Lowenstein Sandler's Insurance Recovery Podcast: Don't Take No For An Answer

Episode 79:
Insurance Coverage for Harvard's SCOTUS Affirmative Action: Broker Malpractice as the Next Chapter in the Coverage Playbook

By Lynda Bennett and Eric Jesse
DECEMBER 2023

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Lynda Bennett: Welcome to, Don't Take No For An Answer. I'm your host, Lynda Bennett, and I am very pleased to be joined today by my partner in crime, my partner in my practice group, and my co-host, Eric Jesse. Good to see you again, Eric.

Eric Jesse: Hey, Lynda. How's it going?

Lynda Bennett: All right. Well, today, we're going to discuss an insurance coverage issue that's been widely reported on in the news.

Eric Jesse: Yeah, it really does exist, doesn't it?

Lynda Bennett: Yeah. Well, this is one where us insurance geeks are going to be able to connect with our audience because I'm sure that they've heard about this case that's been reported in the news widely. So to set the table, what we're going to talk about today is a coverage issue that starts with a recent United States Supreme Court case, the Harvard Affirmative Action Case, that the Supremes decided back in June. Remember that?

Eric Jesse: Yes, I do. It was definitely in the news.

Lynda Bennett: We know we made it when it was discussed in the USA Today, right? So it turns out that there's an insurance coverage issue that came out of that U.S. Supreme Court case, or at least there should be coverage for that. So Eric, why don't you just give us an overview of what happened here?

Eric Jesse: Yeah, so Harvard was sued over their Affirmative Action program back in 2014. And so Harvard gets sued and, what do they do? They reach out to their insurance broker and they tell the broker, "Hey, you need to report this claim to AIG." And I just want to emphasize AIG, who was Harvard's primary errors and omissions insurer, and that policy had $25 million in limits. And it turns out that AIG agreed to cover Harvard's defense costs. You fast-forward

a few years, it also turns out that Harvard had excess insurance above this AIG policy. And so Lynda, I'm sure, as you can imagine, taking a case all the way to the United States Supreme Court. And oh, by the way, there's another Department of Justice investigation that's related that's going on.

Lynda Bennett: Cha-ching, cha-ching.

Eric Jesse: Exactly. It's a little expensive. And so as those defense costs mount, Harvard goes to their broker, Marsh, and says, "Hey, should we give Zurich," Zurich's the excess carrier here right above the AIG policy, "should we be giving Zurich an update about the case?"

Lynda Bennett: And let me guess, no one told the excess insurer about the claim when it was first presented, and I don't know, the policy period is now expired?

Eric Jesse: You must have seen this movie before because exactly right. So they go to Zurich, they present the claim, and what does Zurich do? They deny coverage solely because the notice was late. And so what happens is, the first chapter in the story was Harvard sues Zurich for coverage saying that their late notice should be excused. That case went up to the First Circuit Court of Appeals and Harvard lost. And so that's the end of that chapter. But, Lynda, since you've read this book before, what's the next move?

Lynda Bennett: Sure thing, Eric. I've read this book a few times before, and what happens next is the broker may slot into the position of providing the insurance coverage that should have been provided, but for the broker having a misstep, right?

Eric Jesse: Right. So Harvard has now filed a lawsuit against its insurance broker saying, "You guys messed up and I didn't get the coverage and so now you have to step in and be my insurance company."

Lynda Bennett: And this is a case that our audience really should keep track of. We're joking around a bit, but this is something that happens all the time where, in the first instance, you have to take this all the way to the mat. You have to put the insurer to their paces. You got to see whether that denial is actually going to be held up in court. And it really is only at that point in time that the claim that you have potentially against your insurance broker ripens. But, Eric, before we dive too deep into the meat and potatoes of the broker malpractice claim, let's talk about some of the things that could have, should have, would have been done here in Harvard's case where they wouldn't find themselves in this position. So what was really the first thing that should have been done back in 2014 when that affirmative class action case got filed?

Eric Jesse: Yes, it's one of our mantras in general here on *Don't Take No*, "notice, notice, notice". And it's not just notice to one carrier, it's notice to all. You have to notify the entire tower because notice to one is not noticed to all. So that's first and foremost.

Lynda Bennett: And it matters and a lot of our listeners and a lot of our clients don't understand the intricacies of the policies and how a tower of insurance works. And they think, well, for right now, I don't think that this is going to get

out of my 25 million primary layer. Why would I have to notice all the way up the tower? And this case really is a classic example of, play the long game, play the worst case scenario game so that those excess carriers are in the loop right away so you don't lose coverage as Harvard did here with their excess carrier. And, Eric, I want you to talk a little bit about, what are some of the reasons that clients are resistant to putting the whole tower on notice day one when the claim comes in?

Eric Jesse: Yeah, I think the main reason, and it's not necessarily just the whole tower, sometimes we see it with a primary carrier where clients are just reluctant to provide notice because they don't think the limit, it's going to be an expensive claim or it's going to be within the retention number one. And they combine that with the fact that they're concerned that if they do provide notice it's going to be a black mark against them and the insurance company is going to take them through the ringer on renewal. And, look, if you put 10 claims in, that may be true, but if you put one claim in and it doesn't go anywhere, you shouldn't and probably won't be penalized for that. But if that claim does go sideways, does take that unexpected turn, that's why you have insurance. And so that's why you want to provide notice. And, again, to do it all the way up the tower because, those excess carriers, they're not going to penalize you too hard if they ultimately don't get hit when you're doing your renewal.

Lynda Bennett: And these claims made policies are pretty crystal clear. It's universal in claims-made policies, you are required in the year in which the claim gets made to put that carrier on notice. And even if their obligation to pay arises two or three or four or five years later, if you're an upper layer excess carrier, clients need to understand, policy holders need to understand, that hard and fast deadline of you got to give notice in this policy year is it's pretty serious. And as Harvard learned in this case, the consequences can be very severe if you blow it. So what are some things, Eric, that policy holders can do even before a claim gets in to soften this, what feels like a pretty Draconian result of a year late, but your policy wasn't even triggered yet? What are some of the things that policy holders can do to protect against that even before they get a claim?

Eric Jesse: These policies, in many cases, you can negotiate them and you can negotiate the terms of the notice provision and you can get terms and conditions that can relax the harshness of, you must provide notice during the policy period which the claim is made. So just to kind of run through a few things, and again, this is where policy holders need to be proactive and protect themselves because maybe their broker is looking for these terms, maybe they're not. And that's how we try and help our clients when we get involved because we go write some of the basic things, what we'll ask for and often we'll get is for example, a provision that says the insurance company cannot deny coverage on late notice grounds unless, and until they can show that they were materially prejudiced by the delayed notice. So in this case, if the prejudice concept applied in the Harvard case, it might be hard for Zurich to say, yeah, we're prejudice when our limits hadn't been reached yet. So that's one key provision.

Lynda Bennett: Another one is putting some language into your policy as to who has to know about the claim before you have to put the notice in. So putting something in there with the control group also, and Eric, you touched on it, we really

encourage policy holders to read their policies before they get a claim and see if they can't get an extended reporting period that would allow the window to provide notice of a claim to be held open a little bit longer. So we've kind of set the table here of just some of the best practices that could have avoided the situation that Harvard found itself in, in this case. But now let's take a little bit of a deeper dive into we've got this broker malpractice claim, let's start to break down the position. So what's Harvard's take on why they think their broker should now become responsible for the coverage that Zurich's not providing?

Eric Jesse: So yeah, what Harvard's saying is in reviewing their complaint that they filed, they admit that they told Marsh to notify AIG of this Affirmative Action lawsuit and Marsh did that. But what they're saying is, all right, Marsh needed to take the extra step. They're the insurance professional, they're the insurance expert. So they had an independent duty to realize that the claim needs to be reported up the tower, it should have known better. So that's Harvard's position.

Lynda Bennett: I'll assume the role of the broker here, and I'm going to counterbalance that to say it's nice that you think we needed to look ahead or do more than what you asked us to do Harvard, but you're pretty smart if you thought that this was going to require something more, you're pretty sophisticated. That was really on you Harvard to tell us exactly who you wanted notified or not, right? I mean, that's going to be a pretty clear and quick defense. Sorry that Marsh is going to put out there in response to this, right?

Eric Jesse: Yeah. And is I think you're going to have a fact dispute in that case because Marsh is saying, actually alluding to our conversation a few minutes ago about policyholders not necessarily wanting to report up the tower. They're saying Harvard told them not to report the claim up the tower. So Harvard says there's no proof of that, but we'll see how that pans out in litigation.

Lynda Bennett: So the broker's going to try to position this, listen, I was just an order taker. You gave me an order, I took it, I followed your order. That's the extent of my professional duty to you. And it sounds like you are saying, Harvard's going to take the position. No, we don't really know insurance. That's why we hired you Marsh to serve as our insurance broker. This is a pretty intricate area of the law, and we expect more than following orders from us when we don't really know the space, you do. So Eric, how's that going to tee up in the legal setting? What is the standard on that? Is it order taker, is it fiduciary? Is it something in between? How's that going to work out?

Eric Jesse: Right. So yeah, that's one of our themes here on Don't Take No, which is it's going to be the choice of law is going to matter here because there's not a uniform rule across the country. So there are many jurisdictions that have what we call that border taker standard, where the broker just has to do what the policyholder says. And so here Harvard said, tell AIG. And then they just followed that order and they notified AIG, and they stopped there. And then the other extreme, under New Jersey, for example, brokers are actually a fiduciary, so they have to take the affirmative step.

Here I think it would be clear in New Jersey if the broker was told, notify AIG. The broker also has to say, oh, and by the way, you want us to notify the whole tower too. Because they have that heightened responsibility in New Jersey and in other jurisdictions that follow a fiduciary standard, they have that heightened responsibility. So I look at this and I think, all right, this is from a coverage perspective, this is something that's pretty basic, like Marsh should have known or asked a question. It's not just following their orders on what policy to place, but this is one where I think it should have been a light lift. And we'll also just see how it pans out in Massachusetts because Massachusetts is the order taker state. So Harvard may have a high hurdle to overcome.

Lynda Bennett: Yeah, choice of law is so important, as you said, it's one of our really, our bedrock principles on Don't Take No For An Answer. And the choice of law issue also rears its head in another way, which is when does the statute of limitations begin to run on a broker malpractice claim? Right? So here the mistake we think happened in 2014 when the complaint first came in and only AIG was placed on notice and the excess carrier wasn't placed on notice and the lawsuit gets filed in 2023. That's going to be, I think another very interesting and important choice of law discussion because some jurisdictions start the clock from when the broker malpractice mistake was made, which could have been more than basically a decade ago now. And other jurisdictions will tie the start of the clock to when the carrier denied coverage or when a court ultimately determined that there could be no coverage.

So that's another really important issue when our listeners are confronting a broker malpractice claim. That's something you have to give careful consideration to as well. Where are you filing it? What are the issues where there may be differences in approach, in different jurisdictions? And as we also always like to point out when we talk about choice of law, also give consideration whether you're going to be able to talk out of both sides of your mouth and argue for the law in one jurisdiction to apply for one issue, and the law of another jurisdiction to apply for the other issue. So super important there as well.

Eric Jesse: Yeah. Well, and that's also just not the accrual date too. I mean, you ran through it all, but it's also just the period, because some states have two years, some have four years, some have six years. So all of that needs to be factored into the analysis you were just talking about.

Lynda Bennett: Yep. All right, so before we wrap up, let's just touch on what are the damages that are on the table now for, assuming that Harvard can establish that there was broker malpractice here? What are the damages that a broker's looking at in a situation like this?

Eric Jesse: Yeah, I think it's really two main categories. One is going to be the amount of lost coverage. So if notice was provided and Zurich should have funded X million dollars of defense costs, then Zurich is on the hook for those X million dollars. And here what we also had, as we alluded to, is Harvard fought the good fight against Zurich and tried to get Zurich to provide coverage and they

lost, but they incurred defense costs in that effort. And so those coverage counsel fees are part of Harvard's claim.

Lynda Bennett: Yeah, and one parting shot that I'm going to give on this is, I agree with everything that you said, but policyholders need to be really careful in their broker relationships because some brokers enter into master services agreements or brokerage agreements, and some of those agreements will place limits on the scope of the duties and the services that are being provided. Some of them place limits on how much they can be held liable for.

You and I have reviewed more than one of these broker services agreements where there's a cap on liability that's equal to what the broker was paid for, the services provided, which could be a couple hundred thousand dollars, whereas in this case, Harvard lost an entire policy limit based on the mistake that was made. So really have to encourage policy holders, our listeners to... This is another sort of get in front of it best practice, when you're entering into your broker relationship if there's going to be a written agreement... And I should also mention some of those also bake in choice of law and choice of venue provisions as well. So get in front of it and read those broker agreements very carefully because you can unwillingly really curtail or maybe even eliminate your ability to meaningfully recover from your broker when they make a mistake.

Eric Jesse: Yeah, absolutely. So one final question before we wrap, Lynda. So do you think Harvard Law School is going to invite us to teach an insurance law class?

Lynda Bennett: Oh, well, we're trying to help. I surely hope that they do. Great question and great discussion, Eric.

Eric Jesse: As always.

Lynda Bennett: Yep. And we'll see everybody next time.

Eric Jesse: Take care.

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