

Errors and Omissions Coverage: An Essential Element of Being an Agent

By John Dolgetta, Esq.

It is important for Realtors® to understand the fundamentals of Errors and Omissions Insurance coverage. Errors and omissions coverage, commonly known as E&O insurance, affords licensees and real estate brokerage firms protection against claims or lawsuits initiated by clients who feel that his or her agent failed to provide adequate services. Although most licensees have heard of E&O insurance, and in most instances have E&O coverage, very few actually review the specific terms of the policy to ensure that they are fully protected.

The Potential for a Lawsuit

In every real estate transaction there is the potential for a lawsuit. In an article authored by Barbara Nichols entitled “Don’t Get Sued by Uncle Joe!” (published on www.Realtor.org on August 1, 2006) several cases were highlighted explaining the pitfalls and risks that are inherent in the agent-client relationship. One case involved the representation of relatives (a nephew and his new wife) by a real estate agent, where the agent was not familiar with a specific residential neighborhood. The agent decided to represent the client anyway. The agent located a “wonderful” townhouse which the client ultimately purchased. Within a few months, the agent received a subpoena and was eventually sued, along with the seller and listing agent.

The agent was not aware that the development was previously involved in a lawsuit where the homeowners sued the builder “...to repair leaking windows, poor yard drainage and resulting mold problems.” That case was eventually settled but the builder never remedied the problems. Ms. Nichols correctly pointed out that if the agent would have simply referred her nephew to another sales associate, familiar with the area, the agent would have been able to warn him of the problem. While E&O insurance may, or may not, cover all situations, one fact remains, without such coverage in place an agent is exposed to personal liability.

Important Considerations Regarding E&O Insurance Coverage

There are many basic considerations that licensees need to make when choosing the right type of E&O coverage. Real estate licensees that have existing policies should review the policies in detail on an annual basis. New issues arise constantly, new fact patterns make their way through the court systems on a daily basis, existing laws are being amended and new legislation is being enacted. Some examples are the recently enacted Well Testing Law in Westchester County, the Home Equity Theft Prevention Act, smoke alarm and carbon monoxide detector requirements, issues involving Short Sales and many more.

It is also important to review who is covered under the E&O policy. Coverage does not extend to everyone that works for or is affiliated with a firm or a particular sales associate. It is important to determine whether the firm's employees are covered, whether coverage extends to sales associates that work as independent contractors and whether personal assistants are afforded protection. If they are not covered then they should be added as "additional insureds." Many firms and real estate licensees form limited liability entities, for purposes of protection and if the entity is not named as "additional insured" on the policy it will not be covered. In New York a salesperson can receive commissions in a corporate name or the name of a limited liability company. Liability, however, continues to be personal.

Be Wary of the "Exclusions" in E&O Coverage

While E&O policies cover failures of the real estate professional to provide adequate services, there are many exceptions that exist in the policy. These exceptions should be reviewed carefully. The NAR Risk Management Committee points out that some of these "exclusions" include claims arising out of personal injury, fraud, criminal activity, bankruptcy, mold and other environmental issues; employment related issues with the staff, discrimination, related business activities (e.g. property management, title insurance, property/casualty insurance or mortgage brokerage) and many more. It is important to understand that although many items may be initially excluded from coverage, the policyholder may request that these items be reinserted into the policy or additional endorsements covering these instances be included for an added premium. (See *"Real Estate E&O Insurance-Understanding the Basics,"* NAR Risk Management Committee, published in the *Letter of the Law*, 2003).

When Are You Covered And What Is A "Claims-Made" Policy versus an "Occurrence Based" Policy?

E&O policies usually are "claims-made" policies, which mean that the policy will provide coverage only for claims made during the policy period. Therefore, once the policy lapses or the real estate licensee moves to another brokerage firm, the real estate professional will not be protected unless there was a claim filed while the policy was in effect. Some policies may offer coverage for a specific, limited period of time after a policy has lapsed or terminated. NAR's Risk Management Committee further explains that "[o]ften there is a special provision dealing with coverage for claims which arise from events that occurred prior to the effective date of the policy." It is important to understand the exact time frames covered by the policy.

Another form of coverage is "occurrence based" policies which provide coverage for past transactions even if the real estate licensee moves on to another firm. The NAR Committee also points out that knowing the statute of limitations period can help determine by what length of time the policyholder should have the policy extended.

Basic Coverages, Deductibles and Expenses Relating to E&O Insurance

E&O insurance premiums are relatively expensive. In an article entitled “*For Brokers: E&O Insurance*” (published in *Realtor*, January 1, 2005), Robert Freedman points out that “E&O insurance providers have long granted discounts on their premiums and deductible amounts for taking risk-management measures that could lead to fewer claims. These measures include systematic use of industry-standard contracts and disclosure forms and regular training for licensees on best practices for minimizing risk.” Another way to reduce the cost of premiums is to increase the deductible, which is the initial out-of-pocket amount that the insured is required to pay before the insurance coverage “kicks-in.”

It is also important to review the policy limits of E&O coverage. One must determine whether the policy includes a “per claim” limit, an “aggregate” limit or both. A licensee must ensure that the policy not only covers liability claims but that it also covers defense costs. Legal defense costs can amount to tens of thousands of dollars and can create a financial hardship if not included. Additional basic coverages that should be included are “prior acts” coverage, personal injury, which should also include coverage for libel, slander and invasion of privacy, “lockbox” coverage, “first dollar defense deductible waiver,” “aggregate deductible,” “dishonest acts,” “discrimination and steering,” and “pollution” coverage, just to name a few (see “*E&O Insurance: Good Investment or Wasted Profits*”, published in *Realtor*, November 11, 1996).

The amount of coverage a real estate professional requires should be determined by the size of the business and also the size of the transactions involved. Brokers should obtain rates and policy coverages from various insurance companies before deciding which policy to obtain. Most offices also have the sales associates share in the payment of insurance premiums.

Minimizing Risk Helps with the E&O Premium and Helps Guard Against Claims

Each brokerage firm should institute strong risk management policies so as to avoid higher insurance rates and reduce the total number of potential claims. Detailed office management and risk policies will ultimately help in reducing insurance costs. The NAR Risk Management Committee recommends that a summary of these office policies should be prepared and submitted to insurance companies when pricing E&O Insurance. The summary should include a list of the documents and processes followed in the office.

Brokers and sales associates should be aware that many factors should be considered when obtaining or renewing E&O insurance policies. It is very important to speak with the insurance agent and to discuss these issues with an attorney so that one may make an informed decision and obtain the broadest and most comprehensive coverage available. No one wants to receive that letter from the insurance company indicating that your claim is “hereby rejected” and is not covered under the policy. A review of the insurance policy and the issues detailed in this article can help.

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