may be an integral part of the professional's strategy to protect itself against serial or extremely large malpractice claims. But when the reinstatement endorsement fails to operate as the policyholder intended because of an error in the policy wording as finally issued, that strategy can fall apart.

The U.S. District Court for the Northern District of California addressed the situation in which a reinstatement endorsement did not reinstate insurance coverage the way its accounting-firm insured believed it would in *Mayer Hoffman McCann, P.C. v. Camico Mutual Insurance Co.*⁴⁷ There, an accounting firm and its malpractice insurer faced off on whether the policy's reinstatement endorsement was intended to cover or bar claims that had been defended or paid in part by the original policy limits. The plain language of the endorsement supported the insurer's position that the reinstatement endorsement applied only to claims for which the insurer had not previously made any defense or indemnity payments, but the accounting firm contended that limitation was not consistent with the parties' intent and asked the court to reform the policy based on a mutual mistake.⁴⁸ The endorsement stated:

Upon payment by the *Named Insured*, or on its behalf by an excess liability insurer(s), of \$20,000,000 in *Claims Expenses* and/or *Damages* with respect to Claims that would otherwise have been covered by this Policy but for the exhaustion of the Policy's \$5,000,000 Limit of Liability-Policy Aggregate, the Company agrees thereafter to reinstate the *Named Insured's* \$5,000,000 Limit of Liability-Policy Aggregate under this Policy, **EXCEPT THAT, the reinstated Limit of Liability-Policy Aggregate shall not apply to any Claim for which Claim Expenses and/or Damages have been or are paid in whole or in part by the Policy's original Limit of Liability-Policy Aggregate.**⁴⁹

Leading up to this dispute, the accounting firm had exhausted its \$5 million primary malpractice policy limits in the 2008 policy period on two cases (two of sixteen that it had reported to its carrier) and had gone on to almost fully exhaust its remaining excess coverage, which would prompt the reinstatement of the original malpractice policy limits based on the accounting firm's understanding of its coverage. Thus, on the eve of the final

47. 161 F. Supp. 3d 858 (N.D. Cal. 2016).

48. *Id.* at 861.

49. *Id.* at 862 (emphasis added).

settlement agreement that would exhaust the excess coverage, the accountants put the insurer on notice that the reinstatement endorsement would be triggered. Notably, the triggering settlement related to one of the two cases for which the insurer had paid under its original set of limits.

The insurer paid a portion of the overage with a reservation of rights, but later sought to recoup the money it had already paid. The dispute made its way to court and resulted in dueling summary judgments to decide whether the insurer would have to pay the remaining overage expenses or could recoup what it had already paid.

The insured accountant argued that the court should reform the policy to match its expectations of reinstated coverage for all claims because (1) parol evidence showed that its insurance broker's communications and understanding was inconsistent with the above bolded exception language to the reinstatement endorsement; (2) to give the exception language meaning would make the reinstatement coverage illusory because in its claims-made policy, the insured had one year to report a claim for it to be covered, and it was likely every claim made would incur some expenses, thus disqualifying every claim from ever being coverable under the reinstatement endorsement; and (3) the exception language was not conspicuous, plain, and clear because it was not included on the first page of the endorsement, or individually numbered or headed and was included in the bottom of a paragraph.⁵⁰

The insurer, in contrast, pointed to the plain language of the endorsement and argued that the accountants could not rely on parol evidence to prove an interpretation of the contract language that could not be supported by its plain language. The insurer further argued the coverage was not illusory because the reinstatement endorsement would have provided coverage if the final claim that the accountants resolved had been any one of the fourteen matters for which the accountants had given notice under the 2008 policy for which the insurer had not paid previously. That is, if the accountants had settled the final case earlier in the progression and left a different case for last, they might have in theory run up damages and expenses greater than the excess coverage, triggering reinstatement coverage. Further, the insurer argued that the exclusionary language was conspicuous and enforceable because there was bold language warning of additional restrictions on coverage, admonitions to read the endorsement carefully, and the all-capital phrase "EXCEPT THAT" preceding the exception language.⁵¹ The insurer also emphasized that the accountants were represented by a sophisticated broker that negotiated on their behalf.

50. *Id.* at 867 (parol evidence), 870 (illusory coverage and not conspicuous).

51. *Id.* at 867 (parol evidence not admissible), 870 (not illusory), 871 (conspicuous).

The court sided with the insurer in all respects, finding the language was clear and unambiguous, not susceptible to the interpretation the accountants' parol evidence (their broker's affidavit and communications with the insurance underwriter) would suggest, not illusory and fully enforceable.⁵² *Mayer Hoffman*, thus, serves as a strong reminder not only for accounting professionals, but for all policyholders and their brokers alike, to closely review policies as they are finalized to make sure that they actually reflect the parties' intent. Once a dispute arises, it may be too late to fix any errors.

B. In Pari Delicto Defense: When Is the Plaintiff "in Equal Fault"?

Perhaps a better way for an accounting firm to make sure it has sufficient insurance resources is to defeat the underlying liability all together. A key defense that accounting and auditing professionals turn to in this regard is the equitable *in pari delicto* defense, which translates to "in equal fault." The U.S. District Court for the Southern District of New York recently addressed the *in pari delicto* defense (among others) in *MF Global Holdings, Ltd. v. PricewaterhouseCoopers LLP*⁵³ and clarified that the key consideration for the defense under New York law (which many other jurisdictions also follow) is whether the client acted negligently or intentionally. Only intentional misconduct can potentially bar the plaintiff's claims.⁵⁴ More particularly, for an audit firm to maintain the equitable defense of *in pari delicto* under New York law, it must make a factual showing that the claimant has displayed "immoral or unconscionable conduct that makes the wrongdoing of the party against which it is asserted at least equal to that of the party asserting it, or resorted to gravely immoral and illegal conduct."⁵⁵ The showing is difficult to make at the summary judgment stage because it necessitates an examination of the audit client's scienter concerning the accounting issue underlying the audit failure. The showing is further complicated because the intent to be examined is narrowly focused on (1) the accounting issue or misstatement (the basis of the audit failure); and (2) the client's interference, if any, with the audit (e.g., providing false information or hiding information).⁵⁶ The relevant inquiry is not the company's (or its management's) intent behind engaging in otherwise legal transactions to make the company appear more profitable.

52. *Id.* at 868–69 (parol evidence findings), 870 (illusory findings), and 872–73 (final rulings).

53. *MF Global Holdings, Ltd. v. PricewaterhouseCoopers LLP*, No. 14-CV-2197 (VM), 2016 WL 4197062, at *12 (S.D.N.Y. Aug. 5, 2016).

54. *Id.* at *13.

55. *Id.* at *12 (quoting *Stahl v. Chem. Bank*, 237 A.D.2d 231, 232 (N.Y. App. Div. 1997), and *McConnell v. Commonwealth Pictures Corp.*, 7 N.Y.2d 465, 471 (N.Y. 1960)).

56. *Id.*

In the *MF Global Holdings* opinion, the court denied PwC's summary judgment motion on its *in pari delicto* affirmative defense, among others.⁵⁷ The scale of damage alleged in the *MF Global Holdings* case—\$1 billion—alone might make the matter of interest,⁵⁸ but the court's ruling and reasoning on the *in pari delicto* defense provide a refined and helpful guideline for what sorts of plaintiff misconduct can put the defense in play under New York law (and jurisdictions that apply the defense similarly).

The court previously had set a high standard for PwC to satisfy to prevail on its *in pari delicto* defense:

While *in pari delicto* could apply in a professional malpractice suit in which the corporation intentionally participated in creating and employing the incorrect opinion, such as by intentionally providing inaccurate financial statements to the auditor, no such allegations have been made here. If discovery reveals a basis for allegations of that kind, the Court can revisit whether *in pari delicto* applies on a motion for summary judgment.⁵⁹

In its summary judgment motion, PwC contended that MF Global had been an active participant in the process that led to PwC issuing improper audit opinions, as supported by the robust evidentiary record of MF Global's management and accounting personnel's in-depth involvement in considering, producing memoranda concerning, and ultimately adopting the "sale accounting" treatment (the early recognition of sales revenue) of the company's ill-fated repurchase-agreement financed European debt investments.⁶⁰ In effect, PwC argued that MF Global's management's involvement and participation with the accounting treatment of the very subject of its complaint against PwC should be adequate evidence of the sort of intentional participation that satisfies the *in pari delicto* defense. PwC further claimed that its argument had the force of the law of the case because the court's prior motion to dismiss order stated that *in pari delicto* would apply if MF Global was "an active, voluntary participant in the allegedly improper accounting advice."⁶¹

The court provided three instructive responses in rejecting PwC's arguments. First, the court recounted how New York law on this doctrine has recently evolved: from what the "leading case" on the doctrine decided in 2010⁶² through more recent opinions to make clear that the doctrine applies only where the company was alleged to have engaged in *in-*

57. *Id.* at *21.

58. See *MF Global Holdings, Ltd. v. PricewaterhouseCoopers LLP*, 57 F. Supp. 3d 206, 207 (S.D.N.Y. 2014) (providing more factual background and damage allegations).

59. *MF Global Holdings, Ltd. v. PricewaterhouseCoopers LLP*, No. 14-CV-2197 (VM), 2016 WL 4197062, at *11 (S.D.N.Y. Aug. 5, 2016) (internal quotations omitted).

60. *Id.* at *4, *5 (factual record), *12 (PwC's contention).

61. *Id.* at *12.

62. *Kirshner v. KPMG LLP*, 938 N.E.2d 941 (N.Y. 2010).

tentional wrongdoing or fraud and is inapplicable where the corporation did not intentionally provide inaccurate financial statements to the outside auditor.⁶³ Second, the court adopted the plaintiff plan administrator's pragmatic argument that "companies routinely participate in formulating accounting decisions related to their financial statements" and that allowing such activity to establish the *in pari delicto* defense would effectively put an end to all professional malpractice actions against accountants.⁶⁴ Finally, the court made clear that the relevant factual inquiry into the plaintiff's intentional conduct is not opened to *any* intentional wrongdoing or any participation in the accounting process, but only to intentional wrongdoing as to the specific financial statements and information provided to the auditors that is the subject of the claim.

In addition to setting forth these clear guideposts, the court also distinguished a prior opinion dismissing claims against PwC on *in pari delicto* grounds. The court explained that the *in pari delicto* defense was established in the earlier suit because the complaint in that matter against PwC alleged violations that resulted *only* because MF Global employees violated statutory and common law by transferring customer funds out of secured and segregated accounts. The court went on to explain the lynchpin to its prior opinion was not that the MF Global employees *participated* in the alleged conduct, but that their participation was *unlawful* and it was the very unlawful conduct underlying the claims against the auditors.⁶⁵

The *MF Global Holdings* opinion is a helpful guide to both the type and scope of wrongful conduct that triggers the *in pari delicto* defense's application. The court ultimately found the factual record provided a factual dispute as to whether MF Global's employees relied on PwC's expert advice as to the sales accounting treatment and whether they did so in good faith and that MF Global employees' participation in formulating or supporting the accounting treatment alone did not constitute the intentional wrongful conduct that would establish the *in pari delicto* defense as a matter of law.⁶⁶

From an insurance perspective, however, it bears noting that the facts developed and identified as part of an *in pari delicto* challenge may prompt

63. See *MF Global Holdings*, 2016 WL 4197062, at *12–13 (citing *CRC Litig. Tr. v. Marcum, LLP*, 132 A.D. 3d 938 (N.Y. App. Div. 2015) (recognizing the doctrine only where corporate management was alleged to have engaged in intentional wrongdoing or fraud); *Sacher v. Beacon Assocs. Mgmt. Corp.*, 114 A.D.3d 655, 657 (N.Y. App. Div. 2014) (finding *in pari delicto* defense not properly pled where corporation was not alleged to have intentionally provided inaccurate financial statements)).

64. *MF Global Holdings, Ltd. v. PricewaterhouseCoopers LLP*, No. 14-CV-2197 (VM), 2016 WL 4197062, at *13 (S.D.N.Y. Aug. 5, 2016).

65. *Id.*

66. *Id.* at *15–16.

insurers to trigger conduct-based exclusions that could limit the insurance coverage available not only to the accounting or auditing firm, but also to the client in separate litigation arising from its erroneous financial reporting. Thus, the decision to invoke the *in pari delicto* defense should be carefully considered for potential insurance-related ramifications.

C. *Varying Applications of the “Ongoing Representation Rule”*

Another avenue that accountants and other professionals may use to defend against malpractice claims is to invoke the statute of limitations as a bar to liability. But savvy complainants oppose that timeliness defense based on the ongoing representation or continuous representation rule, which states that the limitations period does not begin to run as long as the professional’s representation of the client is continuing. Although the rule is most often applied in the legal malpractice context, New York courts extended it to accountant malpractice suits in several published opinions this year with some varied standards.

The *MF Global Holdings* opinion discussed in detail above permitted the plaintiff to use the ongoing representation rule to overcome PwC’s statute of limitations defense.⁶⁷ At the same time, the court outlined some boundaries for the rule’s use. To invoke the continuous representation doctrine, a plaintiff must establish (1) ongoing representation connected to the specific matter at issue in the malpractice action; (2) clear evidence of an ongoing continuous, developing, and dependent relationship between the client and the auditor; and (3) the ongoing representation must be specific to the matter in dispute.⁶⁸ The court found the standard had been met with evidence that PwC advised MF Global in responding to an SEC comment letter about its fiscal year 2010 financial statements in June 2011, continued to review and identify corrections to the fiscal year 2010 audit well into fiscal year 2011 (beyond the limitations cut off), and prepared a workpaper in April 2011 detailing the conclusions it had reached in the fiscal year 2010 audit.

A New York state court reached a similar result in *Jefferson Apartments, Inc. v. Mauceri*, concluding that an auditor’s single “recertification of the prior year financials constituted an undertaking to perform further work for the prior year audit” that was sufficient to show ongoing representation that tolled the statute of limitations.⁶⁹ A New York appellate court applied an even less stringent standard in *Stokoe v. Marcum & Kliegman LLP* and allowed the continuous representation rule to defeat a limita-

67. *Id.* at *20.

68. *Id.* (citing *DeCarlo v. Ratner*, 204 F. Supp. 2d 630, 636 (S.D.N.Y. 2002), *aff’d* 53 F. App’x 161 (2d Cir. 2002), and *In re Magnesium Corp. of Am.* 399 B.R. 722, 749 (Bankr. S.D.N.Y. 2009)).

69. 36 N.Y.S.3d 789, 796 (N.Y. Sup. Ct. 2016).

tions argument based on the “‘mutual understanding’ set forth in the engagement letters that defendants *could be called upon* in a government investigation to justify their audit filings.”⁷⁰ Under this holding, the mere possibility of the need for future services where the auditor is standing at the ready may extend limitations for claims against that auditor.

From an insurance perspective, the fundamental concern with the ongoing representation rule is that it avoids finality and allows the risk of a malpractice suit and ensuing liability to linger. This enhanced risk, in turn, could prompt insurers to increase their premiums for accountants and other professionals whose representation of clients could lead to malpractice claims much later in time than anticipated.

III. DEVELOPMENTS IN AGENTS AND BROKERS LIABILITY

This final part of this article discusses recent case law involving claims against and involving insurance agents and brokers. As has become fairly common in the realm of insurance agents and brokers E&O claims, a significant number of the past year’s most relevant decisions involve interpretation of when a complaint sufficiently alleges a “special relationship” between the broker and the insured to survive a dispositive motion. However, some significant decisions were also rendered with respect to the “duty to read” as a defense to a negligent procurement claim; the accrual of a negligent procurement claim for statute of limitations purposes; the economic loss rule as a defense to agent and broker E&O claims; ripeness; proving recoverable damages; and the instances in which an owner of a corporate brokerage entity can be held liable personally for alleged negligence in the course of his work for the brokerage, as an employee of same.

A. *Special Relationship*

An Arkansas federal district court recently found a “special relationship” giving rise to a duty to advise could be found where the broker had alleged knowledge or awareness of circumstances making the homeowner’s insurance purchased on his behalf inappropriate and likely to lead to potential lack of coverage. In *Warren v. Holland*,⁷¹ a homeowner had purchased a Travelers High Value Insurance Policy for his vacation home in Arkansas and renewed the policy annually for several years. In the fourth year, he learned that his vacation home had suffered water and mold damage due to a ruptured steam line fitting.⁷² The Travelers policy contained an exclusion for loss caused by water leakage that was not reported within

70. 135 A.D.3d 645, 646 (N.Y. App. Div. 2016) (emphasis added).

71. 2016 WL 6609194 (W.D. Ark. Nov. 8, 2016).

72. *Id.* at *1.

fourteen days of the commencement of the leak, and Travelers denied coverage because the homeowner acknowledged that he did not discover the damage until more than fourteen days after the leakage began.⁷³

The vacation homeowner sued his insurance broker, Willis, for negligently procuring a policy with a fourteen-day leakage discovery window for a vacation home that was used and occupied only sporadically. The homeowner claimed that both the broker and individual handling his account (Holland) either knew or should have known that he traveled extensively and was away from his Arkansas residence for extended periods of time based on his forty-year relationship with the insurance broker and six-year relationship with his account representative.⁷⁴ In short, the plaintiff alleged Willis and Holland were so familiar with his personal insurance needs that he and they had a special relationship that imposed on them a duty to advise about the appropriateness of the insurance products they procured. He alleged that they breached this duty by recommending the Travelers policy as a replacement for his prior policy with the Hartford, which did not contain the fourteen-day reporting exclusion.

The court denied Willis's and Holland's motions for summary judgment, finding that issues of fact existed regarding whether there was a special relationship. In doing so, the court referenced the fact that the plaintiff had offered evidence of emails, which allegedly made clear that the Arkansas home was a secondary home and he wanted his coverage to be like his prior Hartford policy.⁷⁵ The court concluded "a jury could find that Ms. Holland, [her supervisor] Ms. Sullivan, and/or the other agents working for Willis and/or its predecessors, either knew or should have known that Mr. Warren's Arkansas residence was not his primary home, but was instead a vacation home that was not continuously occupied."⁷⁶ "As a consequence," the court determined, "a jury could find that, given the parties' special relationship and Defendants' knowledge of Mr. Warren's business interests, Ms. Holland's recommendation of an insurance policy with a 14 day reporting requirement was negligent."⁷⁷

Separately, in *Fox Paper, Ltd. v. Hanover Insurance Co.*,⁷⁸ a New Jersey Superior Court, applying New York law, upheld a claim asserting negligent failure to advise in connection with a flood claim, again based on the presumption that the broker knew or should have known sufficient information about the insured's business to impose a duty to advise on the broker. More particularly, the court allowed a negligent failure to advise

73. *Id.*

74. *Id.* at *1-2.

75. *Id.* at *3.

76. *Id.* at *6.

77. *Id.*

78. 2016 N.J. Super. Unpub. LEXIS 2234 (N.J. Super. Ct. Law Div. Oct. 6, 2016).

claim to proceed against a broker who allegedly failed to advise the insured to procure flood insurance for a Brooklyn building located “within feet of the water,” which then suffered uninsured flood damage as a result of Superstorm Sandy. In sustaining the claim, the court noted that the plaintiff had alleged that prior to the storm the defendant broker had inquired about procuring flood insurance for the home of the plaintiff’s corporate executives as well as a warehouse located in New Jersey. The court’s holding suggests that this inquiry was enough to give rise to a duty on the part of the broker to advise the client with respect to flood coverage for other locations, including the Brooklyn location.⁷⁹

These cases are cause for concern for agents and brokers going forward because they evidence the willingness on the part of courts not only to find a basis for a duty to advise where the broker has been asked specifically for his expertise or the broker has engaged in an extended course of conduct in which he should have reason to believe his advice is being sought and specially relied upon, but also where a relevant fact consideration may exist that arguably should have triggered questions from the broker, even though no specific request for coverage advice had been made.

Perhaps even more worrisome for agents and brokers, and the lawyers who defend them, was a decision issued by a Florida federal court holding that a plaintiff does not need to even assert in its pleadings or in opposing a dispositive motion that it shared a “special relationship” with its insurance agent or broker to be able to rely on an alleged “special relationship” as a basis for a negligent failure to advise claim. In *American K-9 Detection Services, Inc. v. Rutherford International, Inc.*,⁸⁰ the court held that as long as the client alleges the broker held itself out as an expert and the client alleges it relied on the expertise of the broker, these allegations alone may be sufficient to withstand a dispositive motion.⁸¹ Notably, in denying the broker’s summary judgment motion, the court focused on the “length and depth of the parties’ relationship” in finding the existence of a special relationship was a question of fact for the factfinder.⁸²

For those looking for signs of hope on this score, it should be noted that the District of Colorado recently applied a much more restrictive standard when deciding if a plaintiff had sufficiently alleged a special relationship with an insurance broker. In *Valley Equipment Leasing Inc. v. McGriff, Seibels & Williams*,⁸³ the court held even if “an agent represents that he or she is knowledgeable about insurance coverages, and regularly in the course of his or her business, informs, counsels, and advises cus-

79. *Id.* at *24.

80. 2016 WL 2744958 (M.D. Fla. May 11, 2016).

81. *Id.* at *13–14.

82. *Id.* at *14.

83. 2016 WL 1697861 (D. Colo. Apr. 28, 2016).

tomers about their insurance needs, the agent has not [necessarily] triggered a special relationship and assumed a heightened duty of care to the insured.”⁸⁴ As such, the court found that although the plaintiff alleged the broker “held himself out as an insurance expert and advised [plaintiff] on a number of matters related to its insurance needs, these allegations are indistinguishable from facts Colorado courts have previously deemed insufficient to substantiate the ‘special relationship’ that triggers a heightened duty of care.”⁸⁵

Also of some hope to agents and brokers is the Eastern District of Kentucky’s decision in *Hammond Transportation, Inc. v. Cottingham & Butler Insurance Services*.⁸⁶ Here, the court granted summary judgment against a plaintiff-insured, holding an insurance broker and the brokerage he worked for were not liable for alleged negligent failure to advise because the plaintiff could not meet its burden of proving that the agent/agency either assumed or impliedly assumed a duty to advise. In finding no duty to advise had been established, the court found that although the payment of a fee beyond a premium *may* indicate an insurance broker impliedly assumed a duty to advise, it is not dispositive.⁸⁷ Indeed, the court held the nature of the fee must be scrutinized and nothing about the fee in the *Hammond* case suggested that the broker or brokerage assumed such a duty.⁸⁸ The court in *Hammond* also looked at the parties’ course of dealing over an extended period of time to determine whether an “objectively reasonable insurance agent [would be put] on notice that his advice [was] being sought and relied on,” or whether the insured made an express request for advice.⁸⁹ The *Hammond* court found that a request for the “best policy,” did not, however, meet its standards to impose the heightened duty to advise.⁹⁰

B. “Duty to Read”

Notably, contributory negligence on the part of the insured, including the failure to read its policy in a timely fashion, can still provide the basis for a complete defense to a negligent procurement case in certain jurisdictions. As a prominent example, in *Liberty Corporate Capital Ltd. v. Club Exclusive, Inc.*,⁹¹ the court reaffirmed the rule in Alabama that contributory negligence on the part of an insured is a complete defense to a negligent failure

84. *Id.* at *4 (citations omitted).

85. *Id.* at *5.

86. 2016 WL 1255718 (E.D. Ky. Mar. 29, 2016).

87. *Id.* at *8.

88. *Id.*

89. *Id.*

90. *Id.* at *9.

91. 2016 WL 6157772 (N.D. Ala. Oct. 24, 2016).

to procure claim. In doing so, the court dismissed the insured's claim because the insured had failed to read its policy.⁹²

The "duty to read" is not always an absolute bar, however. For example, in *Scottsdale Inc. Co. v. Lakeside Community Committee*,⁹³ the court analyzed the interplay between the "duty to read" and the statute of limitations, revived a claim that had been dismissed on timeliness grounds, and dramatically limited the use of the "duty to read" as a basis to contend that a negligent failure to procure claim accrues at the time the deficient policy was issued. In this case, a child whose visits by her mother were being monitored by the Lakeside Community Committee due to the mother's past physical abuse, was killed as a result of internal injuries caused by blunt force trauma while on an unsupervised visit. A Lakeside case worker failed to respond to the mother's advice that the child had a bruise on her stomach and had been crying through the night, failing either to visit to check on her, or instruct the mother to take the child to a seek immediate medical treatment. Lakeside subsequently settled claims of negligence by the Department of Children and Family Services, the appointed guardian for the child (for \$3.5 million), but was found to have no coverage for the settlement because its general liability policy provided no coverage for physical and sexual abuse claims.⁹⁴

Lakeside contended the lack of coverage for the claim was the result of its insurance broker's negligence in procuring a policy that erroneously described Lakeside as a "halfway house" and which contained an endorsement that only referenced physical and sexual abuse by Lakeside employees and denied coverage for same.⁹⁵ Moving to dismiss, the broker argued that the policy in question had been issued more than two years before the lawsuit had been commenced, Lakeside had a duty to read its policy, and its claim for negligent procurement/and breach of contract accrued upon receipt, and the claims were barred by the statute of limitations.⁹⁶ In short, the broker contended that because Lakeside had a duty to read the policy, it was put on notice of the deficiency of the coverage when the policy was issued.⁹⁷

The trial court granted the motion, but the appellate court reversed and reinstated Lakeside's claims. In reversing, the appellate court held that while the two-year statute of limitations applied, the claim did not accrue until coverage was denied. Because the claims against the broker had been brought within three months of denial of the insurance claim, the

92. *Id.* at *2.

93. 2016 Ill. App. LEXIS 748 (Ill. Ct. App. Nov. 1, 2016).

94. *Id.* at *3.

95. *Id.* at *8.

96. *Id.* at *15-16.

97. *Id.*

claims were timely.⁹⁸ Addressing the broker's argument that Lakeside should have been aware of the deficiency of the coverage when the policy was issued, the appellate court concluded this would place too heavy a burden on insureds because, even had representatives of Lakeside read the policy, "they would not know in advance that a claim involving the murder of a child in DFCS custody was not covered until the claim was denied."⁹⁹

C. Ripeness

In contrast with accrual issues, ripeness can also be an issue at the outset of an agent/broker E&O litigation. In *Witkin Design Group, Inc. v. Travelers Property Casualty Co. of America*,¹⁰⁰ the court held the plaintiff's claims against his insurance broker for negligent procurement were not ripe for adjudication when there was an open and unresolved insurance coverage dispute between the insured-client and the insurer.¹⁰¹ The court noted that settled authority in Florida required the claims against the broker to be dismissed (without prejudice) rather than stayed pending the outcome of the underlying insurance coverage action.¹⁰²

In contrast, the Southern District of Alabama refused to dismiss a lawsuit against an insurance broker during the pendency of a underlying insurance coverage lawsuit. In *Georgia-Pacific Consumer Products LP v. Zurich American Insurance Co.*,¹⁰³ the court relied on the timing of when the claims against the insurance broker accrued. The court acknowledged that under Florida law (i.e., *Witkin's* predecessors), a cause of action against an insurance broker for negligent failure to procure insurance accrues when the client incurs damages at the conclusion of the related or underlying insurance coverage proceeding.¹⁰⁴ However, under Alabama law, an insured-client's claims against a broker accrue when the insurer denies coverage.¹⁰⁵

D. Proving Damages

Once a negligent procurement case proceeds, the crucial inquiry shifts to how to calculate and prove the damages that the policyholder suffered as a result of the broker or agent obtaining an unsatisfactory policy on the insured's behalf. A Florida court recently considered the question in *Gelsomino v. Ace American Insurance Co.*¹⁰⁶ and concluded that the insured sat-

98. *Id.* at *19.

99. *Id.* at *19–20.

100. 2016 WL 1572964 (S.D. Fla. Apr. 18, 2016).

101. *Id.* at *2.

102. *Id.* at *3.

103. 2016 WL 1659915 (S.D. Ala. Apr. 25, 2016).

104. *Id.* at *1.

105. *Id.*

106. 2016 WL 6612645 (Fla. Dist. Ct. App. Nov. 9, 2016).

isfied his burden of proof on damages by introducing into evidence the insurance policy that would have covered him but for the fact that the insurance broker procured it for the wrong entity, and the lost wages and past and future medical expenses for which he sought coverage.¹⁰⁷ In reaching this decision, the court reversed a trial court decision setting aside a directed verdict finding a broker partially at fault for failing to obtain coverage protecting the plaintiff against work related injuries sustained while he was working on behalf of a company he and his brother owned that had been incorporated in the Bahamas.¹⁰⁸ Although the plaintiff had arguably failed to prove specifically what would have been covered had the proper insurance been obtained, the appellate court found his proof that he suffered damages that would have been covered had the proper policy been purchased and introduction of the proper policy into evidence was sufficient.¹⁰⁹

E. *Economic Loss Rule*

The calculation of the insured's damages may be further curtailed by application of the economic loss rule in some jurisdictions. In general terms, the economic loss rule provides that a party who suffers only economic harm may recover damages for that harm based on a contract based claim, but not under a tort theory. The application of this rule as a defense to agent and broker E&O claims has become more and more limited nationally, as two recent federal court decisions evidence.

In *Phoenix Packaging Operations, LLC v. M&O Agencies, Inc.*,¹¹⁰ the Western District of Virginia held the "economic loss rule leaves open the possibility of recovering economic damages through a negligence claim . . . , [but only w]here the parties are in contractual privity and their relationship gives rise to duties not imposed by the explicit terms of the contract but by common law."¹¹¹ In reaching this decision, the court confirmed that "professional negligence" claims against an insurance broker or third-party administrator are contract claims for which only ordinary "contractual damages" and *not* punitive damages may be available.¹¹² In *PRMConnect, Inc. v. Drumm*,¹¹³ the federal court for the Northern District of Illinois went a step further and held that the economic loss rule, known as the Moorman Doctrine in Illinois, does not

107. *Id.* at *4.

108. *Id.*

109. *Id.*

110. 2016 WL 3181172 (W.D. Va. June 3, 2016).

111. *Id.* at *5.

112. *Id.* at *6.

113. 2016 WL 3014814 (N.D. Ill. May 26, 2016).

to apply to extra-contractual claims that a client (as opposed to any other third party) brings against an insurance agent or broker.¹¹⁴

F. *Personal Liability of Owner for Conduct in Capacity as Broker Employee*

Lastly, courts this year addressed the question of when an owner of an incorporated insurance brokerage can be sued personally for alleged negligence occurring in his performance of his duties as an employee of the company. In *JT Queens Carwash, Inc. v. JDW & Associates, Inc.*,¹¹⁵ the court concluded that personal liability depended on whether and the extent to which the owner/ employee had personally “engaged in independent tortious conduct that could give rise to his personal liability” separate and apart from any torts alleged against his agency.¹¹⁶ There, the plaintiff asserted claims against insurance broker JDW & Associates, Inc. and its owner, Jay Weiss, on the theory that they had negligently failed to procure general liability insurance naming a carwash business’s landlord as an additional insured.¹¹⁷ The trial court dismissed all of the claims against Weiss individually.¹¹⁸ However, on appeal the appellate court reinstated the negligent misrepresentation claim against Weiss. In so doing, it concluded the allegation that he had personally signed a certificate of insurance falsely stating that the carwash business’s landlord had been added as an additional insured sufficiently alleged “his personal participation in the commission of a tort” and gave rise to potential personal liability on his part.¹¹⁹

G. *Conclusion*

As the broker and agent case law in 2016 continues to evidence, the ability to successfully resolve a failure to advise claim on a dispositive motion keeps getting more difficult with each passing year. This makes awareness of the various alternative defense theories all the more important and a critical part of the agent/broker E&O defense lawyer’s arsenal going forward.

114. *Id.* at *5 (citing *Country Mut. Ins. Co. v. Carr*, 852 N.E.2d 907, 915–16 (Ill. App. Ct. 2006), *vacated on other grounds, In re Country Mut. Ins. Co.*, 889 N.E.2d 209 (Ill. 2007)).

115. 144 A.D.3d 750 (N.Y. App. Div. 2016).

116. *Id.* at *3.

117. *Id.* at *4.

118. *Id.*

119. *Id.* at *3.