Inside an Agent Errors and Omissions Claim on a Business Income Loss

I serve as an expert witness on insurance agent errors and omissions (E&O) claims—on both sides. In one such case, it was alleged that the agent and his agency had breached the standard of care in the placement of business income/extra expense insurance for a popular restaurant in a trendy resort area. My own investigation led me to conclude that the agent had breached the standard of care for an agent in his state.

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October 2021

The ramifications were disastrous. The agency's E&O insurer paid out a six-figure settlement as a result of the agent's breach. The agency lost its client, and its reputation was damaged in the region.

This article describes the mistakes I believe were made. Excerpts from my opinion report are included. The goal of this real-life example is to clarify some of the complex business income/extra expense insurance issues and help agents avoid the same mistakes.[1]

Just the Facts

Pursall's, a popular family-owned restaurant, has its peak season in March through September. On March 7, 2019, there was a fire at Pursall's that caused substantial damage, resulting in its closure until October 15, 2019—the entire busy season.

For decades, the Rapert Insurance Agency insured both Pursall's and Pursall's landlord, Curtis Martin. The producer on the account was Charles Miller, who had been the agent on the account since 2015. Jason Grantly was the family member who managed the insurance for Pursall's since 2016.

Mr. Miller had recommended to Pursall's that they purchase $1.5 million of business income/extra expense (BI/EE) coverage with an 80 percent coinsurance clause, which they did. He also sold Mr. Martin (the landlord) a $140,000 loss of rents policy that was designed to reimburse Mr. Martin for the loss of Pursall's rent if Pursall's had a business income claim. The policy was written in Mr. Martin's name, but Pursall's paid the premium.

During the claims adjustment process, it was determined that Pursall's $1.5 million BI/EE limit was grossly inadequate to pay its loss. It was even inadequate to meet the coinsurance requirement of the policy. It was also determined that the policy Mr. Miller sold to Mr. Martin was improperly written and would not reimburse Mr. Martin for his loss of rent. As a result, Pursall's had to continue to pay its rent out of its already inadequate insurance proceeds.

Opinions from My Report

Following are opinions from my report, which state why I believed that the agent had breached the standard of care for an agent in his state.

The Standard of Care for Insurance Agents in the Rapert Agency's State

The standard of care for insurance agents varies from state to state. In the Rapert Agency's state, insurance agents must exercise good faith, reasonable skill, care, and diligence when placing insurance. (This standard of care is typical of many states in the United States.)

Further, if due to the agent's fault or neglect, the insurance procured is not what was requested by the insured, is materially deficient, or does not provide the coverage that the agent represented it would, the agent may be held responsible. While, generally, an agent does not have a duty to advise its insureds about the types or amounts of coverage they should carry, a duty may be created when the agent expressly undertakes to advise the insured on these matters. It may also be created when there is a course of dealing over an extended period of time that would put an objectively reasonable insurance agent on notice that his advice was being sought or relied on.

The remainder of this article addresses the duties owed by Mr. Miller, as illustrated by excerpts from the testimony that was given in the case.

Of course, Mr. Miller owed the general standard of care to Pursall's. The question addressed in the first opinion is whether, through the course of his actions, he had created a duty to advise Pursall's about its insurance coverage.

Mr. Miller had a duty to advise Pursall's about its insurance coverage. Pursall's had a long-term relationship with the Rapert Agency in which the insured relied upon Mr. Miller for advice on its insurance coverage and Mr. Miller had accepted responsibility to provide that advice.

EXCERPTS FROM STATEMENTS BY THE INSURED, AGENT, AND AGENCY

Insured: On October 24 and 28, 2019, I had telephone conversations with Jason Grantley in which I had the opportunity to ask him several questions, which had not been fully addressed in his deposition. In those conversations, Mr. Grantley described their restaurant's relationship with the Rapert Agency as follows (not a verbatim quote): *They had handled our policy since we had been in business. They had been our agent 20 years ago when we had a fire. There were no issues with that claim. We believed we could trust the agency to cover us properly, and we relied on them to tell us what we needed. We gave Charles the information on the worksheet he provided, and he told us what limit of insurance we should buy.*

Agent: In his deposition, Mr. Miller characterized his responsibility to his insureds as being one in which he invited them to rely on his advice, and he expressly undertook to advise his insureds so that they would have the correct coverage in place.

Policyholder's Attorney:

Q: What was the purpose of that business income worksheet?

A: To help establish a business income limit. To gather information as far as expenses, cost of goods sold, sales, et cetera.

Q: Do you see, as part of your responsibility to insure or make sure that your client has correct coverage in place?

A: Definitely.

Q: To articulate risks that you see to your client?

A: Yes, sir.

Q: To advise of the nature of those risks?

A: Yes.

Q: You see that as your responsibility?

A: Yes.

Q: Do you see yourself as a partner with your client?

A: I do. I mean, I prided myself on establishing a good relationship with my clients and trying to make sure they were insured properly and offering the best possible service I could.

Q: So it is fair to say you saw yourself as an adviser as to insurance for your clients?

A: Yes.

The Agency: What the insured relied on and the agent prided himself on was perfectly in line with what the agency said on its website on March 30, 2018, as Mr. Miller was preparing for the May 15, 2018, renewal.

> Restaurant Insurance—Let's serve up complete protection for your business, your reputation and your livelihood. You prepare your specialties—we'll prepare the protection.... Our agents will help you develop a program that protects against fire, windstorm, and other property losses, covers your liability in the event of lawsuits for injury, and protects you from other events that could disrupt your business.

Mr. Miller breached the standard of care by failing to use reasonable skill, care, and diligence in the sale of business income insurance for Pursall's. Mr. Miller should have known that the type of business income policy sold to Pursall's included all of the payroll expenses as ongoing expenses for the purpose

of applying the coinsurance penalty. He should have known that an endorsement must be added to the policy if the insured wants to exclude all or part of the payroll from the calculations.

In his deposition, Mr. Miller testified that he believed the policy automatically excluded "ordinary payroll." He stated that he had instructed Mr. Grantley not to include it in determining how much insurance he needed to purchase. However, he had not endorsed the policy to exclude ordinary payroll because he believed the policy had already excluded it. Unfortunately, he was incorrect.

The endorsement used to limit or exclude payroll expense from a policy's coinsurance calculation is the Payroll Limitation or Exclusion (CP 15 10) endorsement. Throughout the claim process, Mr. Miller insisted the endorsement was not necessary. This continued until Pursall's attorney actually read him the business income calculation provisions in the policy. Following is the testimony at that point.

EXCERPTS FROM THE AGENT'S TESTIMONY

Policyholder's Attorney:

Q: Under the provision for determining what expenses will be deducted for the purpose of applying the Coinsurance condition, in items (11) it lists all payroll expenses or the amount of payroll expense excluded, and again, if form CP 15 10 is attached.

A: Correct. I see that.

Q: Okay. Have you ever read that before?

A: I may have—no.

Q: Would you agree that this is the policy that you sold to Pursall?

A: Correct.

Q: On the declarations page, you see business income is set at $1.5 million?

A: Correct.

Q: Now, reading what you've just read in the coinsurance penalty, does it change your understanding of how coinsurance is calculated?

A: Yes. The way that reads, I guess ordinary payroll should be included.

Q: And if that's the case, was your recommendation of $1.5 million enough for Pursall?

A: As discussed with the insured, they agreed that $1.5 million was enough.

Q: Is it fair to say that they relied on your advice in that?

A: Yes. I guess it's safe to say.

Q: If you had a misunderstanding as to how the coinsurance penalty was applied, is it fair to say they relied on that misunderstanding?

A: Yes, sir.

If reasonable skill and care were used, the agent would have known that the type of simplified business income worksheet Mr. Grantley was asked to complete in preparation for the May 15, 2016, renewal was inappropriate for a business income policy written with a coinsurance clause. When a business income policy is written with a coinsurance clause, the policy provisions severely limit the items that can be excluded from ongoing expenses when calculating how much insurance must be carried to satisfy the coinsurance clause. Surprisingly for a restaurant, things like rent, electricity, janitorial services, and the cost of live entertainment were not listed. These must be included as continuing expenses whether the restaurant believes they will continue or not.

To assist insureds with properly estimating the correct amount of insurance to carry for a coinsurance policy, the Insurance Services Office, Inc. (ISO), has published a special form for the purpose, the Business Income Report/Worksheet (CP 15 15 10 12). Mr. Miller did not provide Mr. Grantley with that form but instead provided him with a simplified form that did not mention the policy restrictions. That form asked him to estimate "continuing expenses." Unfortunately, because he did not know better, he followed his own judgment, which did not in all cases follow the terms of the insurance policy. Mr. Miller was not aware that the simplified business income worksheet he provided to Mr. Grantley was inappropriate for a policy written with a coinsurance clause and that using it would result in underestimating the amount of insurance needed.

If he had been using reasonable skill and care, Mr. Miller would have known that the policy he had written to cover Pursall's base rent would not respond to Pursall's loss due to the terms of its lease. He should also have understood that the proper way to insure Pursall's lease obligations with Mr. Martin was to insure it under Pursall's own policy with the proper landlord endorsement.

Pursall's rent included both a fixed base rent amount and an additional amount based on a percentage of revenue. The lease required Pursall's to continue to pay the base rent for 12 months, even if the building was unusable due to an insured loss, and buy insurance to cover that obligation.

Mr. Miller was the insurance agent for Mr. Martin as well. He wrote Mr. Martin's policy to include $140,000 of rent coverage. While it was written in Mr. Martin's name, it was paid for by Pursall's with the intent that if Pursall's was closed as a result of a covered loss, Mr. Martin's policy would pay for Pursall's

base rent obligation.

Unfortunately, Mr. Martin's policy did not respond as Mr. Miller had represented. Pursall's lease required them to continue to pay the base rent even though they were shut down due to a covered loss. Rather than breach their lease, Pursall's paid the base rent as required. Since Pursall's was not an insured under Mr. Martin's policy, the insurance company did not reimburse them for their loss.

If the lease had not required Pursall's to pay the base rent during the time the building was untenantable, then Pursall's would not have paid the base rent, and the Martin policy would have paid up to $140,000 for Mr. Martin's loss. But Mr. Miller testified that he never reviewed the lease to determine if the coverage he was selling responded to the requirements of the lease. Even at the time of his deposition, 16 months after the loss, he had not bothered to determine why Mr. Martin's policy had not responded in the way he had represented. Following is the discussion on that point.

EXCERPTS FROM THE AGENT'S TESTIMONY

Policyholder's Attorney:

Q: Did you ever review the lease between Mr. Martin and Pursall before issuing the policy?

A: No.

Q: No?

A: No.

Q: Do you know whether the failure for the loss of rent to be triggered was based on the language of the lease?

A: I cannot say. I don't know.

Q: Would the language of the lease have any effect on whether insurance policy may be triggered?

A: I don't know, to be honest. It's more of a claims question.

Mr. Miller did not understand that the correct way to insure this risk was to include the amount of the base rent in Pursall's business income policy. Because the base rent was an ongoing expense, their policy would have paid it (assuming they had adequate limits, etc.). The policy should also have been

endorsed with the Business Income—Landlord as Additional Insured (Rental Value) (CP 15 03) endorsement, which would have named Mr. Martin as an additional insured under Pursall's policy but limited what he could collect to what was required by the lease.

Even if all of the other errors would have occurred, if Mr. Miller had added the $140,000 in rent coverage to Pursall's policy instead of to Mr. Martin's policy, it would have bumped up their limit by that amount. As it was, for many years, they paid premiums on Mr. Martin's policy that provided them with only illusory coverage.[2]

Mr. Miller breached the standard of care by failing to advise Pursall's that to maintain proper limits it needed to complete the worksheet every year. From the record, it appears that the last worksheet completed for Pursall's was the inadequate one completed in 2016; no worksheets were prepared in the years afterward. If those worksheets had been completed on the proper forms and had contained accurate estimates, they would have reflected that Pursall's needed to purchase substantially more business income insurance to avoid a coinsurance penalty.

Mr. Miller also breached his duty to advise by not informing Pursall's that if it completed the proper worksheet, its insurer would probably delete the coinsurance clause for an additional 10 percent of the business income premium. Because of the painful consequences of a coinsurance penalty and the inherent difficulty of accurately forecasting future financial results, an agent with a duty to advise should generally advise clients that it is wise to purchase the coinsurance waiver. If the proper amount of insurance had been carried in the 2018/19 year to begin with, I believe the additional premium to add the coinsurance waiver would have been approximately $1,400.

It is my opinion that if Mr. Miller had met with Pursall's prior to the May 15, 2018, renewal and properly prepared the business income worksheet, Pursall's would have had $2,064,000 of coverage available for its business income loss, resulting in a payment of $2,064,000 rather than $1,286,145—providing an additional $834,255 in coverage.[3]

Lessons To Be Learned from this Case

Here are key takeaways I gleaned from this case.

There is no substitute for understanding the insurance policies you are selling. I came away from this case convinced that Mr. Miller was a sincere, well-intentioned agent who wanted to do the best for his insureds. Most of the problems were caused by him simply not understanding the insurance policies he was selling.

One of the nation's leading E&O insurers states that an increasing share of claims are caused by this very problem—agents don't have an accurate understanding of what they are selling. As an agent, what can you do to increase your knowledge of the legal contracts you are selling? What can your agency do to encourage excellence in product knowledge?

Don't use a simplified business income worksheet if you are writing a business income policy with a coinsurance clause. When a business income coinsurance form is being sold, it is essential to use ISO's Business Income Report/Worksheet (CP 15 15 10 12) or another form with the same questions. Unfortunately, few agents or policyholders have the accounting knowledge necessary to complete that form. I have found that asking the insured to have their accountant complete the form is often the best strategy. If a simplified worksheet is all that the agent can have completed, then they would be wise to stick to a business income policy written on a monthly limitation basis, even though the premium will be higher.

When you have a duty to advise your clients about their coverages, regular reviews of their situation are indispensable. How could Mr. Miller hope to keep Pursall's business income insurance limits up to date without having them complete a new worksheet every year? How could he hope to provide accurate advice on insuring their lease obligation without reading the lease?

Agents who understand the ins and outs of the coverages they sell and do regular reviews of their clients' needs sell more insurance. In Mr. Miller's case, if he had done what I believe he was professionally responsible to do in this situation, Pursall's would likely have followed his recommendation and increased their business income insurance by 25 percent. He very possibly would have kept Pursall's as a client for many years to come.

It still pays to have good intentions and be likable. The policyholder's attorney originally intended to seek punitive damages in this case because he believed he could show gross negligence on Mr. Miller's part. But after he deposed Mr. Miller, he gave up that thought. Why? Because Mr. Miller came across as a sincere, likable agent who really did want the best for his insured. The policyholder's attorney concluded that no jury would have the heart to punish this agent who may not have been as competent as needed but who certainly had not acted maliciously.

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[1] All names, locations, and dates used in this article have been changed to protect the privacy of the parties involved.

[2] *Note:* In circumstances in which the agent does not have a duty to advise the client, it could be argued that the agent does not have a duty to read the insured's lease and to seek to meet its requirements unless the agent has agreed to do so. However, as has already been addressed, Mr. Miller did have a duty to advise Pursall's. It should also be noted that agents are not attorneys and would be wise to recommend to their insureds that they consult with an attorney for a legal opinion on the requirements of any lease or other contract. Otherwise, the agent may be accused of engaging in the unauthorized practice of law.

[3] In my report, I elaborated my reasons and calculations on this point with material that is too detailed for this article.

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