IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

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| Those Certain Underwriters at Lloyd's, London Who Subscribed Severally As Their Interests Appear Thereon And Not Jointly to Lloyd's Policy Number 390/J145210, and Drive Financial Services, LP, | ) | |
| Plaintiffs, | ) | |
| v. | ) | Civil Action No. 19804-VCP |
| National Installment Insurance Services, Inc., | ) | |
| Defendant. | ) | |

**MEMORANDUM OPINION**

Submitted: May 18, 2007
Decided: December 21, 2007

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**PARSONS, Vice Chancellor.**

This is an action where the insurer, Underwriters, and the insured, Drive, are jointly suing an intermediary broker, NIIS, for negligent misrepresentation in connection with the procurement of an insurance policy. Plaintiffs seek a declaratory judgment that the policy has been rescinded, as well as damages resulting from NIIS' negligence and negligent misrepresentation. NIIS denies the misrepresentation and contests Plaintiffs' claims for damages and other relief.

For the reasons stated in this posttrial opinion, I deny Plaintiffs' request for a declaratory judgment of rescission because such a declaration would have no practical effect. I further find NIIS liable to Underwriters and Drive based on its negligence or negligent misrepresentations, and grant in part and deny in part Plaintiffs' respective damages claims.

## I. FACTS

These are the facts as I find them after trial.

### A. The Parties

Plaintiff Drive Financial Services, L.P. ("Drive"), a Delaware limited partnership,[1] is an indirect subprime automobile lender that purchases retail installment contracts from automobile dealers across the United States.[2] Drive came into existence in late 2000 when the Bank of Scotland purchased a 49% stake in Drive's predecessor First City

[1] Stip. ¶ 2. Citations in the form "Stip." refer to the parties' stipulated facts from the Joint Pretrial Order § B.

[2] Tr. at 289, 295-97 (Simpson). Tami Simpson is Vice President of Compliance and Governance with Drive Consumer U.S.A., Inc., successor in interest to Drive. Tr. at 286-87 (Simpson). Citations in the form "Tr." are to the transcript of the trial held from February 26-28, 2007, and indicate the page and, where it is not clear from the text, the witness testifying.

Funding.[3] First City Funding financed subprime automobile loans.[4] Scot Foith, a Deputy Chief Executive Officer of Drive, oversaw the company's risk & governance and legal areas.[5] Stephen Trent was formerly Drive's Executive Vice President.[6]

Plaintiffs Those Certain Underwriters at Lloyd's, London Who Subscribed Severally as Their Interests Appear Thereon And Not Jointly to Lloyd's Policy Number 390/J145210 ("Underwriters," and together with Drive, "Plaintiffs"), consist of certain syndicates trading at Lloyd's, London who severally subscribed to Policy No. 390/J145210 (the "Policy"), a policy of vendor single interest or VSI insurance, described *infra*, issued to Drive for the period February 1, 2001 to February 1, 2002.[7] David Roberts is an Underwriting Partner responsible for automobile coverage with Managing Agency Partners ("MAP"), a Lloyd's of London agency.[8] MAP was the lead underwriter for the Policy.[9] Graham Morris is a claims examiner at MAP.[10]

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3 *Id.* at 289.

4 Stip. ¶ 8. NAF was another predecessor of Drive. *See* Tr. at 350-51 (Adams); Stip. ¶ 7. The Court will refer to NAF and First City Funding separately (and collectively) as "Drive's Predecessor(s)."

5 *See* PX 104 at 22-23 (Trent Dep.). Citations in the form "PX " refer to Plaintiffs' trial exhibits.

6 *See id.* at 14-15, 23.

7 Stip. ¶ 1.

8 Tr. at 137-38, 141-42 (Roberts).

9 *See id.* at 181.

10 Tr. at 255-56 (Morris).

Defendant, National Installment Insurance Services, Inc. ("NIIS"), a Maryland corporation,[11] is an insurance broker that assisted Drive in procuring VSI insurance coverage.[12] NIIS was not a licensed Lloyd's broker, and had to affiliate with one to provide its customers with coverage from Lloyd's.[13] Before its sale on February 1, 2001 to the James L. Miniter Insurance Agency, NIIS was headed by William R. Adams.[14] James Gilpin is Executive Vice President of Miniter.[15] After its purchase of NIIS, Miniter acted as Third Party Claims Administrator ("TPA") for Drive's claims under the Policy.[16]

Bankers Agency, Inc. ("Bankers") is a Maryland insurance agency.[17] Bankers and its president, Lawrence Hartman, have had a long relationship with NIIS.[18] Craven & Partners Limited ("Craven") is an English insurance brokerage. Neill and Jack Bagwell worked for Craven in procuring the Policy.[19] Although Plaintiffs initially named Bankers

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11 PX 87 at 36 (Adams Dep.).

12 Stip. ¶ 4. NIIS assisted in the procurement of similar VSI coverage for Drive's Predecessors and was familiar with its loan portfolio. *Id.* ¶ 7.

13 PX 87 at 46 (Adams Dep.).

14 *Id.* at 17.

15 PX 107 at 8-9 (Gilpin Dep.).

16 Stip. ¶ 33; s*ee also* PX 107 at 24-25 (Gilpin Dep.) (describing TPA contract).

17 PX 120 at 11 (Hartman Dep.).

18 *Id.* at 12, 28-29.

19 *See* PX 108 at 27 (Neill Bagwell Dep.).

and Craven as defendants in this action, they ultimately settled with Bankers and Craven and dismissed them from the case.

### B. VSI Insurance

Drive sent Bankers a policy application for VSI insurance in October 2000. Bankers enlisted NIIS to obtain insurance on behalf of Drive. NIIS in turn enlisted Craven to solicit coverage from Lloyd's, London. This dispute arose out of the VSI insurance policy Craven and NIIS obtained from Underwriters.

A lender obtains VSI coverage for its automobile lending in order to shift the risk to the insurer of damage to the loans' automobile collateral. With VSI insurance a lender is reimbursed when a delinquent borrower's collateral is repossessed and there is either uninsured physical damage or the collateral is unrecoverable.[20] VSI coverage is triggered when (a) the borrower defaults on the automobile loan, (b) requiring a repossession by the lender of the automobile, (c) with damage that is uninsured by the borrower's primary automobile coverage, and (d) at an amount greater than the VSI policy's deductible.[21]

A VSI policy is written on an individual basis for a particular lending institution.[22] The insurer's exposure is determined by the duration and scope of coverage, the existence of stop-gap measures, and the nature of the insured's lending practices.

A VSI policy may cover losses incurred only during the policy period or, in a prepaid policy, it may cover losses incurred throughout the life of the automobile loan

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20 Tr. at 146 (Roberts).

21 *See* PX 21 at 00058, 00061 (the Policy).

22 *See* Tr. at 348 (Adams).

("runoff").[23] Thus, if a lender's VSI insurance ends after one year, but loans originated during the policy's term incur losses two years later, those loans would be covered under a VSI policy with runoff.

While most policies require the lender to ensure the borrower has her own primary automobile insurance, that requirement may not extend to ensuring the borrower maintains such insurance throughout the life of the loan. A blanket VSI policy, the type at issue here, would cover all loans originated by a lender.[24] Blanket insurance typically requires the lender to verify the borrower's primary insurance only when it originates the loan.[25] Some lenders allow uninsured borrowers to purchase a car when they obtain a "binder" from an insurer, which is a short-term (*e.g.*, ten days) policy meant to tide the borrower over until she can obtain a full policy.[26]

A VSI policy may have durational and size limitations on the loans qualifying for coverage.[27] In addition, insurers may restrict their total liability through the use of a stop-gap measure, where the total payments to the insured are capped as a percentage of the

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23 *See* PX 107 at 29-30 (Gilpin Dep.). A policy without runoff would have a lower premium. Tr. at 343 (Adams).

24 *See* Tr. at 336 (Adams). In contrast, a collateral protection insurance policy would cover only those individual loans whose borrowers' lost their primary insurance. *Id.*

25 *See* PX 107 at 53-54 (Gilpin Dep.). Collateral protection insurance requires continuous tracking throughout the loan and, should the borrower lose his insurance, the lender may "force place" a primary insurance policy on the borrower, who is required to pay the premium. *Id.*

26 *See id.* at 48.

27 *See* PX 21 at 00055 (the Policy).

premium.[28] Alternatively, the structure of coverage may differ whereby an insurer would face liability only after an aggregate deductible is met for the entire portfolio, instead of on a loan-by-loan basis.[29]

Several other factors affect the coverage risk of VSI insurance. For example, an indirect lender, one who finances loans originated by others (*e.g.*, an automobile dealership), is a greater risk for an insurer.[30] The credit quality of the insured's borrowers also affects the risk of loan default. The designations of "A," "B," "C" and "D" quality loans are terms of art in the insurance industry denoting risks involved in a particular type of loan. Prime paper is A quality. B quality is nonprime. C and D class loans are subprime. A quality paper poses the least risk of default by the borrower, and D quality the greatest.[31] Not only does a subprime borrower pose a greater risk of default, but such a borrower is also less likely to carry primary automobile insurance, increasing the level of losses.[32]

### C. Background of the Dispute

#### 1. Drive's search for insurance

Before the events of this action, NIIS had assisted Drive's Predecessors in their procurement of VSI insurance coverage from the insurers Balboa, Utica National, and

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28 *See* Tr. at 349-50 (Adams).

29 PX 105 at 39 (Beck Dep.).

30 *See* PX 87 at 60 (Adams Dep.). Drive is an indirect lender. Tr. at 297 (Simpson).

31 *See* PX 120 at 57 (Hartman Dep.); *see also* Tr. at 290 (Simpson); Stip. ¶ 3.

32 PX 107 at 45 (Gilpin Dep.).

Old Republic.[33] These policies had high losses. As the following table indicates, Drive's Predecessors' VSI insurers paid significantly more in claims than they received in premiums.[34]

| Insurance Carrier | Policy Effective Dates | Rate per Loan | Total Premiums Paid | Total Incurred Losses | Loss Ratio |
|---|---|---|---|---|---|
| Balboa | 11/1/94 - 5/31/97 | $35 | $264,685 | $635,118 | 240% |
| Old Republic | 6/1/97 - 2/1/99 | $41 | $640,286 | $862,168 | 135% |
| Utica | 2/1/99 - 2/1/00 | $41 | $553,459 | $832,876 | 150% |

Due to excessive loss rates, by 2000 NIIS could not continue arranging coverage.[35] In 1999, Utica offered to renew Drive's Predecessor's policy, but at the substantially higher rate of $71.00 per loan.[36] Drive's Predecessor did not accept the Utica offer. After January 31, 2000, when the coverage ran out, Drive continued without VSI insurance.

Drive continued to search for VSI insurance. On multiple occasions in 2000, NIIS "refused to accept an application from [Drive], based on the fact that they were still operating basically the way they had back in the early nineties."[37] Furthermore, the sub-prime insurance market had changed. By mid-2000, even the $71 Utica offer was no

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33 Tr. at 351-52 (Adams); *see also* Stip. ¶ 7.

34 *See* PX 111 at 2 (Cumulative Loss and Premium Information as of Nov. 2000).

35 Tr. at 353 (Adams).

36 *See* PX 120 at 55, Ex. 3 (Hartman Dep.).

37 Tr. at 354 (Adams).

longer available.[38] Trent of Drive then asked Hartman of Bankers whether insurance could be gotten for $80 per loan.[39]

NIIS' interest was piqued when, in late October 2000, Bankers informed NIIS of Bank of Scotland's new relationship with Drive's Predecessor, which was supposed to provide a "much improved quality of business."[40] Hartman told NIIS that Drive was increasing its credit standards and instituting a primary insurance follow-up system.[41] By October 10, 2000, NIIS had advised Bankers that it thought it could get coverage for $80 per loan with runoff, which Bankers conveyed to Drive along with a request for an application.[42] The evidence does not indicate whether NIIS had a particular insurer in mind when it said it thought it could arrange for coverage for $80.

On November 2, 2000, NIIS engaged Craven to seek VSI insurance for Drive at a rate of $80 per loan with a $500 deductible.[43] NIIS provided to Craven a set of past-loss information based on NIIS' historical relationship with Drive's Predecessors, notification of the Bank of Scotland purchase, and Drive's application to Bankers.[44] At a later point,

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38 PX 120 at 60 (Hartman Dep.).

39 *Id.*

40 Tr. at 355 (Adams Dep.).

41 PX 120 at 61 (Hartman Dep.).

42 *Id.* at 60-61; PX 3 (letter from Hartman to Trent dated Sept. 26, 2000, with additional notation indicating a phone conversation on Oct. 10, 2000). Hartman assisted Drive in completing the application. PX 120 at 71 (Hartman Dep.).

43 PX 108 at 34-35 (Neill Bagwell Dep.); *id.* Ex. 3.

44 *See id.* Ex. 3.

NIIS also informed Craven that the Drive portfolio would include lower-risk prime, or prime type, loans in comparison to Drive's Predecessors.[45] The justification for NIIS' communication is at issue.

According to Adams, he had a call around the end of 2000 with Trent of Drive, in which Trent said that based on the Bank of Scotland's credit criteria, the preponderance of the business would be prime paper.[46] At trial Adams testified that, during a call that lasted less than a minute, Trent said, "the preponderance of our business will be A paper."[47] Adams' recollection of that conversation, however, conflicts with other evidence and is not credible. Trent stated that no such telephone conversation took place, and denied that he would have made the statement alleged based on Drive's business at the time.[48] NIIS did not confirm Trent's alleged statement in writing or otherwise with either Drive, Bankers, or the Bank of Scotland.[49] In addition, the testimony of Hartman of Bankers[50] and Simpson of Drive[51] support an inference that Trent's recollection on this point is more reliable than that of Adams. Thus, I find Drive did not have the intention of changing its business after the Bank of Scotland became involved such that a

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45 Tr. at 356 (Adams); PX 87 at 166 (Adams Dep.).

46 PX 87 at 110-16 (Adams Dep.).

47 Tr. at 358.

48 *See* PX 104 at 97-98 (Trent Dep.).

49 PX 87 at 117 (Adams Dep.).

50 PX 120 at 61 (Hartman Dep.).

51 Tr. at 294-95.

preponderance of its loans would be prime paper, and that Trent did not tell Adams that it had.

### 2. Approaching Underwriters

In November or December of 2000, Craven approached Underwriters to inquire if they would be interested in underwriting a VSI policy.[52] NIIS met with Underwriters' underwriting partner Roberts in London on December 18, 2000 for placement of the Drive policy.[53] Roberts had no previous experience with Drive or VSI insurance.[54] NIIS described the expiring portions of Drive's existing portfolio, as well as its expected future composition.

NIIS knew Drive's expiring or existing portfolio was largely subprime, with at least some D class loans and a significant amount of low C class loans.[55] Nevertheless, NIIS told Underwriters the expiring loan portfolio was a "[m]ixture of B and C class loans"; NIIS did not mention any D class loans.[56] At the same time, Underwriters received the three prior VSI carriers' loss history from underwriting Drive's

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52 Tr. at 152 (Roberts).

53 Stip. ¶ 11. The Bagwells from Craven also attended the meeting. *See* Tr. at 154 (Roberts).

54 Tr. at 202, 205 (Roberts).

55 PX 87 at 106 (Adams Dep.); Tr. at 383-84 (Adams) (admitting that most loans in Drive's Predecessors' portfolios were subprime as of October 2000).

56 Stip. ¶¶ 12-13.

Predecessors' loans.[57] Underwriters understood the loss history to represent the same portfolio Drive had at the time of the meeting.[58]

As to Drive's future lending, the parties stipulated NIIS misrepresented the expected make up of Drive's future portfolio to Underwriters.[59] Specifically, NIIS told Underwriters that Drive's "future" loan portfolio would be "90% A and 10% B class loans,"[60] even though Drive never represented to NIIS that its future loan portfolio would have such a composition."[61]

In promoting the Policy's issuance, NIIS intended and expected Underwriters to rely on the information it presented regarding Drive's existing, and expected, loan portfolios.[62] Underwriters relied on NIIS' presentation when they decided to underwrite

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57 *See* Tr. at 204-06 (Roberts).

58 *Id.*

59 Stip. ¶ 17.

60 *Id.* ¶ 14.

61 *Id.* ¶ 16. Furthermore, NIIS did not provide any information to Underwriters to indicate Drive's future loan portfolio would, or was expected to, contain subprime (C or D class) loans. *Id.* ¶ 15.

62 *Id.* ¶ 18; *see also* PX 87 at 47-49 (Adams Dep.).

the Policy.[63] Underwriters undertook no independent investigation of NIIS' presentation to verify the composition of Drive's expiring or expected loan portfolios.[64]

### 3. The Policy

Underwriters issued the Policy with an inception date of February 1, 2001, but indicated that they agreed to insure A and B quality loans only.[65] The Policy had an $80 per loan premium and a $500 deductible per vehicle with full loan runoff.[66] NIIS prepared the formal Policy, which did not mention the limitation to A and B class loans.[67]

NIIS received a binding covernote from Craven, indicating the information upon which the insurance was agreed included the representation that Drive's future portfolio would be comprised of "90% of loans A Paper" and "10% of loans B Paper."[68] The parties stipulated NIIS negligently omitted that information from the covernote it sent to Bankers for transmission to Drive.[69] No one apprised Drive of Underwriters' understanding of the 90% A, 10% B portfolio makeup and their agreement to insure only

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63 Tr. at 149 (Roberts) (describing how Lloyd's syndicates "totally rely on the information provided by brokers); *see also id.* at 165-66 (noting "it was very important that it was no longer going to be this quality of business. It was going to be moving to A/B paper, which was prime paper, as described to me.").

64 *Id.* at 150 (explaining that Underwriters "wouldn't have the time to independently assess every risk that came by, plus the fact [they rely] on the information provided to [them.]").

65 Stip. ¶¶ 20, 26.

66 *Id.* ¶ 27.

67 *Id.* ¶ 32.

68 *Id.* ¶ 23.

69 *Id.* ¶ 24.

A and B quality loans.[70] Ultimately, NIIS failed to obtain a policy of VSI insurance for Drive that covered any C or D quality loans for the period February 1, 2001 to February 1, 2002.[71] This Court has entered a summary judgment finding NIIS negligent on that basis.[72]

Drive paid $2,612,320 in premiums, inclusive of surplus lines tax, for covering 32,654 loans with the understanding that the Policy would provide coverage for subprime loans.[73] The net premium to Underwriters was $1,828,592,[74] the remainder being retained by the brokers as commissions.[75]

**4. Discovery of the misrepresentation**

Drive's lending continued in the same fashion during the Policy period as before, albeit with significant growth in loan volume.[76] The loans purchased by Drive and for which claims were submitted under the Policy were of subprime quality.[77] The Bank of

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70 *Id.* ¶¶ 21-22.

71 *Id.* ¶ 25.

72 *See Certain Underwriters at Lloyd's, London v. Nat'l Installment Ins. Servs., Inc.* ("*Underwriters I*"), 2007 WL 1207106, at *8 (Feb. 8, 2007) (this citation is to the revised opinion dated Apr. 16, 2007).

73 Stip. ¶¶ 19, 30.

74 *Id.* ¶ 31.

75 Tr. at 271-72 (Morris)

76 PX 106 at 19, 43 (Foith Dep.); *see also* Tr. at 294 (Simpson) (noting that the Bank of Scotland purchase substantially increased Drive's capital base allowing it to purchase additional loans).

77 Stip. ¶ 36.

Scotland did not change Drive's underwriting standards.[78] Drive, however, made adjustments to its internal credit scoring model to find higher quality customers within its subprime target market.[79]

In October 2001, Craven submitted Drive's claims for reimbursement to Underwriters.[80] As Underwriters investigated the unexpectedly high losses and the relatively high interest rates of loans they thought were A or B class paper, they continued to pay out for claims under a reservation of rights.[81] Drive received payment through Miniter of $1,354,941 for claims submitted under the Policy.[82]

In April 2002, as part of their investigation, Underwriters discussed some of the claims directly with Drive.[83] Drive did not understand Underwriters' focus on each claim's risk rating (A, B, C, or D). It soon became apparent, however, that the covernote on Underwriters' copy of the Policy had the limitation to A and B class loans, while Drive's copy did not.[84]

Based on the parties' disagreement over what the Policy covered, Drive filed suit in Texas to compel Underwriters to pay its claims. In December 2002, Underwriters and

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78 PX 106 at 19 (Foith Dep.).

79 *See* Tr. at 295 (Simpson).

80 *See* Tr. at 258-59 (Morris).

81 *Id.* at 266-67.

82 Stip. ¶ 35.

83 Tr. at 269-70 (Morris).

84 *Id.* at 269-70.

Drive reached a settlement agreement ("Settlement") which had the effect of rescinding the Policy.[85] Drive incurred $109,374.14 in legal fees before the Settlement.[86]

Drive received payment through Miniter of $1,354,941 based on 245 claims.[87] Underwriters incurred a total of $82,517.42 in claims processing and related expenses.[88] By the time the Policy was rescinded, Drive had submitted a total of 476 additional claims to Miniter with a claim amount of $2,271,182.87 which had not been processed for payment.[89] Underwriters incurred $109,899.18 in legal fees before the Settlement and the effective rescission with Drive.[90]

### D. Procedural History

On August 1, 2002, Underwriters filed this action against Drive, NIIS, and Craven. Shortly thereafter, on August 24, 2002, Drive filed suit against Underwriters, NIIS, Craven and Bankers in the 193rd Judicial District Court of Dallas County, Texas. Underwriters amended its complaint in this Court on September 23, 2002 to add Bankers as a Defendant, and filed a second amended complaint on December 20, 2002 to clarify

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85 Stip. ¶ 38. The Settlement, entitled "Confidential Settlement Agreement and Release," is available at PX 37.

86 Stip. ¶ 47.

87 *Id.* ¶ 40.

88 Underwriters incurred $21,879.32 in adjuster expense in connection with the paid claims; paid Miniter $37,950 for its claims processing services; paid Miniter $17,952 in connection with appraisal fees for Drive claims from September 12, 2002 to November 27, 2002; and paid $4,736.10 for an audit in connection with the use of Miniter as a TPA under the Policy. *Id.* ¶¶ 41, 43-45).

89 *Id.* ¶ 42.

90 *Id.* ¶ 46.

the causes of action against each Defendant. As part of their Settlement, Underwriters and Drive agreed to a complete release of all claims on December 31, 2002. As a result of the Settlement, Drive dismissed the Texas litigation, effective April 3, 2003. On March 12, 2004, Plaintiffs moved for realignment, to make Drive a Plaintiff in this action, which this Court granted on July 13, 2004. Plaintiffs subsequently filed a third amended complaint.

After extended discovery, NIIS moved for summary judgment on November 6, 2006; Plaintiffs cross moved for summary judgment the next day. This Court adjudicated those motions on February 8, 2007: denying Underwriters' motion against Craven and NIIS for negligent misrepresentation; denying NIIS' motion against Drive for failure to show damages; and denying Drive's motion against Craven for negligence.[91] The Court also granted in part Drive's motion for summary judgment against NIIS for negligence, finding "(1) that NIIS had a duty to communicate to Drive all material limitations on the coverage provided by the Policy; and (2) that NIIS breached that duty."[92] Plaintiffs later settled with Bankers and Craven, and this Court dismissed them from the litigation.

Plaintiffs filed their Fourth Amended Complaint (the "Complaint") on February 21, 2007. The Court conducted a trial from February 26-28, 2007, followed by extensive briefing and posttrial argument on May 18, 2007. Based on the parties' arguments, briefs and supporting evidence, the Court's opinion is as follows.

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91 *See Underwriters I*, 2007 WL 1207106, at *12 (Feb. 8, 2007).

92 *Id.*

## II. ANALYSIS

The Complaint asserts claims against NIIS on behalf of Underwriters and, separately, Drive. I begin with Underwriters and Drive's joint request for declaratory judgment.

### A. Underwriters and Drive's Request for Declaratory Judgment

Underwriters and Drive jointly seek a judicial declaration voiding the Policy from its inception.[93] Plaintiffs argue the Policy was void *ab initio* because it was issued in reliance on NIIS' material misrepresentation in the application process.

NIIS questions the Court's subject matter jurisdiction over Plaintiffs' request for a declaratory judgment, arguing there is no "actual controversy." First, NIIS contends it is not a proper defendant. Second, NIIS argues Plaintiffs' request for declaratory relief is moot.

#### 1. Standard for declaratory relief

Parties to a contract may seek a declaratory judgment to determine "any question of construction or validity" and may seek a declaration of "rights, status or other legal relations thereunder."[94] Declaratory relief is in the discretion of the Court and not available as a matter of right.[95] While there is a split of authority as to who should bear

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93 Compl. ¶¶ 31-40; s*ee also* Pls.' Jt. Post-trial Br. ("POB") at 18. Plaintiffs' reply brief is designated as "PRB."

94 10 *Del. C.* § 6502.

95 10 *Del. C.* § 6506.

the burden of persuasion,[96] "the better view is that a plaintiff in a declaratory judgment action should always have the burden of going forward."[97]

### 2. Is there an "actual controversy?"

For a dispute to be settled by a court of law, the issue must be justiciable, meaning that courts have limited their powers of judicial review to "cases and controversies."[98] Even though the Delaware Constitution does not have a direct analog to Article III's "case or controversy" requirement, the analysis is generally the same.[99] NIIS makes two arguments that there is no "actual controversy" -- NIIS is not an appropriate defendant, and Plaintiffs' claim is moot.

An "actual controversy" must exist for declaratory judgment jurisdiction.[100] "The basic inquiry is whether the parties' conflicting contentions present a genuine and substantial controversy between parties having adverse legal interests."[101] The Delaware Supreme Court has articulated four prerequisites that must be met for an "actual controversy":

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96 *See Energy Partners, Ltd. v. Stone Energy Corp.*, 2006 Del. Ch. LEXIS 182, at *21 n.55 (Oct. 11, 2006).

97 *Rhone-Poulenc Surfactants & Specialties, Inc. v. GAF Chem. Corp.*, 1993 Del. Ch. LEXIS 59, at *7 (Apr. 6, 1993).

98 U.S. CONST. art. III, § 2; s*ee also Energy Partners*, 2006 Del. Ch. LEXIS 182, at *22 n.56.

99 *Energy Partners*, 2006 Del. Ch. LEXIS 182, at *22.

100 *See, e.g., Gannett Co. v. Bd. of Mgrs. for the Del. Crim. Just. Info. Sys.*, 840 A.2d 1232, 1237 (Del. 2003) (stating broad rule).

101 *Energy Partners*, 2006 Del. Ch. LEXIS 182, at *24.

> (1) It must be a controversy involving the rights or other legal relations of the party seeking declaratory relief; (2) it must be a controversy in which the claim of right or other legal interest is asserted against one who has an interest in contesting the claim; (3) the controversy must be between parties whose interests are real and adverse; [and] (4) the issue involved in the controversy must be ripe for judicial determination.[102]

NIIS disputes the second prerequisite, arguing "there is no longer a defendant against whom judgment of rescission can be ordered," because "[t]he claim for rescission . . . is now offered against NIIS who was not a party to either the [Policy] or the rescission agreement."[103]

The "actual controversy" requirement is the foundation for the mootness doctrine, which provides for dismissal of litigation if the alleged threatened injury no longer exists.[104] The Court should not resolve moot issues because it wastes judicial resources on academic questions with little or no practical benefit.[105] A dispute is moot if "a grant of relief cannot have any practical effect on the existing controversy."[106]

NIIS argues Plaintiffs' request for declaratory judgment is moot because the "[r]escission of the [P]olicy by mutual agreement of the parties obviated the need for

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102 *Rollins Int'l Inc. v. Int'l Hydronics Corp.*, 303 A.2d 660, 662-63 (Del. 1973).

103 Corrected Post-Trial Br. of Def. NIIS ("DAB") at 2.

104 *Energy Partners*, 2006 Del. Ch. LEXIS 182, at *24.

105 *Cal. Pub. Employees Ret. Sys. v. Coulter*, 2005 Del. Ch. LEXIS 54, at *9 (Apr. 21, 2005).

106 *Nama Holdings, LLC v. Related World Market Ctr., LLC*, 922 A.2d 417, 435 (Del. Ch. 2007) (citation and quotation omitted).

declaratory relief."[107] Plaintiffs counter that a declaration the insurance policy is void would have the practical effect of aiding them with the proof of Drive's negligence claim.[108] A judicial declaration rescinding the Policy is unnecessary; Drive can prevail on its negligence claim whether or not this Court voids the Policy. Moreover, Plaintiffs have not shown a judicial declaration voiding the Policy would have any practical effect. I therefore deny their request for such a declaration.[109]

### B. Underwriters' Claim for Negligent Misrepresentation

Underwriters contend, "there can be no dispute that NIIS negligently made misrepresentations to Underwriters concerning the general nature of Drive's business as well as the make up of its expiring and future portfolio."[110] Due to NIIS' alleged negligent misrepresentations, Underwriters seeks damages of $976,144.60. NIIS denies liability for the following reasons: (1) there was no negligent misrepresentation; (2) Underwriters were contributorily negligent; (3) Drive did not assign any of its causes of action against NIIS to Underwriters; (4) NIIS was Drive's agent, not Underwriters' agent;

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107 DAB at 2.

108 Transcript of Post-Trial Argument on May 18, 2007 ("Arg. Tr.") at 17-18.

109 The denial of this claim for equitable relief does not deprive the Court of subject matter jurisdiction. Equitable jurisdiction is ascertained as of the time the complaint is filed. *See Diebold Computer Leasing, Inc. v. Commercial Credit Corp.*, 267 A.2d 586, 590-91 (Del. 1970); *see also* DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY (hereinafter "WOLFE & PITTENGER") § 2-4 (2007). This Court's jurisdiction is unaffected by its determination that equitable relief is not warranted. *See Prestancia Mgmt. Group v. Va. Heritage Found., II LLC*, 2005 Del. Ch. LEXIS 80, at *11 (May 27, 2005); *see also* WOLFE & PITTENGER § 2-4.

110 POB at 22.

and (5) Underwriters have no claim for the broker commissions paid by Drive or, alternatively, have waived their claim.

### 1. Choice of law analysis

The Court first must determine the applicable law for Underwriter's substantive claims. Plaintiffs argue for the application of Maryland law because NIIS was a Maryland business and the majority of the communications concerning the Policy took place in Maryland.[111] Defendants agree, arguing Maryland has the "most significant relationship to the events at issue relative to the negligent misrepresentation claim."[112]

Delaware courts look to the Restatement (Second) of Conflict of Laws for guidance in choice of law disputes.[113] Section 145(1) provides that "the rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state which, with respect to that issue, has the *most significant relationship* to the occurrence and the parties . . . ."[114] Factors the Court should use to determine the state with the most significant relationship include the: (a) place of injury, (b) place of conduct causing the injury, (c) domicile and residence of the parties, and (d) place where the relationship, if any, between the parties is centered.[115] The most significant

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111 *See POB* at 18 n.12.

112 DAB at 14.

113 *See Gloucester Holding Corp. v. U.S. Tape & Sticky Prods., LLC*, 832 A.2d 116, 124 (Del. Ch. 2003).

114 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145(1) (1971) (emphasis added) (hereinafter "REST. 2D CONFL. OF LAWS").

115 *Id.* § 145(2).

relationship test requires a court to apply the law of the state with the most significant contacts, as opposed to the largest number of contacts.[116]

Consistent with the agreement of the parties, the Court concludes Maryland has the most significant relationship with respect to Underwriters' misrepresentation claim against NIIS. NIIS is incorporated in Maryland, and maintained its principal place of business in Maryland during the relevant period. Adams of NIIS, whose misrepresentations are at the heart of Underwriters' claim, operated from Maryland. Accordingly, the Court will evaluate Underwriters' claims under Maryland law.

**2. Is NIIS liable for negligent misrepresentation under Maryland law?**

In Maryland, to prove negligent misrepresentation a plaintiff must show:

> (1) the defendant, owing a duty of care to the plaintiff, negligently asserts a false statement; (2) the defendant intends that his statement will be acted upon by the plaintiff; (3) the defendant has knowledge that the plaintiff will probably rely on the statement, which, if erroneous, will cause loss or injury; (4) the plaintiff, justifiably, takes action in reliance on the statement; and (5) the plaintiff suffers damage proximately caused by the defendant's negligence.[117]

A negligent assertion may occur in the presentation of past or present fact.[118]

**a. Did NIIS negligently assert a false statement?**

The first element of negligent misrepresentation has two parts: the defendant must (1) owe a duty of care to the plaintiff and (2) negligently assert a false statement. The threshold issue is whether NIIS, an insurance broker, owed a duty of care to

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116 *See Travelers Indem. Co. v. Lake*, 594 A.2d 38, 48 n.6 (Del. 1991).

117 *Martens Chevrolet, Inc. v. Seney*, 439 A.2d 534, 539 (Md. 1982).

118 *See Weisman v. Connors*, 540 A.2d 783, 796 (Md. 1988).

Underwriters, the insurer.[119] Underwriters assert NIIS "admit[ted] to having a duty of utmost good faith to present clear and accurate information to Underwriters."[120] NIIS replies that it was Drive's, and not Underwriters', agent.[121]

Underwriters' only evidence NIIS, as an independent insurance broker, owed a duty to them comes from Adams' trial testimony. Adams admitted that a broker has a duty of utmost good faith vis-à-vis the insurer.[122] While persuasive, Underwriters' evidence is not conclusive. "[T]he existence of a legal duty ordinarily is a question of law to be decided by the court."[123]

"[I]f the risk created by negligent conduct is no greater than one of economic loss, generally no tort duty will be found absent a showing of privity or its equivalent."[124]

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119 "Absent a duty of care, there can be no liability in negligence." *Walpert, Smullian & Blumenthal, P.A. v. Katz*, 762 A.2d 582, 587 (Md. 2000).

120 PRB at 4.

121 *See* DAB at 3 (citing Compl. ¶ 21). NIIS' description comports with the general view that, "[a]n insurance broker is ordinarily employed by a person seeking insurance, and . . . is to be distinguished from the ordinary insurance agent, who is employed by insurance companies to solicit and write insurance by, and in the company." *American Cas. Co. of Reading, Pa. v. Ricas*, 22 A.2d 484, 487 (Md. 1941).

122 *See* Tr. at 383 (Adams). According to Adams, the duty requires a broker "[t]o give as clear and as concise and as accurate information and position on a prospective insured as you possibly can to the insurer." *Id.*

123 *Todd v. Mass Transit Admin.*, 816 A.2d 930, 933 (Md. 2002).

124 *Jacques v. First Nat'l Bank of Md.*, 515 A.2d 756, 761 (Md. 1986). The court in *Jacques* reasoned:

> We discern from our review of the development of the law of tort duty that an inverse correlation exists between the nature of the risk on one hand, and the relationship of the parties on

"[T]he rationale underlying the requirement of privity or its equivalent as a condition of liability for negligent conduct, including negligent misrepresentations, resulting in economic damages [is] to avoid liability in an indeterminate amount for an indeterminate time to an indeterminate class."[125]

Maryland courts have not directly addressed whether an insurance broker may be held liable in tort to an insurer solely for pecuniary loss. The Maryland Supreme Court has relied on New York law for determining third party liability in the absence of privity.[126] As there was no contract between Underwriters and NIIS, the Court must determine if there was the "equivalent" of privity.

In general, "the required nexus that approaches privity . . . must be such that would allow the defendant to predict its liability exposure."[127] Maryland courts have followed New York's *Credit Alliance Corp. v. Arthur Andersen & Co.*[128] in determining

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> the other. As the magnitude of the risk increases, the requirement of privity is relaxed -- thus justifying the imposition of a duty in favor of a large class of persons where the risk is of death or personal injury. Conversely, as the magnitude of the risk decreases, a closer relationship between the parties must be shown to support a tort duty. *Id.*

125 *Walpert, Smullian & Blumenthal*, 762 A.2d at 596 (quoting *Ultramares Corp. v. Touche, Niven & Co.*, 174 N.E. 441, 444 (N.Y. 1931)).

126 *See id.* at 607.

127 *Chicago Title Ins. Co. v. Allfirst Bank*, 905 A.2d 366, 381 (Md. 2006).

128 65 N.Y.2d 536 (N.Y. 1985).

the equivalent of privity.[129] To find a nexus approaching privity, the *Credit Alliance* test requires three elements:

> (1) an awareness by the maker of the statement that it is to be used for a particular purpose; (2) reliance by a known party on the statement in furtherance of that purpose; and (3) some conduct by the maker of the statement linking it to the relying party and evincing its understanding of that reliance.[130]

In one New York case that applied *Credit Alliance*, the insurer argued there was sufficient "linking conduct" when the broker knew who the underlying insurer would be from "a promotional flyer that the broker received from an entity described by the carrier as a 'wholesale broker', and which identifies the carrier as the underwriter of the insurance being promoted."[131] Dismissing the insurer's argument, the court found that "[m]ore is needed to show the functional equivalent of privity than that a reliant party was actually known."[132] Another New York court found there was no relationship approaching privity when a broker "merely represented that the insured's signature [on an application for automobile insurance] was bona fide."[133]

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129 *See Walpert, Smullian & Blumenthal*, 762 A.2d at 601-02; *Chicago Title Ins. Co.*, 905 A.2d at 380-81.

130 *Prudential Ins. Co. of America v. Dewey, Ballantine, Bushby, Palmer & Wood*, 605 N.E.2d 318, 321-22 (N.Y. 1992).

131 *Point O'Woods Ass'n v. Those Underwriters at Lloyd's, London Subscribing to Certificate No. 6771*, 733 N.Y.S.2d 146, 147 (N.Y. App. Div. 2001).

132 *Id.*

133 *Merchants Ins. Co. of N.H., Inc. v. Gage Agency, Inc.*, 801 N.Y.S.2d 859, 861 (N.Y. App. Div. 2005).

In this case, the first two elements of *Credit Alliance* are easily satisfied. NIIS' stipulation that its description of Drive's expiring and future portfolios was intended to support the issuance of an insurance policy demonstrates "an awareness by the maker of the statement that it is to be used for a particular purpose." The evidence also shows Underwriters relied on NIIS' presentation, satisfying the second element.

The third element, "some conduct by the maker of the statement linking it to the relying party and evincing its understanding of that reliance," also exists here. Unlike the New York cases previously cited, this case involves an arms-length transaction where NIIS made an in-person representation regarding Drive's loan portfolio. Drive's agent, Adams of NIIS, intended the statement to convince Underwriters to issue the Policy. Furthermore, finding NIIS to have had a duty to present factually correct information to Underwriters would not contravene the public policy concerns discussed earlier. There is no risk that exposing NIIS to liability in this situation "will saddle [it] with boundless obligations or open the litigation floodgates, because the only possible plaintiff is the insurer to which the misrepresentation was made."[134] Thus, I find NIIS had a relationship with Underwriters that was, for purposes of determining liability for negligent misrepresentation, equivalent to privity.

Finally, the first element of negligent misrepresentation requires proof of a false statement. Underwriters accuse NIIS of misrepresenting Drive's expiring and future

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[134] Douglas R. Richmond, *Insurance Agent and Broker Liability*, 758 PLI/Lit 131, 174-75, PLI Order No. 11361 (Apr. 2007).

portfolios. The parties stipulated NIIS misrepresented Drive's future portfolio.[135] I also find NIIS mistakenly misrepresented Drive's expiring portfolio. In the meeting Adams had with Roberts, NIIS represented to Underwriters that Drive's portfolio was a combination of B and C class loans, and did not tell Underwriters that Drive's expiring portfolio contained any D class loans.[136] Drive and its predecessors were subprime lenders, and Drive's portfolio as of November 18, 2000 contained at least some D class and a significant amount of low-C class loans.

**b. Did NIIS intend and expect its presentation of Drive's portfolios to be acted upon by Underwriters?**

The second element of the negligent misrepresentation tort requires NIIS to have intended its presentation to be acted upon by Underwriters. Adams of NIIS testified to that effect, and the parties stipulated, "NIIS intended for Underwriters to rely on the information it presented regarding the nature of Drive's business and its existing and expected loan portfolio."[137] Hence, the second element is satisfied.

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135 "NIIS misrepresented the expected make up of Drive's future portfolio to Underwriters." Stip. ¶ 17. Despite its stipulation to the contrary, NIIS' posttrial brief purports to deny the existence of such a misrepresentation. *See* DAB at 9-13. NIIS' stipulations of fact in the Pretrial Order are binding admissions, and NIIS' counsel acknowledged that fact at trial. *See* Tr. at 48-51.

136 NIIS argues that Bagwell of Craven "was responsible for the representation that the expiring portfolio consisted of B/C." DAB at 8. This assertion is not credible. Not only does NIIS not cite to any evidence to support it, but NIIS stipulated, "*NIIS represented to Underwriters* that Drive's loan portfolio as 'expiring' was a 'Mixture of B and C class loans.'" Stip. ¶ 12 (emphasis added); *see also* Tr. at 170-72 (Roberts) (stating it was Adams of NIIS and the Bagwells from Craven that misrepresented the portfolio composition).

137 Stip. ¶ 18.

The third element is whether NIIS knew Underwriters would rely upon its representation, and if the representation was wrong, it would cause Underwriters injury. Because Adams effectively conceded as much,[138] the third element also is satisfied.

**c. Did Underwriters reasonably rely?**

The fourth element is whether Underwriters justifiably relied on NIIS' misrepresentation. Roberts of Underwriters testified that the custom and practice of the London market was such that Underwriters routinely relied on information provided to them by insurance brokers. Consistent with this practice, Adams acknowledged he had an obligation to provide accurate information to Underwriters and expected that they would rely on it.[139] Roberts further testified that he, in fact, relied on the information NIIS supplied concerning Drive's existing and expected portfolios. For its part, NIIS contests the reasonableness of Underwriters' reliance.

NIIS contends Underwriters should have been particularly careful with underwriting Drive's VSI insurance because it was Underwriters' first dealing with Drive, and Roberts' first experience underwriting VSI insurance.[140] Yet, "Maryland law

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138 Adams testified that he expected the "insurer to whom [he] presented information would rely on the application in their underwriting decisions." PX 87 at 48 (Adams Dep.).

139 *Id.* at 47-49; Tr. at 383.

140 NIIS cites to *Int'l Bhd. of Teamsters v. Willis Corroon Corp.*, which noted, in considering the duty of an *insured* to examine a policy, that it could be material "whether the policy was a new one or a renewal." 802 A.2d 1050, 1059 (Md. 2002). That observation about the importance of an *insured* reading her policy, however, has little bearing on evaluating an *insurer's* duty to investigate.

does not impose on insurers a duty to investigate insurance applicants."[141] Insurers "are entitled to believe what an applicant claims to be true."[142] An insurer presented with a "considerable amount of suspicious information," however, has a duty to investigate before issuing a policy.[143] Indeed, requiring investigation merely because a new entity or customer is involved, as opposed to circumstances suggesting a false or misleading insurance application, would eviscerate Maryland's rule limiting the obligation to investigate to "extraordinary situations."

As to Drive's expiring portfolio, NIIS argues, "it is questionable whether any reasonable reliance was or could have been placed on [NIIS' misrepresentation], particularly in light of the information concerning prior premium and loss history which revealed loss ratios in excess of 100%."[144] NIIS misrepresented the expiring portfolio as being a mixture of B and C class loans, when in fact it was a mixture of C and D loans.[145]

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141 *Chawla v. Transam. Occidental Life Ins. Co.*, 440 F.3d 639, 647 (4th Cir. 2006).

142 *North Am. Specialty Ins. Co. v. Savage*, 977 F. Supp. 725, 731 (D. Md. 1997).

143 *Chawla*, 440 F.3d at 647 (punctuation omitted). The duty to investigate only exists in *extraordinary situations* when the insurer is on notice that some type of investigation is necessary. *Savage*, 977 F. Supp. at 732; *Clemons v. Am. Cas. Co.*, 841 F. Supp. 160, 167 (D. Md. 1993).

144 DAB at 8.

145 NIIS disputes Underwriters' reliance on the description of Drive's expiring portfolio as a mixture of B and C class loans, because Roberts was unfamiliar with the A, B, C, and D risk classification system. This argument lacks merit because NIIS admits Underwriters underwrote the insurance for Drive in reliance on the representation that the quality of the loans, going forward, would be A and B. In other words, although Roberts may not have been familiar with the particular details of the classification system, he understood it reflected the relative quality of the loans. Thus, NIIS' misrepresentation suggested that a change by Drive

Underwriters admittedly understood at the December 2000 meeting with NIIS and Craven that Drive's portfolio had a similar risk profile to its predecessors' previously insured portfolios.[146] In these circumstances, I find Underwriters' reliance on NIIS' misrepresentation reasonable, but only in the limited sense that Underwriters understood from it that Drive intended to improve its portfolio of B and C class loans to A and B loans. Had Underwriters understood the truth that Drive's portfolio consisted only of C and D loans, they might have proceeded differently.

NIIS further denies Underwriters reasonably relied on its misrepresentation of Drive's future portfolio. NIIS urges the Court to hold that Roberts acted unreasonably in basing his underwriting decision on "verbal, unsubstantiated representations by NIIS and Craven."[147] NIIS contends Underwriters at least should have made some inquiries to substantiate NIIS' presentation, particularly since Roberts had no prior experience with either Drive or VSI insurance. As discussed earlier, in Maryland, insurers have no duty to investigate new clients merely because they are new. Thus, Underwriters justifiably relied on NIIS' misrepresentations of Drive's expiring and future portfolios.

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from a portfolio of B and C loans to one of A and B loans would not be that dramatic.

146 NIIS makes this argument within the context of its discussion of contributory negligence, addressed *infra*. DAB at 18. I discuss these arguments here because I also find them applicable to determining whether Underwriters' reliance was reasonable.

147 DAB at 18 (discussing NIIS' contributory negligence defense).

### d. Were Underwriters' damages proximately caused by NIIS' misrepresentation?

The final element is whether NIIS' misrepresentation proximately caused Underwriters' damages. "Negligence . . . is not actionable unless it is a proximate cause of the harm."[148] "Negligence which constitutes a proximate cause of an injury need not necessarily be the sole cause," but it "must be 1) a cause in fact, and 2) a legally cognizable cause."[149] Maryland courts employ two tests to determine whether cause in fact exists: the "but for" test and the "substantial factor test."[150] "Legal cause, on the other hand, asks whether the defendant, in light of 'considerations of fairness and social policy,' should be held liable for the injury, even when cause in fact has been established."[151] "The question of legal causation often involves a determination of whether the injury was foreseeable."[152]

Underwriters assert, "because of NIIS' negligent misrepresentations, [they] issued a policy of insurance that did not reflect the true intention of the contracting parties . . . ."[153] Underwriters ask the Court to award them total damages of $976,144.60, plus interest from December 31, 2002, as relief for NIIS' negligent misrepresentations.

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148 *Atlantic Mut. Ins. Co. v. Kenney*, 591 A.2d 507, 512 (Md. 1991) (citation omitted).

149 *Id.*

150 *See, e.g.*, *Wankel v. A & B Contractors, Inc.*, 732 A.2d 333, 349 (Md. Ct. Spec. App. 1999).

151 *Id.* (citation omitted).

152 *Id.*

153 POB at 24.

Specifically, Underwriters ask for $109,899.18 in pre-rescission legal expenses, and $82,517.42 in claims processing expenses for the use of a Third Party Administrator to handle the increased volume of claims. Underwriters also claim they should receive the difference between the total premium paid by Drive ($2,612,320), which Underwriters effectively reimbursed Drive for as part of their settlement, and the net premium Underwriters actually received after taxes and broker commissions were paid ($1,828,592) for a total of $783,728.

Because NIIS does not contest the claim for $109,899.18 in legal expenses,[154] Underwriters are entitled to recover that amount. NIIS does contest, however, the other aspects of Underwriters' claim for damages. I address each of these in turn.

**1. Adjustment and claims handling expenses**

NIIS denies Underwriters' right to receive their claim handling expenses. NIIS argues the "claims handling expenses were not incurred as a proximate result of alleged misrepresentations but rather by operation of the Settlement Agreement between [Underwriters] and Drive."[155] NIIS contends that had there been no Settlement Agreement and "[h]ad [Underwriters] successfully tried its rescission against Drive . . . the parties would have been made whole through return of Drive's premiums net any commissions and expenses."[156] In support of their claim, Underwriters asserts there is no difference between the legal and claims handling expenses -- both were incurred while

154 DAB at 4.

155 *Id.* at 6.

156 *Id.*

the Policy was in effect, were born by Underwriters, and would not have been incurred but for NIIS' misrepresentations.

NIIS' negligent misrepresentations of Drive's expiring and future portfolios are the proximate cause for the claims processing expenses arising out of the Policy. Had there not been a Policy, there would have been no expenses related to processing claims under the Policy. Furthermore, NIIS has not shown that either Drive or Underwriters, but particularly Drive, would have paid the claims handling expenses whether or not it had the Policy.[157] Thus, NIIS must reimburse Underwriters for their $82,517.42 in adjustment and claims handling expenses.

**2. Commission expense of $783,728**

Drive paid $2,612,320 for coverage under the Policy. Of that amount, Underwriters received only $1,828,592 in net premium for all the loans purchased by Drive during the policy period. The remainder of the premium paid by Drive was retained by third parties as surplus lines taxes and commissions.

As a result of the Settlement Agreement, Underwriters returned the entire $2.6 million in premiums Drive paid for the Policy leaving Underwriters out of pocket for monies retained by brokers and other third parties. Underwriters contend they *had* to return the entire value of the contract, because general contract law *requires* a party

[157] NIIS has not cited any evidence demonstrating the claims handling expenses mirror, for example, expenses for handling uninsured losses. *Cf.* Tr. at 305 (Simpson) (stating Drive currently does not have claims handling expenses because it no longer has an effective policy).

wishing to rescind a contract to return the opposite party to the status quo ante.[158] Underwriters also cite Texas case law that if a risk never attached because a policy was void *ab initio*, the insured is entitled to a return of all premium paid.[159] NIIS counters that it received no commission from either Plaintiff and it would be inequitable to force NIIS to pay commissions received by Craven and Bankers when they already have settled with Underwriters.[160]

NIIS responds that "Plaintiffs cannot equitably receive payment from Craven and Bankers, discharge their liability, and then claim the same amount from NIIS."[161] I agree. I am not persuaded by Underwriters' argument that they *had* to reimburse Drive for all of its commissions. While, as part of a rescission, the insured should be refunded its entire premium (including commissions), Underwriters failed to provide adequate justification as to why they, as opposed to the brokers who received the commissions, had to return those sums.[162] NIIS' negligent misrepresentation is not the proximate cause for

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158 PRB at 10 (citing 17A AM. JUR. 2D *Contracts* § 574 (2007)).

159 *See* PRB at 10 (citing *In re Tex. Ass'n of School Boards*, 169 S.W.3d 653, 659 (Tex. 2005)).

160 NIIS cites *Kortwright v. MutualLife Ins. Co. of N.Y.*, 243 N.W. 904 (Neb. 1932), for the proposition that to recover the commissions, Underwriters would have to prove "neglect on the part of the [brokers] to whom commissions were paid." DAB at 7. NIIS contends that because Underwriters, as a result of their settlements, never proved Craven's or Bankers' fault, they cannot recover their commissions from NIIS. Because I find for NIIS on other grounds, I need not address this dispute.

161 DAB at 7-8.

162 *See also* Couch § 57:34 ("If an agent has received or retained the portion of the premium to which the agent would be entitled if the policy were not cancelled, the agent must, upon its cancellation, return or refund the unearned portion.").

this aspect Underwriters' pecuniary loss. Rather, the claimed shortfall stems from Underwriters' reimbursement to Drive of its entire premium as part of the Settlement and their and Drive's subsequent settlements with Craven and Bankers. Based on the record, I find Underwriters could have negotiated a different settlement agreement whereby they were not responsible for broker commissions, particularly since the brokers were Drive's, and not Underwriters', agents. Alternatively, Underwriters could have taken an assignment of, or otherwise preserved, Drive's claims against Craven and Bankers, such that, for example, NIIS could have pursued them if it ultimately reimbursed Underwriters for the disputed commissions. I therefore deny Underwriters' claim to recover as damages the difference between the premium they returned to Drive, and what they actually received.

**e. Are Underwriters precluded from receiving damages due to their own contributory negligence?**

The Maryland Supreme Court has defined contributory negligence as:

> the neglect of the duty imposed upon all individuals to observe ordinary care for their own safety. It is the doing of something that a person of ordinary prudence would not do, or the failure to do something that a person of ordinary prudence would do, under the circumstances.[163]

In Maryland, contributory negligence is a complete bar to recovery, "regardless of the quantum of a defendant's primary negligence."[164] In the context of insurance

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163 *Baltimore Gas & Elec. Co. v. Flippo*, 705 A.2d 1144, 1155 (Md. 1998) (citation omitted).

164 *Harrison v. Montgomery County Bd. of Educ.*, 456 A.2d 894, 898 (Md. 1983).

procurement, Maryland courts have recognized contributory negligence in negligence actions.[165] There is no Maryland case directly on point, however.[166]

NIIS argues primarily that Underwriters acted unreasonably when it relied on NIIS' misrepresentations in underwriting the Policy. In addition, "NIIS urges the Court to accept the proposition that . . . [Underwriters'] conduct . . . should be scrutinized more carefully" because "Lloyds is a veritable giant in the insurance industry and can hardly claim nescience."[167] Defendants, however, point to no precedent requiring the Court to apply special scrutiny toward Underwriters. In fact, as stated in Part I.B.2.c, Maryland imposes no duty on insurers to inspect an insured's application, absent an extraordinary situation with sufficient suspicious information to place the insurer on inquiry notice.

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165 *See, e.g.*, *Cooper v. Berkshire Life Ins. Co.*, 810 A.2d 1045, 1067 (Md. Ct. Spec. App. 2002).

166 As Underwriters note, other jurisdictions have rejected the use of a contributory negligence defense in connection with claims of negligent misrepresentation. PRB at 13 n.15; *see also* Sonja Larsen, *Applicability of Comparative Negligence Doctrine to Actions Based on Negligent Misrepresentation*, 22 A.L.R. 5th 464 (1994) (noting that courts declining "to apply comparative negligence principles have generally asserted that these principles should not apply to actions in negligence for economic loss or loss of property," while others find "there should be no distinction between negligent misrepresentations and other actions sounding in negligence for the purpose of applying comparative negligence"). Maryland courts appear to have followed the latter path. *See, e.g.*, *Int'l Bhd. of Teamsters v. Willis Corroon Corp.*, 802 A.2d 1050, 1059-60 (Md. 2002) (implicitly accepting contributory negligence as a defense to negligent misrepresentation by reversing lower court decision applying contributory negligence for failure to find sufficient facts, and not due to misapplication of law). Because my decision here rests on other grounds, I assume, without deciding, that Maryland would allow a contributory negligence defense to a claim for negligent misrepresentation.

167 DAB at 16.

Because NIIS failed to show the existence of any such suspicious information, Underwriters had no such special duty.

NIIS' further arguments for contributory negligence also lack merit because they are largely conclusory and unsupported by the evidence. NIIS argues Underwriters were contributorily negligent when they did not: place the limitation to prime loans in the policy itself; require Drive to maintain a primary insurance verification program consistent with subprime lending industry standards; and use a claims administrator from inception. I find Underwriters reasonably relied on the limitation in the legally binding covernote. I also find NIIS failed to show Underwriters acted imprudently in not requiring better primary insurance verification or installing a claims administrator at the beginning. I therefore hold Underwriters were not contributorily negligent, and are entitled to damages from NIIS in the amount of $192,416.60.

### C. Drive's claim for negligence

"To state a cause of action for negligence, the plaintiff must show (1) the existence of a duty; (2) breach of that duty; (3) proximate causation; and (4) damages."[168] As to the first two elements of negligence, this Court previously held "NIIS had a duty to communicate the 90% A and 10% B limitation of the Policy [imposed by Underwriters], and breached this duty by failing to communicate this limitation to Bankers and

[168] *Underwriters I*, 2007 WL 1207106, at *6 (Feb. 8, 2007).

ultimately to Drive."[169] I therefore turn to the final two elements, proximate causation and damages.

### 1. Proximate causation

The parties dispute whether Drive has the burden of showing the availability of alternate insurance, or whether NIIS has the burden of showing its unavailability as a defense. NIIS argues, "[i]n order for NIIS' alleged negligence to have been the proximate cause of Drive's uninsured VSI claims, Drive must prove there was comparable VSI coverage that Drive would have purchased."[170] Drive disagrees, contending under Maryland law the broker has the burden of showing the unavailability of alternate insurance. NIIS responds that to the extent Maryland law puts the burden of proof on brokers, it is merely procedural, and the law of the forum, Delaware, should apply. In the alternative, NIIS argues that if the Court considers the burden of proof here to be substantive, it should apply Texas law because it is the state with the most significant relationship. Whichever state's law applies and, even if it has the burden of proving the availability of alternative insurance coverage, Drive further contends it has met that burden. Thus, the Court must decide which state's law governs the issue of

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169 *Id.* at *28. Drive alleges NIIS breached its duty in that it: "negligently misrepresented to Drive the scope and limitations of the Policy and that it had coverage for subprime automobile loans"; "fail[ed] to obtain the insurance Drive requested for its subprime loan portfolio and fail[ed] to advise Drive that it did not obtain this insurance"; and "procure[d] an insurance policy on Drive's behalf that was voidable or otherwise defective." POB at 27-28. Because these allegations substantially overlap and the level of damages is ultimately unaffected by which of the alleged breaches is established, I address them generically, rather than individually.

170 DAB at 22.

proximate causation, and whether, in any case, the record shows the availability of VSI coverage for an indirect subprime lender like Drive.

### a. Conflict of laws analysis

Under either Delaware or Maryland law, Drive has the burden to prove proximate cause. Generally, "[t]he forum will apply its own local law in determining which party has the burden of persuading the trier of fact on a particular issue . . . ."[171] If, however, "the primary purpose of the relevant rule of the state of the otherwise applicable law is to affect decision of the issue rather than to regulate the conduct of the trial," "the rule of the state of the otherwise applicable law will be applied."[172]

In *Patterson Agency, Inc. v. Turner*, a Maryland case where the agent failed to procure adequate insurance, the court had to decide whether, as part of her burden of proof for proximate causation, the plaintiff had to prove the availability of alternate insurance.[173] Noting that "the question of whether a valid policy would have been issued is a matter peculiarly within the knowledge of the agent or broker," the court required the insurer to prove the unavailability of insurance as an affirmative defense.[174]

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171 REST. 2D CONFL. OF LAWS § 133.

172 *Id.*; *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 53 (Del. Ch. 2001) (citing REST. 2D CONFL. OF LAWS § 133).

173 372 A.2d 258, 261 (Md. Ct. Spec. App. 1977).

174 372 A.2d at 261 (quoting Thomas R. Trenkner, *Liability of insurance broker or agent to insured for failure to procure insurance*, 64 A.L.R. 3d 398 (1975) (hereinafter "Trenkner")); *see also United Capitol Ins. Co. v. Kapiloff*, 155 F.3d 488, 499 (4th Cir. 1999) (citing *Patterson Agency* on the insurer's burden).

NIIS argues, "Maryland's rule shifting the burden of proof on proximate cause is merely a common law rule affecting how Maryland cases will be tried, not a statement of substantive state policy."[175] NIIS misapprehends the issue. The *Patterson Agency* Court did not *shift* the burden of proof on proximate cause; a plaintiff in such a negligence action always bears that burden. Rather, the court in *Patterson Agency* decided the plaintiffs did not need to show the availability of alternate insurance to prove proximate causation.[176] Defendants had to raise that issue by way of an affirmative defense. Because under Maryland law this is an issue of substantive law, the law of the forum, Delaware, is inapplicable.

NIIS argues in the alternative that the determination of Drive's burden should be based on Texas, and not Maryland, law because Texas is the state with the most significant relationship. Drive retorts that one cannot take a piecemeal approach to the determination of which law applies. As NIIS notes, however, Delaware courts recognize, under the concept of depeçage, that a court need not use a single jurisdiction's law to adjudicate all issues in a case.[177] If there were a conflict between Texas and Maryland law, and Texas had the most significant relationship to Drive's negligence claim, then

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175 DAB at 26.

176 *But see, e.g., Bayly, Martin & Fay, Inc. v. Pete's Satire, Inc.*, 739 P.2d 239, 243 (Colo. 1987) ("A few courts . . . have held that causation need not be proven by the plaintiff and will become an issue only if raised as an affirmative defense."); Trenkner, 64 A.L.R. 3d 398.

177 *See Pittman v. Maldania, Inc.*, 2001 WL 1221704, at *3 (Del. Super. Ct. July 31, 2001) (defining depeçage as the process of deciding choice of law on an issue by issue basis). Drive fails to rebut this argument. *See* PRB at 19 n.21 (merely labeling NIIS' assertion "curious[]").

Texas law would govern. Ironically here, NIIS, a Maryland corporation, seeks to apply Texas law, and Drive, a Delaware limited partnership with its principal place of business in Texas, seeks to apply Maryland law.

NIIS argues Texas places the burden of proof for causation on the plaintiff in professional liability cases.[178] The issue before me, however, is not who has the burden of proof, but rather the scope of Drive's burden. In Texas, the plaintiff has the burden of proving the availability of alternate coverage.[179] Texas courts do not require the plaintiff to prove the existence of a *specific* alternate policy.[180] The alternate coverage need not be part of a "standard" policy widely available in the marketplace, a plaintiff need only prove the existence of some coverage that would have covered her loss.[181] Texas does

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178 *See* DAB at 28 (citing *Belt v. Oppenheimer, Blend, Harrison & Tate, Inc.*, 192 S.W.3d 780, 783 (Tex. 2006); *Stinson v. Cravens, Dargan & Co.*, 579 S.W.2d 298, 300 (Tex. Civ. App. 1979)).

179 "Implicit in a case alleging negligent failure to obtain insurance is the requirement that the loss be one that is covered in *some* policy." *Lin v. Metro Allied Ins. Agency, Inc.*, 2007 WL 2518996, at *5 (Tex. App. Aug. 31, 2007) (emphasis in original) (citing *Hardware Dealers Mut. Ins. Co. v. Berglund*, 393 S.W.2d 309, 310-11 (Tex. 1965); *Stinson*, 579 S.W.2d at 300); s*ee also Parkins v. Texas Farmer Ins. Co.*, 641 S.W.2d 254, 255 (Tex. App. 1982). In *Lin*, the court found a quote from another insurance company that included "contractual coverage" sufficient to support a jury finding that the failure to provide commercial general liability insurance was the proximate cause of plaintiff's injuries. *See* 2007 WL 2518996, at *5 (overturning a JNOV under a "no-evidence" standard of review). In *Stinson*, a boat owner was unable to recover for losses related to his uninsured boat because he did not "bring the loss under the coverage of *any* policy shown by the evidence to be available." 579 S.W.2d at 300 (emphasis in original).

180 *Lin*, 2007 WL 2518996, at *6 (quoting *Parkins*, 641 S.W.2d at 255).

181 In *Lin*, the court noted that even if a commercial general liability insurance policy normally would not have covered breaches of contract, plaintiff's evidence of an

not require the alternate insurance policy to be available at the same price or with the same limitations.[182] The key inquiry is whether the plaintiff's loss would have been covered. Finally, only reasonable, commercial offers would satisfy a plaintiff's burden.[183] Because Texas law requires the plaintiff insured to show the availability of some insurance, it conflicts with Maryland, which requires the defendant insurer to prove the unavailability of insurance.[184]

Delaware courts look to the Restatement (Second) of Conflict of Laws for guidance in conflict of law disputes.[185] Section 145(1) provides that "the rights and liabilities of the parties with respect to an issue in tort are determined by the local law of

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alternate insurance quote providing such coverage was sufficient to support a jury verdict in plaintiff's favor. *Id.* at *6-7.

182 The *Lin* court did not discuss the terms and price of the alternate policy relied upon by the plaintiff; it was sufficient that the policy purportedly would have covered the plaintiff's loss. *Id.* at *6.

183 While Texas courts require only the availability of "some" coverage, a requirement of reasonableness seems implicit. For example, in *Lin*, the plaintiff's evidence of alternate coverage was a bona fide offer for insurance. 2007 WL 2518996, at *5.

184 To support imposing on defendants the burden of proving coverage unavailability, some commentators cite *Stevens v. Wafer*, 14 S.W.2d 295 (Tex. Civ. App. 1929). *See* Robert Michael Ey, *Cause of Action Against Insurance Agent or Broker for Failure to Procure Insurance*, 14 Causes of Action 881, § 51 (2006); Trenkner, *supra* note 174. *Stevens*' holding, however, is inapposite. It stands for the defendant agent having the burden of proving the insured could not have recovered under the particular policy at issue. *See* 14 S.W.2d at 296 ("It has repeatedly been held in this state that the burden is upon the insurer to prove insured's breach of conditions in the policy, and that the plaintiff need only prove his insurance and his loss under it.").

185 *See, e.g.*, *Gloucester Holding Corp. v. U.S. Tape & Sticky Prods., LLC*, 832 A.2d 116, 124 (Del. Ch. 2003).

the state which, with respect to that issue, has the *most significant relationship* to the occurrence and the parties . . . ."[186]

In a tort action, the Court considers four specific contacts in applying these broad principles to the choice of law determination: (1) the place where the injury occurred; (2) the place where the conduct causing the injury occurred; (3) the domicile, residence, nationality, place of incorporation and place of business of the parties; and (4) the place where the relationship, if any, between the parties is centered.[187] "These contacts are to be evaluated according to their relative importance with respect to the particular issue."[188]

Texas has the most significant relationship to Drive's claims for NIIS' negligence and negligent misrepresentation. Of the four contacts, the first three are most important as there is no single state where the relationship between the parties is centered. As to the first element, Drive suffered harm in Texas because it has its principal place of business there.[189] Since NIIS made its misrepresentations in Maryland and London, the second

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186 REST. 2D CONFL. OF LAWS § 145(1) (emphasis added); *id.* § 148(2) (stating the most significant relationship test is appropriate in fraud and misrepresentation actions "[w]hen the plaintiff's action in reliance took place in whole or in part in a state other than that where the false representations were made"). When determining which state's law to apply on the issue of proximate cause, it "will usually be the local law of the state where the injury occurred." *Id.* § 160(2).

187 *Id.* § 145(2); *see also id.* § 148(2) (describing similar contacts for fraud and misrepresentation cases).

188 *Id.* § 145(2).

189 Although NIIS failed to cite any direct evidence that Texas is Drive's principal place of business, the record amply supports that inference. Drive's Original Petition in its Texas litigation states that its "principal office is located in Dallas, Texas." PX 40 ¶ 3. Drive's application for insurance and Craven's placement slip for Drive use the Texas address. PX 108 (Neill Bagwell Dep.) Ex. 3 at 4, Ex. 16

element is indeterminate. NIIS made the misrepresentation that most directly gave rise to Drive's claim, however, in the covernote it prepared in Maryland for ultimate transmission to Drive in Texas. The third element points to Texas again because it is Drive's principal place of business.[190] Based on these circumstances, the Court finds Texas to be the state with the most significant relationship.[191] Thus, under Texas law, Drive must prove its loss would have been covered in *some* available policy.

**b. Was there alternative coverage available to Drive?**

Under Texas law, as discussed earlier, Drive's burden for proximate causation includes showing the availability of alternate insurance coverage. Such coverage must be

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at CRA00118. Most, if not all, correspondence to and from Drive uses the Texas address. *See, e.g.*, *id.* Ex. 15 (Trent accepting VSI coverage); PX 21 (Hartmann letter enclosing Policy); PX 1 (Hartman letter to Drive); PX 4 (Drive letter to Hartman). Indeed, the only document the Court knows of referencing Drive but not using its Texas address is the Policy, which uses Drive's address in Delaware. *See* PX 21 at 000055.

190 In a misrepresentation case, "the principal place of business" is a "contact[] of substantial significance when the loss is pecuniary . . . ." REST. 2D CONFL. OF LAWS § 148 cmt. i. "The domicil, residence and place of business of the plaintiff are more important than are similar contacts on the part of the defendant." *Id.* "[T]he principal place of business is a more important contact than the place of incorporation." *Id.*

191 This conclusion comports with comment j in Section 148, where the Restatement outlines its general approach to misrepresentation claims:

> So when the plaintiff acted in reliance upon the defendant's representations in a single state, this state will usually be the state of the applicable law . . . if (b) this state is the state of the plaintiff's domicil or principal place of business, . . . or (d) this state is the place where the plaintiff was to render at least the great bulk of his performance under his contract with the defendant.

*Id.* § 148 cmt. j.

commercially reasonable, but need not refer to a specific policy. Furthermore, the alternate policy may have different limitations or price than the voided policy.[192] The differences, however, must not be of such a magnitude as to render it unlikely that Drive's damages would have been covered by the alternate policy.

Drive points to three items of evidence as demonstrating the availability of alternate VSI coverage. While proof of proximate causation requires only a showing of some alternate coverage, the particular terms of the likely coverage are relevant to determining Drive's compensable damages, if any. Thus, the Court will address both those issues in analyzing Drive's evidence.

First, Drive cites several admissions by Adams of NIIS. He admitted, for example, that in September 2000, "there could have been a policy available to [Drive]."[193] Adams' qualified his statement by noting that such a policy "was available with very strong restrictions being placed on the type of a policy that would have been written to acquire it."[194] At trial Adams testified that obtaining subprime coverage with runoff with standard conditions was impossible, and that any such insurance with runoff,

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192 NIIS argues it is insufficient merely to show "VSI coverage was 'available,'" reframing the issue as "whether comparable VSI coverage was available at a price that Drive would have paid to place such coverage." DAB at 30. Although it argued for application of Texas law, NIIS offers *no* Texas precedent for this proposition. Instead, NIIS relies on a New York case, *Rodriguez v. Investors Ins. Co. of Am.*, 607 N.Y.S.2d 329 (N.Y. App. Div. 1994), but the relevant portion of that case is only dicta, at best. *See id.* at 55-56.

193 Tr. at 374; PX 87 at 72-73 (Adams Dep.).

194 PX 87 at 72-73 (Adams Dep.).

at best, would have had limitations making only a percentage of the insured's claims recoverable.[195]

At the December 18, 2000 meeting with Roberts of Underwriters where Adams misrepresented Drive's expiring and future portfolios, Adams told Roberts there was another bid by an American insurance carrier.[196] I assign little weight to Adams' statement, however, because it probably related to the availability of alternate coverage for prime and nonprime (A and B class) loans as Adams had advised Roberts Drive's future portfolio would contain, rather than the subprime (C and D class) loans it actually contained. In other words, nothing in the record indicates Adams did not believe, albeit mistakenly, that Drive's future portfolio would have A and B class loans when he met with Roberts. Accordingly, his statement about the availability of another bid from an American carrier probably pertained to a VSI policy on loans of the same quality.

Drive further cites a January 11, 2001 letter from Adams to Neill Bagwell of Craven in which Adams first discussed VSI rates in the $50-$60 range for 100% dealer generated A and B loans, and then stated an $80 rate for Drive would result in a loss ratio of 35%.[197] Drive argues Adams' statement, together with his deposition testimony, show his belief that $80 would be a proper rate for a subprime portfolio, because as of that time Adams did not think Drive would be moving toward prime and nonprime paper. Drive mischaracterizes Adams' testimony. First, Drive failed to adduce any evidence that, as of

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195 *See* Tr. at 348-49, 360, 366-67.

196 Tr. at 168 (Roberts).

197 PX 87 (Adams Dep.) Ex. 12.

January 11, 2001, Adams had not yet formed the belief that Drive would be moving away from subprime paper.[198] Second, Adams testified that his opinion of $80 being a proper price was based on his "anticipat[ion], going forward, . . . [of] A and B paper being predominantly the type of business that [Drive] would be writing."[199] Thus, Adams' statements provide no reliable basis for finding $80 per loan would have been an appropriate price for subprime VSI insurance.

Second, Drive cites testimony provided by Gilpin of Miniter as showing the general availability of VSI insurance for subprime loans, and that there was an alternate policy available to Drive at $80 per loan. Gilpin stated that around 2001 subprime VSI insurance would have been as high as $220 per loan, with a $500 - $1000 dollar deductible.[200] This evidence is probative of the existence of alternate insurance coverage, but at a rate substantially greater than the Policy's $80 per loan premium and $500 deductible. Furthermore, it is unclear whether such a policy would have offered similar coverage to the Policy. For example, Gilpin only offered "good until canceled" VSI policies, which allowed either the insurer or the insured to cancel at any time.[201] Because Drive's "covered" losses of over $7 million far exceeded the total premium at $80 per loan (approximately $2.6 million), it is unlikely Gilpin's insurer would have continued to

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198 Drive's citation to PX 87 at 112, 166 (Adams Dep.) merely shows that Adams claims not to have heard of Drive's expected shift towards prime paper until sometime after November 2, 2000.

199 PX 87 at 139 (Adams Dep.)

200 PX 107 at 58 (Gilpin Dep.). Separately, Gilpin noted another insurance agency, Matterhorn, was offering such insurance. *Id.* at 57.

201 *Id.* at 140-42.

provide coverage for the full term of the policy. Thus, Gilpin's testimony does not demonstrate the existence of an alternate VSI insurance policy for $80 or more per loan that would have covered the losses Drive claims in this action.

In 2000, Adams of NIIS asked Miniter to provide a quote for Drive's portfolio.[202] Miniter was prepared to present a proposal for insurance by Interstate Indemnity Company (the "Interstate Proposal") for $80 per loan, with runoff coverage and no deductible.[203]

The Interstate Proposal does not support an inference that alternate insurance would have been available, because it most likely referred to a portfolio of prime and nonprime loans, and its terms were materially different from the Policy.[204] The Proposal, on its face, does not indicate the risk classification of the loans to be covered. The evidence indicates, however, that the Proposal's $80 per loan rate assumed Drive's prospective portfolio would be "85% 'A' [p]aper and 15% 'B'" paper.[205] That is, the

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202 *Id.* at 105-06.

203 *Id.* at 92, 113. The Interstate Proposal is available at PX 107 (Gilpin Dep.) Ex.6. The Proposal was never presented to Drive. PX 107 at 91 (Gilpin Dep.).

204 NIIS also seeks to exclude the Interstate Proposal as inadmissible hearsay. Drive contends the Proposal falls within the business record exception under D.R.E. 803(6). Based on the testimony of Gilpin, who stated he was prepared to submit the Interstate Proposal to Drive during the relevant time period. I hold the Proposal is admissible under Rule 803(6) for the limited purpose of showing the terms Gilpin was prepared to offer in his capacity as Interstate's agent. *See* PX 107 at 114 (Gilpin Dep.).

205 PX 107 (Gilpin Dep.) Ex. 5 at MIN00748 (handwritten note on Drive's VSI insurance policy application sent to Gilpin from Adams on Dec. 13, 2000); *id.* at 135-36 (Adams wrote the note); s*ee also id.* at 147 (noting Gilpin relied on that information, among other things, when making the Interstate Proposal).

Interstate Proposal was not to insure a portfolio of C and D loans, but rather a portfolio that included, at the least, a high proportion of A and B loans. Furthermore, the Proposal's $80 rate did not reflect Drive's true loss history on its expiring portfolio because it was based on Drive's loss history only until November 23, 1999.[206] As NIIS notes, Craven found that applying the $80 per loan premium to that aspect of Drive's loss history yielded a loss ratio of only 39%, while applying it to Drive's history as of November 2000 yielded an unfavorable 79% loss ratio.[207]

In addition, the Interstate Proposal's terms were materially different than the Policy, and do not evidence alternate coverage. Unlike the Policy from Underwriters, which had a guaranteed rate of $80 per loan for its one-year duration,[208] the premium under the Interstate Proposal would not be guaranteed. Instead, the parties could have cancelled the policy. The deductible in the Proposal also varied with the age of the policy: the deductible would be $1000 if either party canceled in its first year, $500 in its second year, and $250 in its third year.[209]

Third, Drive relies on testimony from an expert witness broker, Gary Beck, to prove VSI insurance for subprime loans was generally available. NIIS argues Beck's testimony stands only for the proposition VSI insurance was available, not that it was

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206 *Id.* Ex. 5 at MIN00751.

207 *Compare* PX 9 at CRA000241, *with* PX 111 at 4.

208 PX 107 at 140 (Gilpin Dep.). A guaranteed rate of $80 per loan for the life of the Policy was important to Drive. *See* PX 86 (Jan. 24, 2001 letter from Adams of NIIS to Hartman of Bankers).

209 PX 107 (Gilpin Dep.) Ex.6 at MIN00217.

available for subprime borrowers at a practical price.[210] The probative value of Beck's evidence is limited for several reasons. In terms of qualifications, Drive presented Beck primarily as an expert on broker conduct. He is not an underwriting expert and had not brokered a VSI policy since 1991.[211] Moreover, Beck's report makes only general observations about the VSI market without even attempting to relate them to the losses claimed by Drive. Regarding the VSI market, the report states:

> 5. VSI was generally available at the relevant time periods of the instant dispute.
>
> 6. It was, however, becoming more difficult to place because the new securitizations were creating a pressure on the supply side.
>
> 7. Portfolios of subprime paper were even more difficult, *vis-à-vis* banks, to place due to underpricing and poor underwriting results in the line.[212]

In fact, Beck admittedly did not conduct any analysis as to whether Drive, a subprime issuer, could have obtained alternate coverage.[213] While he stated that Drive could have obtained VSI coverage from four different carriers writing VSI policies at the time, Beck never investigated what price Drive, as a subprime lender, would have had to

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210 *Compare* PRB at 26-27 *with* DAB at 35-37.

211 In comparison, Adams, Gilpin, and Hartmann had much more extensive and current experience in the VSI insurance business. *See* Tr. at 329, 337 (Adams); PX 107 at 11-13, 104 (Gilpin Dep.); PX 120 at 22, 26 (Hartman Dep.).

212 PX 75 at 2 (Beck's Expert Report). If VSI coverage for subprime loans was difficult to place for a bank, a direct lender, the market for an indirect lender like Drive probably would be even more difficult.

213 PX 105 at 38-39 (Beck Dep.).

pay for such coverage.[214] According to Beck, subprime VSI was available and no single credit risk was uninsurable, but a subprime lender would have to "pay dearly for it."[215] Beck provided no estimates, however, on what such insurance would have cost.[216] At best, therefore, Beck's testimony stands merely for the proposition that anything is available for a price.

To rebut Drive's proofs and demonstrate the unavailability of alternate insurance, NIIS cites a letter from Hartman of Bankers, who has focused on VSI insurance since 1984, urging Drive to take the insurance from Underwriters. Hartman's letter states, "V.S.I. insurance for sub-prime companies is almost non-existent and for full loan term coverage, *non existent*."[217] Hartman's statement reflects the general market, or rather the lack thereof, for subprime VSI insurance.[218]

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214 *Id.* at 40-42.

215 *Id.* at 38.

216 *Id.* at 42.

217 PX 8 at 000010 (letter from Hartman to Trent of Drive, dated Nov. 7, 2000) (emphasis in original).

218 NIIS also argues Drive was so price sensitive, that it would not have accepted higher insurance premiums, and notes that Drive has gone without insurance since the Policy's termination. I consider Drive's behavior since termination of the Policy irrelevant to disproving the availability of alternative insurance. In *Wood v. Newman, Hayes & Dixon Ins. Agency*, the defendant insurance agency challenged a negligence claim by arguing plaintiff would not have acted differently upon discovering its coverage gap. 905 S.W.2d 559, 563 (Tenn. 1995) (applying Tennessee law, which does not require plaintiffs to prove alternative coverage). Speculating as to what an insured would have done had it been notified of its lack of coverage "is not only futile, . . . it is irrelevant: the fact remains that the agent's failure to inform the [insured] of the change in coverage completely denied them any opportunity to explore other methods of protecting their property." *Id.* at 564.

Drive has shown VSI insurance for subprime loans was available in 2001, but not that such coverage was available at prices or on terms comparable to the Policy, or that it would have covered Drive's loss. In particular, Drive has not shown by a preponderance of the evidence that it could have obtained effective coverage for its subprime portfolio on terms even remotely comparable to the Policy Underwriters provided for what they thought were A and B class loans -- *i.e.*, $80 per loan, a deductible of $500, runoff coverage, and a guaranteed rate for one year. Based on all the evidence and to the extent it is relevant, I find Drive has not shown alternative coverage was available at a price it would have paid. More importantly, the Court finds Drive has not shown NIIS proximately caused its uninsured losses, because it failed to prove the existence of any coverage that realistically would have covered those losses.

**2. What are Drive's compensable damages?**

Drive seeks reimbursement of legal fees relating to its rescission of the Policy and recovery of its uninsured losses. Drive asks for $109,374.14 in legal fees and expenses incurred in defending itself against Underwriters' rescission claims. NIIS makes no substantive counterargument. Thus, for the same reasons discussed as to Underwriters' request for legal expenses, I grant Drive's request for reimbursement of its legal expenses in the amount of $109,374.14.

Drive also claims damages resulting from its uninsured losses. The parties stipulated, "Drive's total losses that would have been covered under the policy had the policy remained in force are $7,142,100.60."[219] These uninsured losses do not include

[219] 2d Suppl. Joint Pre-trial Order ¶ 52.

what it would have cost Drive to insure against them. Assuming the same $80 per loan premium as specified in the Policy, Drive argues it would have paid a total premium of $2,612,320. Subtracting that cost from its uninsured losses, Drive claims $4,529,780 in damages as a result of NIIS' negligence.

Although "mathematical certainty" is not required to award damages, Drive has failed to provide the Court with an adequate basis for a reasonable estimate of monetary damages, even assuming it had met its burden to prove proximate cause (which it did not).[220] Drive has not shown that the alternate coverage would have been at an $80 per loan rate with a $500 deductible and runoff coverage. In fact, Drive has not shown with any reasonable precision what the contours of the alternate coverage would have been. Without some reasonable basis to estimate premiums, predict an appropriate deductible and length of policy, and determine whether runoff would have been available, I could only speculate about the amount of Drive's damages. One plausible inference from the evidence, for example, is that the best policy Drive could have obtained would have cost somewhere between $125 and $220 per loan, with a $1000 deductible, and no runoff coverage. Taking into account the cost of insurance, such a policy may not have covered any of Drive's uninsured losses. Because the record provides no reasonable basis for determining the referenced variables, I conclude Drive has not proven its claim to recover its uninsured losses.

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[220] *See Red Sail Easter Ltd. Partners, L.P., v. Radio City Music Hall Prods, Inc.*, 1992 Del. Ch. LEXIS 224, at *19 (Sept. 29, 1992).

## D. Prejudgment Interest

In the Joint Pretrial Order, the relief sought by Plaintiffs includes, "all allowable pre-judgment interest."[221] Neither side, however, identified any issue of fact or law remaining to be litigated regarding prejudgment interest. Plaintiffs' opening posttrial brief mentioned interest only in their conclusion, where they sought "appropriate interest" on the total amount of damages claimed by Underwriters from December 31, 2002, and on damages claimed by Drive from February 1, 2001, the inception date of the Policy. In its answering posttrial brief, NIIS asserted Plaintiffs had not addressed the issue of whether and how prejudgment interest would apply, and suggested they might have abandoned their interest claim. In a footnote, NIIS further stated:

> NIIS believes that, for a number of reasons, prejudgment interest is not recoverable here. However, the issue is particularly complicated in this case due to conflict of laws issues, multiple alternative dates for calculating interest, and factors applicable to any discretionary award of interest. For these reasons, NIIS has not addressed in this brief the issue but rather hereby reserves the issue until after the Court has ruled on the claims in chief.[222]

Plaintiffs summarily repeated their request for prejudgment interest in their reply brief, but otherwise did not respond to NIIS' suggestion.

I fault both Plaintiffs and Defendant NIIS for their collective failure to provide the Court a more informative record on which to decide prejudgment interest issue. Plaintiffs minimally raised this issue in the Joint Pretrial Order, and NIIS said nothing substantive about it. NIIS' belated and unilateral decision to bifurcate and stay the question of

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221 Jt. Pretrial Order at 18.

222 DAB at 1 n.1.

prejudgment interest, as reflected in its answering posttrial brief, takes undue liberties with the Court's processes and will not be countenanced. The wisdom of such a piecemeal approach to litigation and the sometimes significant delays it can cause in the entry of a final judgment is debatable, at best. Thus, absent a ruling from the Court to the contrary, the parties must be prepared to present at trial all issues ripe for decision at that time. Disagreements about the scope of a trial should be presented at the pretrial conference, if not earlier.

Turning to the merits of Plaintiffs' request for prejudgment interest, I note that generally, under the law of this forum, "[a] successful plaintiff is entitled to interest on money damages as a matter of right from the date liability accrues."[223] The law of the forum is inapplicable, however, because the application of prejudgment interest is generally an issue of substantive law.[224] Accordingly, I will apply Maryland and Texas law, respectively, to Underwriters' and Drive's claims for interest.

Underwriters seek interest from December 31, 2002. Under Maryland law, prejudgment interest may be awarded in tort actions when the damages are "readily ascertainable."[225] Prejudgment interest is not generally a matter of right and is left to the

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223 *Summa Corp. v. Trans World Airlines, Inc.*, 540 A.2d 403, 409 (Del. 1988).

224 *See Cooper v. Ross & Roberts, Inc.*, 505 A.2d 1305, 1307 (Del. Super. Ct. 1986); *see also* E. H. Schopler, *Conflict of laws as to interest recoverable as part of the damages in a tort action*, 68 A.L.R. 2d 1337 (describing majority rule).

225 *Merrick v. Mercantile-Safe Deposit & Trust Co.*, 855 F.2d 1095, 1106 (4th Cir. 1988) (citation omitted).

discretion of the fact finder.[226] "The purpose of the allowance of prejudgment interest is to compensate the aggrieved party for the loss of the use of the principal liquidated sums found due it and the loss of income from such funds."[227] In these circumstances, which include the clearly established fault of NIIS, Underwriters are entitled to receive prejudgment interest as compensation for the income they lost on their proven damages.

Unless otherwise provided by statute, prejudgment interest is calculated at the legal rate of six percent per annum,[228] and is simple, not compound.[229] Thus, under Maryland law, NIIS must pay Underwriters interest at the rate of six percent per annum, without compounding, as of the December 31, 2002.

Drive seeks interest from February 1, 2001. In Texas, "prejudgment interest is awarded to fully compensate the injured party, not to punish the defendant," and functions as "additional damages for lost use of the money due as damages during the lapse of time between the accrual of the claim and the date of judgment."[230] The two

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226 *Ver Brycke v. Ver Brycke*, 843 A.2d 758, 777 (Md. 2004); *see also Buxton v. Buxton*, 770 A.2d 152, 165-66 (Md. 2001) (describing limited range of inapposite situations where prejudgment interest is either available as a matter of right or denied as a matter of law).

227 *I.W. Berman Props. v. Porter Bros., Inc.*, 344 A.2d 65, 79 (Md. 1975). The exercise of discretion to award prejudgment interest is based on the "equity and justice appearing between the parties and a consideration of all the circumstances." *Id.* at 74.

228 *Harford County v. Saks Fifth Ave. Distrib. Co.*, 923 A.2d 1, 14 (Md. 2007); Md. Const. Art. III, § 57.

229 *See Columbia Commc'ns Corp. v. EchoStar Satellite Corp.*, 2 F. App'x 360, 372 (4th Cir. 2001) (citing *United Cable Television of Baltimore Ltd. P'ship v. Burch*, 732 A.2d 887, 892 (Md. 1999)).

230 *Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809, 812 (Tex. 2006).

sources for an award of prejudgment interest are common law equitable principles and an enabling statute.[231] Considering all the circumstances of this case, I conclude Drive ought to receive prejudgment interest as compensation for its lost income.

Prejudgment interest accrues on the earlier of (1) 180 days after NIIS first received written notice of Drive's claim or (2) the date Drive filed suit.[232] "[P]rejudgment interest accrues at the rate for postjudgment interest and is computed as simple interest."[233] The postjudgment interest rate is the Federal Reserve's prime rate on the date of computation, which is defined as the 15th of the month preceding judgment.[234] Drive first filed suit on August 24, 2002, and points to no written notice given to NIIS that would support a date of accrual earlier than August 24, 2002. Thus, under Texas law, NIIS must pay Drive prejudgment interest at the applicable rate from August 24, 2002 to the date of the Judgment, without compounding.

## III. CONCLUSION

For the reasons stated in this Opinion, I deny Plaintiffs' request for a declaratory judgment voiding the Policy. Finding NIIS liable for negligent misrepresentation, I further hold Underwriters are entitled to receive $109,899.18 for their legal expenses

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231 *Harris County Toll Rd. Auth. v. Sw. Bell Tel., L.P.*, 2006 Tex. App. LEXIS 8165, at *9 (Sept. 14, 2006) (citing *Johnson & Higgins of Tex., Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 528 (Tex. 1998)).

232 *See id.* at *10; *Johnson & Higgins*, 962 S.W.2d at 528-31; *see also* TEX. FIN. CODE ANN. § 304.104 (Vernon 2007).

233 *Ziemian v. TX Arlington Oaks Apartments, Ltd.*, 233 S.W.3d 548, 553 (Tex. App. 2007) (citing *Johnson & Higgins*, 962 S.W.2d at 532).

234 *See* TEX. FIN. CODE ANN. § 304.003 (Vernon 2007) (also specifying the minimum rate as 5%, and the maximum rate as 15%).

relating to the rescission of the Policy and $82,517.42 in adjustment and claims handling expense, but deny Underwriters' request for $783,728 in commission expense. Finding NIIS liable for negligence and negligent misrepresentation, I grant Drive's request for $109,374.14 in legal fees and expenses relating to the rescission of the Policy, but deny Drive's claim to recover uninsured losses of $4,529,780. I further grant Plaintiffs' request for interest as specified herein.

Plaintiffs' counsel shall submit a proposed form of final judgment, on notice, in accordance with the Court's rulings within ten (10) days of the date of this Opinion.