

Errors & Omissions Insurance

An Ounce Of Prevention Is Worth A Pound Of Cure

By: Robert S. Kutner, Esq.

Despite the explosion of claims for violation of the Consumer Protection Act, General Laws Chapter 93A, it is surprising how many real estate offices are operating without any professional liability errors & omissions insurance, commonly known as "E&O Insurance." The failure of many offices to obtain such insurance reflects both a misunderstanding of the scope of protection afforded and a naivete concerning the risk of suit. During the past decade even the most conscientious brokers have found themselves targets of claims by consumers. While the neighboring state of Rhode Island (one of five states nationally) requires all real estate agents to purchase E&O insurance, Massachusetts does not. Here's what you need to know in deciding what is of value and importance to you.

What Does E&O Cover?

E&O insurance is simply malpractice insurance for real estate agents. From my experience in representing brokers in upwards of 500 claims, typical claims seek damages of \$ 10,000 to \$30,000. Statistics gathered by the National Association of REALTORS® indicate that nationally more than two-thirds of the claims involve the condition of a property. Primary are claims alleging misrepresentation, (57 percent) followed by alleged nondisclosure of defects at 12 percent. Less frequently, claims are asserted for breach of fiduciary duty (10 percent), transactional processing issues (7 percent), property management (5 percent) and negligent referral (4 percent).

As buyers pay higher prices for homes, they are more prone to expect perfection. Matters that frequently give rise to claims for misrepresentation or nondisclosure include: (1) water penetration into the basement; (2) prior septic system problems (regardless of passing a Title 5 inspection); (3) roof leaks; or (4) past termite or carpenter ant infestation. Defects in a property are generally matters about which the listing broker will have little information, except what the broker is told by the seller(s). Fortunately, lack of actual knowledge of a defect is usually a good defense to a claim for nondisclosure and reasonable reliance on a seller is usually a good defense to a claim for misrepresentation. Regardless of the strength of one's defenses, such claims are draining financially, emotionally and timewise. It often takes more than a year to resolve a claim. While E&O insurance is not absolute protection, coverage can make it far easier to sleep.

Policies generally provide coverage limits of \$250,000 to \$1 million, but different limits are available. Policies authorize the carrier to hire an attorney to defend the broker and often contain deductibles of \$1,000 to \$5,000 that apply to: (1) defense costs; (2) settlement payments or judgments; or (3) both. Rarely do lawsuits reach trial, since the cost of having attorneys prepare for trial in a \$ 10,000 to \$30,000 case makes little economic sense. Between dismissals without payment and settlements, more than 95 percent of such claims are resolved without trial.

Exclusions Are Crucial

When examining any E&O policy, understanding the extent of coverage and what matters are excluded is crucial. Unlike aspirin, all E&O policies are not alike! Express exclusions sometimes provide that E&O policies will not cover agents for claims seeking recovery for: bodily injuries; operation of a motor vehicle; acts of unlawful discrimination; management of properties (as opposed to sale or lease of properties); pollution and toxic waste; intentional fraud or criminal conduct; and for punitive damages. However, the actual exclusions differ from one policy to another. Because bodily injury claims are generally excluded from E&O policies, a separate comprehensive general liability (businessowner's) policy should be obtained.

There may be subtle, but significant limitations on the scope of coverage of E&O policies which relate to coverage for "prior acts." Most E&O policies provide coverage on a "claims made" basis, as opposed to providing coverage on an "occurrence" basis. Only claims made during the policy period (one year) will be covered, regardless of when the injury to the homebuyer occurred. However, policies will differ significantly as to the extent they will cover "prior acts."

For example, a buyer may file a lawsuit alleging that the broker failed to disclose a water problem in the basement. Suppose the sale occurred in June 1997, but the buyer did not discover the defect until April 1998. Suppose further that the broker had no knowledge of the buyer's claim until receiving a Chapter 93A demand letter in July 1999. The claim was "made" in July 1999. Only if the broker has an E&O policy in effect at that time will there be coverage on a "claims made" basis. However, even that coverage will disappear unless the policy covers "prior acts" which occurred more than two years earlier. Some E&O carriers will allow brokers to pay an extra premium to purchase additional years of "prior acts" coverage. Others make such coverage dependent upon the broker having been continuously insured on a "claims made" basis. Still others will not cover prior acts. Because of the risk of no coverage for prior acts, extreme care should be taken when changing carriers to make sure that there is no lapse in coverage. The statute of limitations for violations of Chapter 93A is typically four years.

Choosing A Carrier

When choosing a carrier the annual premium and deductible are merely two of the factors that should be considered. What is the financial viability of the company? Ratings of insurance companies should be examined through such services as Best's Directory. The A.M. Best Company can be accessed on the Internet at their web site, www.ambest.com/rating.html.

Some carriers offer coverage for claims involving agents who have sold their own homes. Other carriers offer riders to provide coverage for environmental pollution on properties as well as for discrimination claims. Most attorneys recommend obtaining optional discrimination or civil rights coverage even though only defense costs are covered. The limitation to defense costs is that it is viewed as against public policy to insure a person against discrimination. For similar reasons most policies will not afford protection against intentional wrongdoing or punitive damage (double or treble) awards under Chapter 93A.

Among the carriers that currently provide coverage in Massachusetts are CNA, Lancer Claims Service (Fireman's Fund), Safeco Insurance and CRES Insurance Services. My office, Casner & Edwards, LLP, is privileged to have been approved as panel counsel for each of these carriers. Safeco has been endorsed by NAR for 2000.

EDITOR'S NOTE: For more information on E&O insurance, read the MAR-prepared brochure, A REALTORS® Guide to E&O Insurance, available from MAR.

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