New Jersey Law Journal
STATEWIDE LEGAL AUTHORITY SINCE 1878
An ALM Publication
VOL. 225 NO. 48 MONDAY, DECEMBER 2, 2019 NJLJ.COM

PROFESSIONAL LIABILITY

Of Squares and Rectangles: The Fiduciary Standard Imposed on Insurance Brokers, Both Problem and Answer

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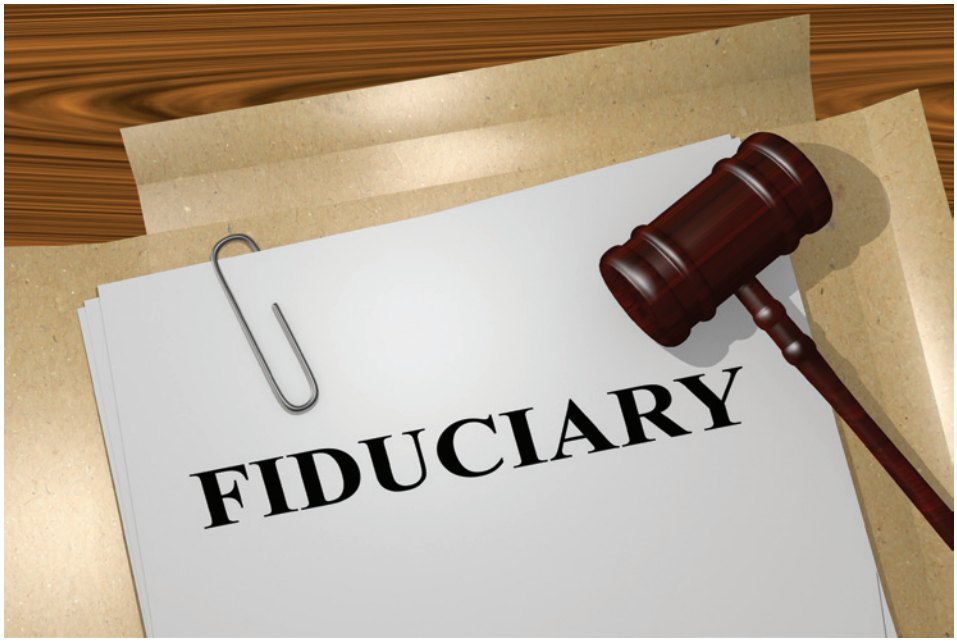

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Every square is a rectangle, but not every rectangle is a square. That was the theme of the article *Professional Negligence vs. Breach of Fiduciary Duty in Insurance Broker Malpractice Actions*, NJLJ Jan. 11, 2019), wherein it was explained that not every claim for professional negligence against an insurance broker is a claim for breach of fiduciary duty. While both claims are rectangles, they don't always square.

Since the article, two major events occurred that changed the contours of insurance producer liability in New Jersey. First, on Feb. 25, 2019, the state legislature unanimously passed Senate Bill No. 2475 (the "Bill"), which prohibited claims for breach of fiduciary duty against insurance producers acting in their professional capacity, unless a claim was made for wrongful retention or misappropriation of funds. However, the governor's office objected to the elimination of the fiduciary standard and, as a result, it was conditionally vetoed. Second, in August 2019, the Appellate Division decided *Shaw v. Shand*, A-5686-17T1 (App. Div. Aug. 15, 2019). In *Shaw*, a home inspector case, the court sua sponte abrogated *Plemmons v. Blue Chip Ins. Serv.*, 387 N.J. Super. 551 (App. Div. 2006), thereby exposing insurance producers to claims under the Consumer Fraud Act, N.J.S.A. 56:8-1, et al. (CFA). Thus, the standards governing the liability of insurance producers in New Jersey are at odds.

Traditionally, insurance producers in New Jersey were held to a high professional standard. New Jersey courts have repeatedly held that insurance producers owe a "fiduciary duty" to their clients. The term "fiduciary" is found at N.J.A.C. 11:17A-4.10 in the regulations promulgated by the Commissioner of Banking and Insurance pursuant to the Insurance Producers Licensing Act, N.J.S.A. §17:22A-48 (the "Act"). The origin

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of the fiduciary duty standard is the 1967 case of *In re Parkwood Co.,* 98 N.J. Super. 263 (App. Div. 1967), which concerned an appeal of the Commissioner of Banking and Insurance's revocation of an insurance producer's license due to his refusal to return a premium paid for a policy that was never bound.

In the 1967 opinion, the Appellate Division, without reference, stated, "An insurance broker acts in a fiduciary capacity and is held to a high standard of conduct," thereby creating the fiduciary standard applied to insurance producers in New Jersey. *Id.* at 268. That edict was then used as justification for inclusion of the fiduciary standard in the applicable regulations, specifically N.J.A.C. 11:17A-4.10, which states, "An insurance producer acts in a fiduciary capacity in the conduct of his or her insurance business." 22 N.J.R. 33, 40. In response to the comment to the proposed regulation that "no justification exists for holding insurance producers to a higher standard than the 'prudent man' standard," the Department of Banking and Insurance noted, without sufficient explanation: "the requirement that an insurance producer act in a fiduciary capacity is a product of case law. *In re Parkwood Co.,* 98 N.J. Super. 263 (App. Div. 1967)." 22 N.J.R. 33. The Supreme Court in *Aden v. Fortsh*, 169, N.J. 64 (2001), then relied upon N.J.A.C. 11:17A-4.10 and dicta in *Rider v. Lynch*, 42 N.J. 465 (1964), to formally recognize the fiduciary duty standard.

Lost in the discussion between *In re Parkwood Co.* in 1967 and *Aden v. Fortsh* in 2001, though, was the recognition that *In re Parkwood* concerned an allegation of a failure to return a premium paid, or, a type of misappropriation claim. In early 2019, as a result of the vast expansion of the original intent of the Act, the legislature passed the Bill, which revised the Act to limit the liability of insurance producers as fiduciaries. While iterations of the Bill had been introduced in prior legislative sessions, the Bill finally obtained enough support to unanimously pass both the Assembly and the Senate on Feb. 25, 2019. Accordingly, the legislature expressed the will of the people to limit the liability of insurance producers and to not hold them to the high standards placed upon other fiduciaries, except in the limited circumstances of handling money. That result would have been consistent with the holding of *In re Parkwood Co.* The governor's conditional veto, however, effectively gutted the purpose of the Bill.

Then, in August 2019, the Appellate Division decided *Shaw*, potentially exposing insurance producers to claims under the CFA. Before *Shaw*, insurance producers were considered exempt from CFA liability as highly regulated semi-professionals. In *Shaw*, however, the Appellate Division reversed its prior decision in *Plemmons*, which held that insurance producers are semi-professionals exempt from the CFA. Instead, the Appellate Division held that "the judicially created learned profession exemption must be narrowly construed to exempt CFA liability only as to those professionals who have historically been recognized as 'learned' based on the requirement of extensive learning or erudition." *Shaw*, at *3.

Development of the Learned Professional Exemption and CFA Preemption

The learned professional exemption was first recognized by the Appellate Division in *Neveroski v. Blair*, 141 N.J. Super. 365 (App. Div. 1976), *superseded by statute*, *Lee v. First Union Nat'l Bank*, 199 N.J. 251 (2009). In *Neveroski*, the Appellate Division held that a real estate broker is not subject to CFA liability for services provided because they were "in a far different category from the purveyors of products or services or other activities." The Appellate Division found that the semi-professional status subject to testing, licensing, regulations and penalties through other legislative provisions placed real estate brokers outside the bounds of the CFA. *Id.,* at 379-81 ("the nature of his activity is recognized as something beyond the ordinary commercial seller of goods or services—an activity beyond the pale of the act under consideration").

While the legislature later amended the CFA to specifically apply to transactions involving the sale of "real estate," the premise that learned professionals remain exempt from the CFA remained and was later recognized by the Supreme Court in *Macedo v. Dello Russo*, 178 N.J. 340, 345-46 (2004), in addressing whether the CFA can apply to the conduct of a physician acting in his professional capacity. Importantly *Macedo* found that the issue of whether a separate regulatory scheme governs the profession is "entirely irrelevant to the threshold

question of whether the CFA applies to learned professionals." *Id.,* at 345.

As the learned professional exemption developed, challenges were also made to the application of the CFA on the basis of preemption. The seminal case on this issue was *Lemendello v. Benefit Mgmt. Corp.*, 150 N.J. 255 (1997), in which the court addressed whether the CFA applied to lenders who engaged in "loan packing" schemes. The court held that due to the presumption that the CFA applies to the provision of services to the public, "a court must be satisfied … that a direct and unavoidable conflict exists between the application of the CFA and application of the otherwise regulatory scheme or schemes …. We stress that the conflict must be patent and sharp, and must not simply constitute a mere possibility of incompatibility." *Id.*, at 270. The court concluded that the high bar for preemption therefore required CFA application, despite the existence of concurrent regulatory schemes outlined in the Insurance Trade Practices Act, the Credit Life and Health Insurance Act, and the Act. *Id.*, at 272-73.

In *Plemmons*, the Appellate Division determined that *Macedo* governed whether the CFA should apply to insurance producers as semi-professionals. Because *Macedo* held that the issue of preemption is irrelevant to the question of whether the CFA applies to learned professionals, the Appellate Division found that insurance producers were exempt from CFA liability because they were subject to testing, licensing and regulation "comparable to real estate brokers." *Plemmons,* 387 N.J. Super. at 564 (citing *Neveroski*, 141 N.J. Super. at 564-65). Accordingly, insurance producers were exempt from CFA liability since 2006.

'Shaw v. Shand'

The Appellate Division in *Shaw*, addressed whether home inspectors are exempt from CFA liability as semi-professionals. The Appellate Division noted that the New Jersey Supreme Court never actually held that certain semi-professionals are exempt to CFA liability. Rather, while *Macedo* referenced the decision of *Neveroski* in dicta, it never addressed whether the semi-professional exemption was properly applied in *Neveroski* because *Macedo* only addressed physician liability. *Id.,* at *26-27, n. 13. Physicians are traditionally considered learned professionals, like lawyers and accountants, not semi-professionals. Similarly, in *Lee*, the Supreme Court never articulated a standard for what professions may be considered learned for the purposes of CFA liability. Instead, the Supreme Court addressed the narrow issue of whether a securities broker is exempt from CFA liability. *Lee*, 199 N.J. at 263-64. After distinguishing these narrow New Jersey Supreme Court holdings, inter alia, the Appellate Division abrogated its decision in *Plemmons*. *Shaw,* at *32. The Appellate Division held that the standard set forth in *Lemelledo* must be utilized to determine whether a semi-professional is exempt from CFA liability based upon preemption principles.

In light of the analysis in *Shaw*, and the language in *Lemelledo* requiring a sharp conflict between the applicable regulatory scheme and the CFA, insurance producers could potentially be exposed to liability under the CFA for the first time in 13 years. Fortunately, Judge Sabatino issued a concurring opinion in *Shaw* recognizing that "the licensure requirements for insurance brokers—*and their associated fiduciary duties*—appear to me to be more stringent than those governing home inspectors. Comparatively, the grounds for a blanket occupational exemption from the CFA's anti-fraud provisions are weaker." *Shaw,* at *2 (emphasis added). Judge Sabatino is correct. The licensure requirements for insurance brokers, and their associated fiduciary duties, are more stringent than those governing home inspectors. *Rider v. Lynch* and *Aden v. Fortsh* treat insurance brokers more like lawyers and doctors than home inspectors. There is also the fact that insurance producers are one of the listed licensed professionals protected by the Affidavit of Merit Act, N.J.S.A. 2A:53-27, et al.

The application of the CFA to professionals who are held to a similar fiduciary standard as lawyers and doctors does not square. Perhaps the regulation imposing a questionable fiduciary standard on insurance producers is the answer to insulating them from liability under the CFA pursuant to *Lemelledo*. In other words, the problem may now be the answer until, of course, we return to problem. ■