CPCU SOCIETY
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Consulting, Litigation & Expert Witness Interest Group

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You can read newsletters filled with hot topics, join online discussion boards, initiate idea exchanges, make valuable connections and much more — for every interest group. Have you selected your primary interest group yet? If not, go to the interest group area of the Society's Web site, www.cpcusociety.org, to indicate your primary area of interest. You can also identify your preference as to how you wish to receive an interest group's newsletter. Of course, as a paid CPCU Society member, you have electronic access to all interest group newsletters.

Message from the Chair

by Vincent "Chip" Boylan Jr., CPCU, RPLU

Vincent "Chip" Boylan Jr., CPCU, RPLU, is senior vice president of Willis of Maryland Inc., a subsidiary of Willis HRH. He is past president and a former education director of the CPCU Society's District of Columbia Chapter. Boylan has been a member of the CLEW Interest Group Committee for more than nine years and has served as the CLEW webmaster. Currently, he is chairman of the Insurance Agents & Brokers of Maryland, that state's affiliate of the National Association of Professional Insurance Agents.

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

—Mark Twain

Samuel Clemens (pen name Mark Twain) probably developed this philosophy as he plied the many occupations he pursued during a variety-filled career. In addition to making a living as a celebrated author, at one time or another Twain tried his hand at being a printer; newspaper reporter and editor; silver miner; inventor (three patents to his name); publisher; lecturer; and steamboat pilot. Twain achieved the license necessary to hold the latter position only after studying 2,000 miles of the Mississippi for more than two years. An often unpredictable major waterway like the Mississippi can teach anyone, including one with Clemens' experience, a good deal about trouble.

How many of us during our careers have been confronted with something we knew for sure but later learned "just ain't so"

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What's in This Issue

Message from the Chair

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and got us into trouble? For example, a coverage interpretation or ruling that left a policyholder without the protection we were sure existed. Or the latest ISO version of a policy form with a "premium neutral clarification" that somehow always seems to clarify protection right out the window. How about longstanding case law that evaporates overnight with today's court opinion?

Challenges like these are an unavoidable fact of working in the ever-changing fast lane of today's business climate. Adapting to and evolving with this constantly transforming environment are essential (although often unwritten) components of our job descriptions.

Where do we go for help as we struggle to avoid the "just ain't so" predicaments that Mark Twain warned us about?

The CPCU Society in general, the CLEW Interest Group in particular, and this newsletter specifically (including past and future editions) can often point the way or give us examples of how we can steer clear of troubled waters. I have often read articles in this publication that enlightened me on a subject that I knew little, if anything, about. More importantly, all too often a contributing author has conveyed knowledge that hit me with a "what I knew for sure that just ain't so" thunderbolt between the eyes.

Articles in this issue remind us of CLEW members who volunteered their time and brainpower to develop and present seminars at the Society's Annual Meeting and Seminars in Denver — seminars that serve to pilot us through often uncharted waters. In the following pages, you will read more about these seminars and those individuals who deserve our appreciation for their work on them: **Stanley L. Lipshultz, CPCU, J.D.; Robert L. Siems, CPCU, J.D.; George M. Wallace, CPCU, J.D.; Nancy D. Adams, CPCU, J.D.; Kathleen J. Robison, CPCU, ARM, AIC; Donald S. Malecki, CPCU;** and **Gregory G. Deimling, CPCU, ARM, AMIM.**

Samuel Clemens probably coined his Mark Twain pen name from a term he knew from his river boat pilot days. The necessary depth of the river for safe passage of a steamboat was two fathoms (or about 12 feet). The leadsman, a crew member who used a sounding line to continuously measure the depth of the potentially shallow water, shouted out the readings, or "marks," on the line. "Twain" is an archaic term for the number two. When the leadsman cried out "mark twain," he was letting the pilot know that the mark on the line showed two fathoms, which was enough clearance for safe passage.

As we all struggle for "mark twain," or clear passage, through the often murky waters of the world in which we work today, let's continue to rely on the CPCU Society, the Consulting, Litigation & Expert Witness Interest Group (and other Society interest groups) and each other to navigate past "just ain't so" moments.

Finally, special congratulations to our own Stanley Lipshultz, past editor of this newsletter and past chair of our interest group (as well as one of its founders), on being named this year's well-deserving recipient of the George M. Gottheimer Memorial Award. "You da man, Stan!" ■

Editor's Notes

by Jean E. Lucey, CPCU

Jean E. Lucey, CPCU, earned her undergraduate degree in English and graduate degree in library science through the State University of New York at Albany. After a brief stint as a public school librarian, she spent six years at an independent insurance agency outside of Albany, during which time she obtained her broker's license and learned that insurance could be interesting. Serving as director of the Insurance Library Association of Boston since 1980, Lucey attained her CPCU designation in 1986. She is a member of the CLEW Interest Group Committee.

Your Consulting, Litigation & Expert Witness (CLEW) Interest Group was quite active and visible at the Society's Annual Meeting and Seminars in Denver, as mentioned by **Vincent "Chip" Boylan Jr., CPCU, RPLU,** in his Message from the Chair. In this issue, you will find information about the annual George M. Gottheimer Memorial Award and this year's most worthy winner, **Stanley L. Lipshultz, CPCU, J.D.,** as well as details of the meeting's mock trial and those who populated its cast.

Included in the August 2009 issue of the CLEW newsletter was Part One of "Surprise! And the Other Three 'S' Words that Result in Time Element Disagreements," by **Charles W. Carrigan, CPCU, CPA, CFF, AIC.** The first two "Ss" discussed were "suspension period" and "sales trend." Please see Part Two in this issue for further elucidation, including discussion of "saved expenses," the third "S," as well as suggested solutions.

Remember that parody of the song "Show Me the Way to Go Home; I'm Tired and I Want to Go to Bed" that began, "Indicate the Way to My Habitual Abode, I'm Fatigued and I Want to Retire"? Attorneys **Edward M. Slaughter, J.D.,** and **Lauren E. Wood, J.D.,** of the law firm of Hawkins, Parnell & Thackston LLP, do not fall into the trap of overblown rhetoric when they ask, "Is Your Expert a Liar or Does He Really Believe That Garbage?". Of course we are no doubt safe in thinking that none of our readers are prevaricators (I didn't swear off such rhetoric), but certainly you may have run into them in one capacity or another — perhaps as adversaries or perhaps even as colleagues on a particular case. Prudent handling of this sort of situation can be much enhanced by the guidance that this item provides.

Data breaches are something to which we may have grown somewhat accustomed, but that doesn't make them any more welcome. **David Speciale,** a client relations manager at Identity Theft 911 LLC, summarizes the situation in this realm and offers pertinent suggestions for their avoidance.

We are graced by the participation of **Donald S. Malecki, CPCU,** in this newsletter. He addresses a situation involving a claims-made tail for products liability coverage. "It must be noted, first of all, that a claims-made tail is not coverage but rather a late reporting provision," Malecki states, in a manner equally elegant, to my mind, as the summary of the application of coinsurance being "has/needs times wants equals gets." Those who ask the questions certainly benefit from Malecki's responses, and we are most fortunate to be able to share his insights.

Please do not hesitate to respond to anything you read in these pages, whether to agree with something that has been said, state the need for additional discussion or express contrary views. You can do so by e-mailing me at jlucey@insurancelibrary.org. If you prefer that something you send me not be shared in a subsequent newsletter, let me know. ■

Lipshultz Receives Coveted CPCU Society George M. Gottheimer Memorial Award

by the Consulting, Litigation & Expert Witness Interest Group Committee

The Consulting, Litigation & Expert Witness (CLEW) Interest Group Committee bestowed its third annual George M. Gottheimer Memorial Award on **Stanley L. Lipshultz, CPCU, J.D.** Lipshultz is a consultant with Interisk Limited in North Bethesda, Md. The presentation was made on Aug. 30 in Denver, immediately preceding the CLEW Interest Group's mock trial, "Rocky Mountain Heist … Or Certificates of Insurance, Additional Insureds and Other Myths," held during the Society's 2009 Annual Meeting and Seminars. The award is presented to a CPCU Society member who has made an outstanding contribution to the field of insurance education, risk management or insurance consulting.

The Society cited Lipshultz's premier educational achievements as a member of its District of Columbia Chapter and his distinguished and voluminous contributions — in many capacities — at the Society level. Those contributions include having been a course instructor for CPCU and the Independent Insurance Agents of Maryland and D.C. for almost 30 years; his volunteer service as a CLEW Interest Group Committee member, including serving as newsletter editor and chair; his service as a CPCU Society Governor and Executive Committee member and as chair of the Diversity Committee; his impact in writing the scenarios for, and serving in, various roles in the 13 mock trials presented by CLEW Interest Group at the CPCU Society's Annual Meeting and Seminars since 1995.

"We had several worthy nominees this year, but Stan's contributions to the Society and CLEW stood apart from the others," said **James A. Robertson, CPCU, ARM,** a member of the Gottheimer Award Selection Committee. "We are very privileged to be the beneficiary of his talents."

James A. Robertson, CPCU, ARM, of the CLEW Interest Group (pictured on left), presented the award to Lipshultz.

The Award is named in memory of **George M. Gottheimer Jr., CPCU, Ph.D., CLU, ARe,** a longtime supporter of CLEW and a person of towering stature in the insurance industry. Gottheimer, who was an insurance and reinsurance management consultant, embodied the concept of a lifelong learner and was one who loved to teach. He passed away in 2007.

". . . Stan's contributions to the Society and CLEW stood apart from the others."

The two previous recipients of the Gottheimer Award are **Donald S. Malecki, CPCU,** a distinguished insurance scholar and teacher for more than 40 years, who was honored in 2007; and **Norman A. Baglini, CPCU, Ph.D., CLU, ARe,** professor of risk management, insurance and business ethics at Temple University in Philadelphia, who received the award in 2008. ■

Showdown at the Mile-High Corral — CLEW Interest Group Presents Mock Trial in Denver

by George M. Wallace, CPCU, J.D.

George M. Wallace, CPCU, J.D., is a partner in the law firm of Wallace & Schwartz in Pasadena, Calif. His practice centers on litigation in the field of insurance coverage and insurance bad faith (for both insurers and insureds) and defense of professional liability claims in addition to general business litigation and appellate practice. He is currently a member of both the Los Angeles and the San Gabriel Valley Chapters as well as a member of the CLEW and the Claims Interest Groups.

A tangled saga of Ponzi schemes, toxic mortgages, credit default swaps and certificates of insurance provided the background for this year's Consulting, Litigation & Expert Witness (CLEW) Interest Group mock trial presentation. "Rocky Mountain Heist … Certificates of Insurance, Additional Insureds and other Insurance Myths" was held at the Society's 2009 Annual Meeting and Seminars in Denver on Aug. 30. The legal jousting began immediately as the case of *Kopath, et al. v. Great Sahara Desert Bonding & Insurance Company* was gaveled to order by the honored and Honorable **Stanley L. Lipshultz, CPCU, J.D.** (See the article on the George M. Gottheimer Award in this issue.)

Robert L. Siems, CPCU, J.D., appeared as counsel on behalf of the plaintiff, Seymour "Sy" Kopath, Ph.D., with **George M. Wallace, CPCU, J.D.,** appearing for the defendant, Great Sahara Desert Bonding and Insurance Company ("Great Sahara"). Through the attorneys' opening statements and the testimony of witnesses, the following tale emerged.

Nearly 2,000 CPCUs, non-CPCUs and guests attended the Annual Meeting and Seminars, Aug. 29–Sept. 1, at the Colorado Convention in Denver, Colo. More than 50 seminars, on topics ranging from coverage analysis and sustainability to managing change and dodging the unemployment crisis, were presented.

"Dr." Kopath **(James A. Robertson, CPCU, ARM)** was the longtime business partner of G. Reid Steele, a brilliant and powerful figure in the world of high-flying international finance. Together, Kopath and Steele formed G. Reid Steele Associates, which quickly grew to be the largest private financial enterprise on the planet, accepting and managing enormous sums for its clients while returning amazingly — some would say suspiciously — high returns. Seeing opportunity in the booming real estate market, the two spun off a separate mortgage brokerage company, G. Reid Funding, operated by Steele. Kopath remained in charge of the original business, now operating under its new name of "Ponz Inc."

The two wheeler-dealers had a final brainstorm — bundling the mortgages generated by Steele's operation as "Structured Investment Vehicles" (SIVs) and reselling those new securities to investors through Ponz Inc. To make the new investment vehicles as palatable as possible to his clients, Kopath proposed to back them by offering "Credit Default Swaps" (CDSs) that would promise to pay a guaranteed return in the event of defaults on the various mortgages underlying the SIVs.

A CDS is not a form of insurance, but a CDS contract is structured very much like an insurance policy: The "protection seller" promises the "protection buyer" that it will pay in case of a "credit default event" arising from an identified security, such as an SIV issued by G. Reid Funding and sold by Ponz Inc. For purposes of this case, prior to the start of trial, the Court of Appeal for the Fictitious District of Colorado determined that the law of insurance would govern all legal disputes arising from credit default swap transactions.

By a happy coincidence for Kopath, just as he was seeking someone to provide CDS services, the managers of the Shifting Sands Mutual Insurance

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Showdown at the Mile-High Corral — CLEW Interest Group Presents Mock Trial in Denver

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One hundred eighteen attendees had much to discuss at the 2009 edition of the mock trial held at the CPCU Society's 2009 Annual Meeting and Seminars in Denver, Colo.

Company decided that their company should enter the CDS market and formed a new subsidiary, Great Sahara Desert Bonding and Insurance Company. By an even happier coincidence, Great Sahara continued to do business with Shifting Sands' most successful and notorious producer, Ara N. Omitian **(Norman F. Steinberg, CPCU)** and his DW/EiC ("Don't Worry, Everything is Covered") Insurance Agency.

Omitian, fortuitously meeting Dr. Kopath and knowing an opportunity when he saw one, persuaded Ponz Inc. to use his agency, and his connections to Great Sahara, to meet all of its CDS needs. As the applications began to flow from DW/EiC to Great Sahara, and as the premium dollars began to flow, the company's head of underwriting, Alexander Isaac Toupee, known to his friends as Al Ike Toupee **(Vincent "Chip" Boylan Jr., CPCU, RPLU),** saw to it that new CDS instruments were approved and issued at a furious pace.

Meanwhile, Ara Omitian created a specialized department within DW/EiC, staffed with the brightest young talent — all devoted to the issuance of "certificates" that could be presented by Kopath to the purchasers of Ponz Inc. SIVs, assuring them that they were protected by an appropriate CDS instrument. Omitian's gifted young "wizards" issued these certificates much as certificates of insurance might be issued, but felt free to modify the terms and representations of the certificates in any way that the customer, Ponz Inc., requested. They made these modifications without ever transmitting copies of the certificates to Great Sahara. In fact, Great Sahara specifically requested that copies of the certificates not be sent.

The high-flying days of G. Reid Funding and Ponz Inc. were too good to last. As the real estate "bubble" collapsed and more and more mortgages began to default, the Ponz SIVs began to look increasingly unsteady. Worse, both Kopath and Steele were sought by law enforcement authorities as the dubious nature of their investment scheme came to light. Steele was last seen fleeing the country, and his whereabouts are presently undetermined.

While awaiting trial in his own criminal case, Dr. Kopath, on behalf of his investors, presented a demand for Great Sahara to pay on the CDS purportedly backing an investment designated as SIV #666, which had a face value of $10 million. Great Sahara's head of claims, W. E. Neverpeigh **(Joan D. Fitzsimmons, CPCU, CLU)**, appalled by the profligate issuance of supposed "certificates," declined the claim, much to the chagrin of her underwriting department.

Kopath, on behalf of his investors, brought suit against Ara Omitian, DW/EiC Agency and Great Sahara, demanding payment of the $10 million. In a surprise move on the eve of trial, Omitian's own professional liability carrier reached a settlement with Kopath for an undisclosed amount, and Omitian became a friendly witness in support of Kopath's pursuit of a further recovery from Great Sahara.

A jury of eight, and the Denver audience, learned of this labyrinthine history through the testimony of "Sy" Kopath (who was permitted, on a motion by his counsel, to appear in court in civilian attire, rather than in handcuffs and an orange jumpsuit), Ara N. Omitian, Al Ike Toupee and W. E. Neverpeigh. They heard as well from expert witnesses retained by each side — **Akos Swierkiewicz, CPCU,** for the plaintiffs and **Steven A. Stinson, CPCU, J.D., CLU, AIC, AAI,** for the defense.

Having been instructed by the judge concerning the law of certificates of insurance, actual and apparent authority of agents, and other relevant issues, the jury withdrew to deliberate while the audience and cast discussed the case, with an eye on best practices in the issuance of certificates. When the jurors returned, they announced their verdict — that the claim presented was not covered and that Great Sahara was not obliged to pay any portion of the $10 million sought by Kopath.

Although court was then adjourned, The Mighty CLEW Players will reconvene this September at the CPCU Society's 2010 Annual Meeting and Seminars in Orlando, Fla. ■

Surprise! And the Other Three 'S' Words that Result in Time Element Disagreements — Part Two

by Charles W. Carrigan, CPCU, CPA, CFF, AIC

Charles W. Carrigan, CPCU, CPA, CFF, AIC, is principal of Carrigan Accounting Associates LLC, a certified public accounting firm currently based in Portsmouth, N.H. With more than 30 years' service to the insurance industry providing forensic accounting services, he is responsible for developing the scope, staffing and audit program for evaluating insurance/reinsurance claim submissions relating to insured commercial insurance/reinsurance claims. Carrigan earned a bachelor's degree in accounting from Northeastern University. He is a member of the CPCU Society's Boston Chapter.

Editor's note: Part one of this article was published in the August 2009 issue of the CLEW newsletter and addressed "suspension period" and "sales trend." Part two addresses "saved expenses" and offers "suggested solutions."

Saved Expenses

When comparing the claim to the loss calculation, one of the more common omissions is the failure to exclude cost-of-sales in the claim submission. Rather, the insured is under the impression that the claim need only account for lost sales, which is a common oversight when claims are not prepared and submitted by qualified accountants or other persons with a financial background. The categories of saved expenses (discontinued expenses) normally include:

(1) **Payroll** — During a prolonged full-suspension, such as six months or more, the insured generally would be able to keep most employees working, perhaps doing cleanup and debris removal in the week(s) immediately following the loss. However, shortly thereafter there may be little or no work to be done for most of the nonessential personnel. These nonessential employees should be temporarily laid off until the reconstruction is complete or nears completion. This poses a number of controversial issues:

(a) First, if the insured does keep his/her employees on after a loss to help clean up, remove debris and similar tasks, these expenses would be indemnifiable for a "reasonable" time following the loss. **Caution!** If the insured's employees are involved in cleanup and debris removal, these expenses should be indemnified under the *contents coverage and should not be compensated again under the business interruption or extra expense coverage*. The accountant should obtain clarification from the adjuster concerning payments relating to internal labor used for cleanup and/or debris removal. The portion paid under the contents coverage should be *deducted* from the "normal, continuing payroll" to avoid *double* indemnity.

(b) Second, the interpretation of "necessary essential employees" often leads to controversy during the suspension period. Essential employees generally are considered to be officers, managers and other "key employees," such as the sous chef in a fancy restaurant. When the policy includes indemnification for "continuing normal operating expenses incurred, including payroll" (and most business interruption and extra expense policies contain similar language) that language is usually qualified in the "Loss Determination" section of the Policy with similar language: "The operating expenses, including payroll, *necessary to resume "operation" with the same quality of service that existed just before the direct physical loss*." The insured may have a different understanding of "*necessary*" functions some employees performed during a full suspension. The adjuster may consider this to be a *management decision* and not *necessary for the resumption of operations*.

(c) Also, shortly after the loss, if hourly employees are working overtime at premium rates and performing functions other than cleanup/debris removal (which

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Surprise! And the Other Three 'S' Words that Result in Time Element Disagreements — Part Two

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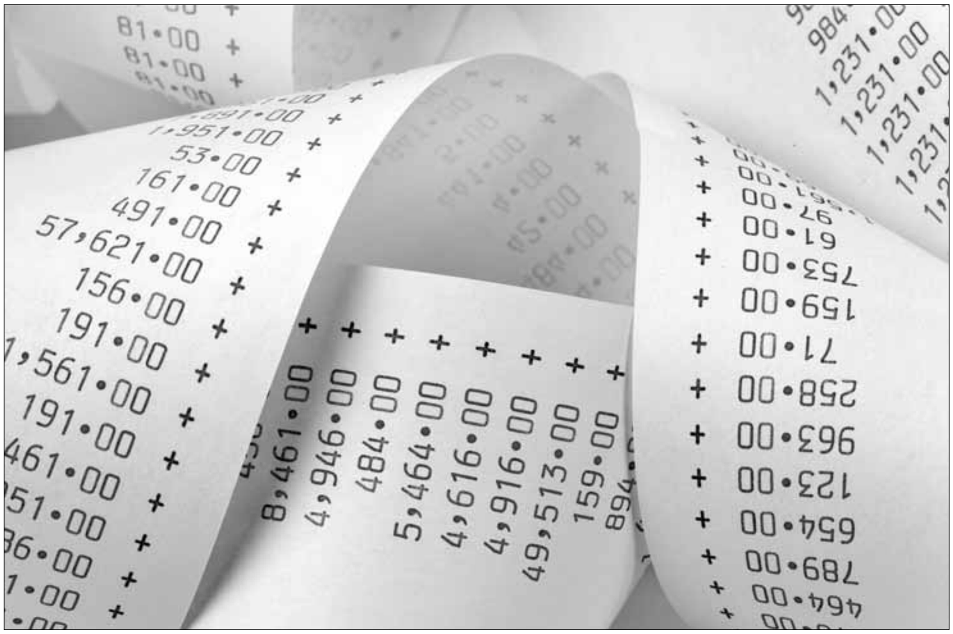
may be covered under the contents coverage), the "normal" payroll would be compensated as a continuing expense under the business interruption coverage, whereas the premium portion of the payroll would be covered under the extra expense coverage. *This could be relevant if the business interruption coverage has a coinsurance clause and the insured is a coinsurer, whereas the extra expense coverage is not subject to coinsurance and does* ***not*** *have any waiting period.*

(d) Often, the insured will utilize its own employees to perform repairs related to the building, machinery and equipment rather than engage outside contractors for certain aspects of the rebuilding process. The adjuster may recommend advances for these repairs under the building or personal property coverage. The claim evaluator must be aware of these "earmarked" payments through adjuster queries, and be sure to reduce post-loss continuing payroll and related payroll taxes and fringes to avoid duplication when evaluating continuing and saved expenses.

(e) Sales salaries and commissions — For a short suspension, sales salaries may continue, especially if a salesperson is vital to the company's survival and as long as the insured *actually* continued payments. In a prolonged suspension, the adjuster may consider continuing *only* the salaries of the sales manager(s) in the business interruption measurement. In either case, the "normal" commissions would be a saved expense on those sales not generated during the suspension period, even though the lost sales would be included in the business interruption loss calculation. Note: sales commissions may be reflected on the insured's financial statements as a component of "cost-of-goods-sold" to arrive at gross profit. However, the commission would be discontinued in relation to the lost sales.

(2) **Depreciation** — Seldom will a claim recognize depreciation as a saved expense. During a short suspension period with minimal building or personal property damage, there may not be a need to discontinue any depreciation. However, during a prolonged suspension period, and especially during a full suspension, there likely will be some discontinued depreciation warranted. The reason for this is that when an asset is purchased for a substantial amount, say in excess of a few thousand dollars, the cost recovery (expense) is amortized over the expected useful life of the asset. This is a basic accounting principal that matches the expense of the asset with the "life" over which the asset is expected to be used to produce revenue. If the asset is destroyed, it would be insured under the contents coverage, and, depending upon the coverage (usually Replace Cost Valuation — RCC), a replacement or repair is performed over a period of time during the suspension period. Therefore:

(a) If the asset is destroyed and not replaced for several weeks or months, to continue to record a monthly depreciation expense would be a "doubling-up" of continuing expenses — the first time when the payment is made to repair or replace the damaged or destroyed asset (as paid under the building or personal property coverage), and then a second time when depreciation is recognized on the damaged



or destroyed asset during the time it was no longer being used (suspension period). Another way of demonstrating this concept is that the coverage provides for continuing expenses "normally charged to the operation of the business." Yet, if the asset is destroyed and is in the process of being replaced and indemnified under the personal property claim, to continue depreciation for the damaged or destroyed asset during the suspension period would a double payment.

(3) **Rent and Lease** — Included within the original document request, there should be a request for a copy of *all real estate and personal property leases*. Most real estate leases contain an "abatement clause" if the premises are untenable, i.e., the rent may discontinue. (Usually there is a 30-day wait period following the loss before such abatement will be issued.) For leased equipment, there may be separate coverage, or, more likely, the insured will be responsible for the undepreciated value of the equipment, which may be equal to the remaining lease payments due the lessor. In such cases, coverage may be available under the contents coverage, resulting in a saved expense for the business interruption calculation.

(a) In addition to potentially discontinuing rent and lease expense, during a prolonged period of restoration, such as six months or more, the insured may be entitled to a property tax rebate. This would likely be received sometime after the reconstruction is completed and most likely will not be reflected on the insured's books and records until *after* the loss is settled. The claim evaluator should check with the local taxing authority to see if a rebate is in order and, assuming that the insured is responsible for annual property taxes as is usually stipulated within the lease under an "Actual Loss Sustained" policy, a discontinued expense may be warranted during the suspension period for the portion of the tax abatement relative to the period of restoration.

(b) Rent for temporary building and/or equipment may be indemnifiable under extra expense if the amount of rent at the temporary location is greater than the pre-loss "normal" expense. The extra expense would be for the incremental increase above the pre-loss "normal."

(c) If the insured owned the building, with a bank(s) holding a mortgage, the lien-holder would become a named "loss payee." Once the building coverage was paid, the related mortgage interest would cease and become a saved expense. As the rebuilding process continued, assuming the insured elects to rebuild, a new mortgage may be taken out and new interest expense would begin. At the end of the suspension period, the total interest paid must be analyzed to calculate either a saved or extra expense.

(4) **Telephone and Utilities** — During the suspension period, one would normally expect to see telephone and utilities expenses decrease, becoming a discontinued expense incorporated into the business interruption calculation. However, there are circumstances when either telephone or utilities may actually increase during the suspension period. For example, the insured may spend an increased amount of time contacting suppliers and customers attempting to rebuild inventory and supplies that were destroyed. Also, utilities might increase if the suspension period included winter months when portable, temporary lighting and heating were required for construction to continue. In such cases, the pre-loss "normal" telephone and utilities would continue and any excess over normal would be claimed under the extra expense coverage.

(5) **Supplies and Miscellaneous Variable Expenses** — A line-by-line analysis of expenses before the loss (normal) should be compared to the actual post-loss expenses. Basically, all expenses can be classified into one of two general categories: variable or fixed expenses.

(a) Variable expenses are those that are sales related and vary according to sales volume. These expenses would be expected to decrease during the suspension period as sales reduce or cease. Sales commissions are an example of a variable expense.

(b) Fixed expenses are those expenses that remain basically the same dollar amount each month (except for a possible periodic increase) regardless of sales

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volume. Insurance is usually a monthly fixed amount, amortized over the policy period.

When comparing pre-loss "normal" monthly variable expenses and pre-loss "normal" monthly fixed expenses to post-loss "expected expenses," an "explosion" of the components is necessary to understand why there is a large variation between the pre- and post-loss expenses. This requires contacting the insured's claim preparer and asking for clarification and supporting documentation. This is especially true when large deviations from normal are observed. These could be items that qualify as extra expenses or the increase in expense could be related to the building or personal property claims, which may have already been indemnified under those coverages.

Conclusion — From All Perspectives

Time Element claims, particularly business interruption claims, are inherently subjective in nature and therefore require scrutiny of the pre-loss operating results to prepare a reasonable projection of "The likely Net Income of the business if no physical loss or damage had occurred … ." Also, the post-loss operating results need to be compared to the projected "normal" operating results and material differences questioned, documented, understood and presented by the accountant before the adjuster can attempt to settle the loss. It should be noted that even though an insured had a Net Operating Loss during the pre-loss period, this does not preclude recovery under a business interruption or other Time Element coverage. For example, a $100,000 projected Net Loss during the suspension period does not preclude an insured from recovering $500,000 under the policy due to necessary normal continuing expenses and/or extra expenses of $600,000 incurred during the suspension period.

Suggested Solutions

A speedy response is critical. If an independent forensic accountant is to be engaged, the engagement should be early on in the adjustment process.

As an example, the following is a description of the program used by Carrigan Accounting Associates LLC:

(1) For Carrigan's Automated Business Interruption Program, we suggest receiving an electronic copy of the first notice of claim (the ACORD form or a similar, brief, one-page form such as one that we have customized). This initial notice would contain some of the essential claim, insured and insurer information and includes a request for the "Dec" sheet. Then, we quickly contact the adjuster to obtain the ***estimated suspension period*** and the insured's contact information. We then make a call to the insured's designated claim preparer to introduce ourselves, explain our appointed role and request that the claim preparer electronically transmit a brief, one-page form that captures *minimal* pre-loss financial information, which should be accompanied by the insured's most recent federal income tax return.

(2) Upon receipt of this preliminary information, we can quickly and automatically calculate a preliminary reserve figure relating to the Time Element aspects of the claim. The reserve estimate can then be transmitted to the adjuster for consideration. Generally, the adjuster will receive the estimated reserve figure within 24 hours of our receipt of the requested data from the insured's representative.

(3) Next, the follow-up document request is transmitted electronically to the claim preparer. As the requested information is received, the data is entered into the system and a loss estimate is prepared for comparison with the insured's claim. Significant differences between claim and loss estimates are identified for follow-up by the claim evaluator, who requests clarification, additional explanation(s) and/or documentation as the need dictates to narrow differences in sales-trend (estimated Gross Revenues and Gross Profit) and differences relating to saved expenses (continuing/discontinuing). Utilization of telephonic and electronic exchanges between the claim preparer and the claim evaluator can minimize use of the adjuster's time and expense.

(4) When differences have been resolved as far as they can be between the claim preparer and the evaluator, the accountant prepares a comparative claim of loss report for submission and review by the adjuster. Through questions and answers between the Time Element claim evaluator and the adjuster, the loss calculations can be quickly revised and updated, often while the conversation is in progress.

(5) Often, following the above four-step process, the adjuster can reach agreement with the

insured through consultation and negotiation, and the claim can be settled. If not, obviously the claim evaluator will be available to present, explain and defend the loss calculation with the insured as directed by the insurer's adjuster.

Advantages of Automated Time Element Claim Evaluation

Advantages of our program include:

(1) Speedy response, which reduces and avoids duplication of effort.

(2) Using electronic programming and transmissions, adjuster's time is "freed up" to continue with other complex problems in adjusting the claims relating to building, personal property, cleanup, contractors, etc. This is especially beneficial during multiple CAT claims from a single occurrence.

(3) With quick involvement of the forensic accountant/claim evaluator, estimated reserve figures can be provided to an adjuster using a standardized format with which he or she will be familiar.

(4) With expeditious communication between the insured's claim preparer and the claim evaluator, many, if not most, contentious issues can be reduced or eliminated.

(5) Cost effective! Because of the automation of the claim/loss process, manual time is substantially reduced. The intention is to eliminate travel expenses (airlines, car rentals, hotels, meals, etc.) and to perform claim evaluation utilizing telephone, scanners, facsimile, e-mail and customized computer programs resulting in claim evaluation expenses substantially lower than would otherwise be considered a "normal" expense.

Skilled supervisors, with many years of experience in the evaluation of thousands of commercial insurance claims, oversee the handling and processing of each automated claim-to-loss comparison. The assigned supervisor makes certain that the adjuster is kept informed of the progress of the assignment at every step in the process, and, of course, is available for discussion with the adjuster at any time. ■

Is Your Expert a Liar or Does He Really Believe That Garbage?

by Edward M. Slaughter, J.D., and Lauren E. Wood, J.D.

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Editor's note: This article is an adaptation from a previously published work, "When Experts Lie — The Lawyer's Duties of Advocacy and Candor in Tension," by Edward M. Slaughter, J.D., and Lauren E. Wood, J.D. It was published in the July 2009 edition of *For the Defense,* a publication of DRI — The Voice of the Defense Bar, an international organization of attorneys defending the interests of business and individuals in civil litigation.

There are three kinds of liars: the common liar, the damned liar and the expert witness. **William L. Foster,** *Expert Testimony: Prevalent Complaints and Proposed Remedies*, 11 Harv. L. Rev. 169, 169 (1897). Because lawyers frequently rely on expert testimony to explain the science or applicable standard of care supporting the various theories underlying their cases, the ethical obligations of attorneys and their experts are inextricably intertwined. While attorneys are subject to strict ethical rules requiring them to speak and act truthfully, these rules do not apply directly to expert witnesses. Compounding this problem is the fact that experts themselves are subject to few professional regulations, rendering them free agents in the testimonial marketplace.

Though lawyers can never knowingly offer false testimony through an expert witness, this standard is so vague that it rarely succeeds in preventing the testimony it seeks to exclude. (See the *American Bar Association Model Rules of Professional Conduct,* Rule 3.3.) First, scrutinizing the favorable opinions of a witness the lawyer has hired to advance the interests of his client is in tension with that lawyer's duty to act as a zealous advocate. Second, the lawyer is often ill-equipped to determine whether an expert opinion is objectively true or untrue. Evaluating the truth of opinions, which are subjective by definition, is an epistemological task that would drive Kant to the bottle. Moreover, experts are retained because they have special knowledge beyond that of a lay person or lawyer. Determining whether a witness with advanced training and knowledge subjectively believes the opinions he offers, all the while protecting the clients' interests, is an extraordinary responsibility. And yet that is precisely what attorneys must do.

Former U.S. Attorney General **Dick Thornburgh,** commenting on the attorney's ethical duty to keep junk science out of the courtroom, said "[I]t is unethical lawyers who are largely to blame for junk science." Dick Thornburgh, *Junk Science — The Lawyer's Ethical Responsibilities*, 25 Fordham Urb. L.J. 449 and 462 (1998). He suggested that lawyers have an ethical obligation to test the opinions of their own experts and offer only those that can be supported. He concluded that attorneys who present junk science testimony in bad faith should face Rule 11 sanctions. *Id.* at 467.

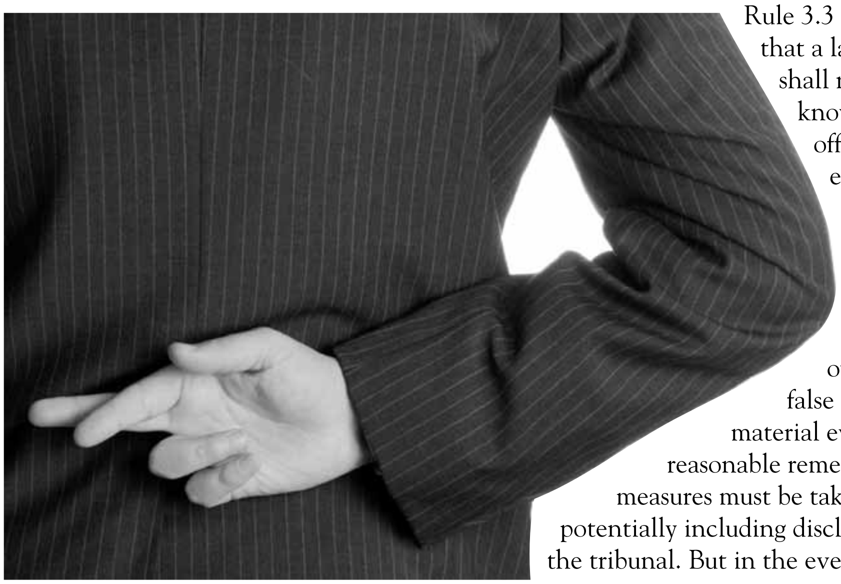
Does an expert have a similar ethical duty? Should he? Short of the penalties resulting from outright perjury, there is little to deter an expert from presenting questionable testimony. In fact, the opposite is true. He is paid to construct theories that become the foundation of an attorney's case, and there is an undeniable temptation to present those theories even when they are dubious.

Some states have reacted by enacting laws that more closely regulate expert testimony, particularly in the area of medical malpractice. For example, certain jurisdictions require that a neutral expert witness evaluate the merits of a malpractice action before suit is filed to determine whether credible evidence exists that the relevant standard of care was breached. See American Academy of Pediatrics, Policy Statement — Expert Witness Participation in Civil and Criminal Proceedings, *Pediatrics*, Vol. 109 No. 5, pp. 974-979 (May 2002). Another proposed regulatory method takes aim at the expert's professional reputation in the form of peer review or sanctions.

The former approach calls for a panel of professionals in the expert's field to review and critique transcripts of the expert's testimony, with the testimony and corresponding peer analysis to be published in industry journals. The latter envisions an industry regulatory body that would impose sanctions, expel experts from memberships in professional organizations or take other disciplinary action. *Id.* After all, the expert's true currency in this business is his reputation, and for better or worse, it is inexorably linked to that of the attorney who has retained him.

Testifying experts and attorneys are also subject to state and federal rules governing perjury. Under federal law, a person may be guilty of perjury where he has testified that a "material matter" is true when he actually believes it to be untrue. See 18 U.S.C. § 1621(1). The penalty for perjury is a fine and/or up to five years' imprisonment. 18 U.S.C. § 1621. An attorney who procures an expert to testify falsely could also be found guilty of suborning perjury under 18 U.S.C. § 1622. Though the penalties for perjury are steep, they do not serve as a major deterrent — successful prosecutions are rare due to the difficulty in proving the elements of belief and materiality.

But when does an expert's opinion qualify as a lie under Model Rule of Professional Conduct 3.3, which governs the attorney's duty of candor? The adversarial process often creates incentives for paid expert witnesses to exaggerate or lie that are rarely found in disinterested witnesses. Still, there is no authority conclusively establishing the boundaries of the expert opinion. See **John L. Watts,** *To Tell The Truth: A Qui Tam Action for Perjury in a Civil Proceeding is Necessary to Protect the Integrity of the Judicial System*, 79 Temp. L. Rev. 773, 790. Identifying a dishonest expert opinion is difficult because opinions go beyond objective truth. An opinion is defined as "a view or judgment not necessarily based on fact or knowledge." *Oxford English Dictionary*. 2nd ed. New York: Oxford University Press. 1989. Some opinion testimony may be untrue. Other opinion testimony represents novel beliefs subject to contentious disagreement but genuinely held by their proponent. The ethical challenge lies in suppressing the former without chilling the rights of counsel and their witnesses to present the latter.



Rule 3.3 instructs that a lawyer shall not knowingly offer false evidence. If the lawyer discovers that his witness offered false material evidence, reasonable remedial measures must be taken, potentially including disclosure to the tribunal. But in the event that an attorney fails to readily make such a disclosure, how can this rule be enforced? Some circumstances permit courts to infer an attorney's knowledge of perjury. The most obvious inference is made when an expert witness has offered testimony in a previous case that contradicts that which he is offering in the present case. See, e.g., *In the Matter of Peasley*, 90 P.3d 764 (Ariz. 2004). In such a situation, the attorney is presumed to at least have knowledge that one or the other of the expert's statements was false, even if he cannot identify which. *Id.* at 779; Rule 3.3, comment 8.

Is an attorney culpable of a similar Rule 3.3 violation if he offers conflicting expert opinions in the same lawsuit? Though it is unlikely that the conduct of the attorney or his expert witness in the story related below violated any ethical rule, it should serve as a cautionary tale for members of both professions who tread the line between truth and fiction. It also illustrates the importance of communication in the expert-for-hire scenario. Though a failure to communicate may not rise to the level of professional malpractice, it certainly defies common sense.

Our story begins with a $25 million property loss. While the property was being constructed, it was destroyed by fire in the middle of the night. On the day prior to the fire, a large quantity of solvent had been utilized without adequate ventilation. The plaintiff's theory of liability in the case was that the client's solvent caused the fire when vapors were ignited by electrical sparking in the attic. To explain this theory, one of plaintiff's experts relied on the concept of fractional distillation, a process traditionally occurring only in laboratory settings whereby a product's lighter chemicals are separated out and are able to move independently through the atmosphere. But in his deposition, the expert opined that the product at

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issue spontaneously underwent fractional distillation, certain chemicals migrated into the property's HVAC system and condensed, then later re-vaporized and were ignited by an incendiary arc from the electronic air cleaner.

'Identifying a dishonest expert opinion is difficult because opinions go beyond objective truth. An opinion is defined as 'a view or judgment not necessarily based on fact or knowledge.'

Does this testimony qualify as junk science, or just zealous advocacy? Under these facts, the hypothetical tows the line. Ultimately, though, there is no evidence that the expert's testimony was presented in bad faith or was patently false. Plaintiff's counsel did make a tactical error, however, in failing to communicate this theory to his remaining experts, one of whom testified unequivocally at his deposition that fractional distillation not only cannot occur at room temperature, but cannot occur outside a laboratory environment. Clearly unaware that his testimony was undermining the plaintiff's theory of causation, when asked if there was any way that vapors entering the HVAC system could have become fractionally distilled, the expert scoffed: "positively not."

In order for this scenario to implicate Rule 3.3, it must be shown that the expert's testimony was knowingly false. Though the knowledge element can be inferred where a single individual offers contradictory testimony, it can't be presumed when the testimony is advanced by separate individuals who are capable of holding independent beliefs.

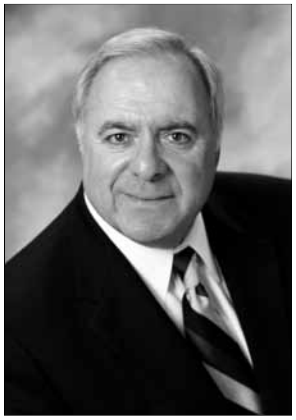
Given the relationship between attorney and expert, it may be advisable — even absent the existence of an applicable ethical duty — for the expert to investigate any lawyer wishing to retain him before any money changes hands. At a minimum, the expert should research the attorney's ethical standing with the State Bar, determine his win-to-loss ratio and inquire into his billing practices. Most importantly, an expert should communicate his opinions to the attorney in advance of his deposition or trial, even if not prompted, and request a synopsis of any other expert opinions the attorney intends to offer in the case.

An attorney should take the same precautions. Though a lawyer may still present an expert opinion if he is uncertain about its validity, his uncertainty must be both reasonable and genuine. **Geoffrey C. Hazard Jr.** and **W. William Hodes,** *The Law of Lawyering: A Handbook on the Model Rules of Professional Conduct* § 3.3:401 (2d ed. 1992 Supp.) Acting reasonably when uncertain about the validity of expert testimony requires that the lawyer make a serious evaluation of the expert and his opinions before offering them.

Though it takes years to build up a professional reputation as a trial attorney or as an expert in a given field, it can take only minutes to spend that currency. This result can be avoided by both sides working together to present credible, persuasive testimony and doing their part to keep junk science out of the courtroom. ■

Insider Data Breach

by David Speciale



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We often hear the old adage, "Stripped for parts our body is worth $4.50." However, as Robert O'Harrow Jr. in *No Place to Hide* points out, "Our digital identity is worth much more."

The "Fourth Annual U.S. Cost of Data Breach Study," conducted by the Ponemon Institute, estimates the average total cost of a data breach last year at $6.65 million, compared to an average of $6.3 million in 2007. The study, which examined 43 organizations across 17 industry sectors, indicates that more than 88 percent of all cases involved insider negligence. A significant percentage of victims will stop doing business with the company that suffered the breach, while others will retain lawyers. Thus, when a data breach takes place, businesses pay a huge price.

Negligence may account for the majority of the data breaches; however, malicious acts can be devastating. The current recession has led to downsizing among corporations, and disgruntled employees may seek revenge through the theft of Non-Public Personal Information ("NPPI"). Employees always on the lookout for opportunities at other companies may take confidential information as a means of obtaining a better job. Criminal organizations have been known to place individuals within a company for the purpose of obtaining NPPI through the breach of a company system.

According to the Privacy Rights Clearing House, 339,674,601 represents the approximate number of records containing sensitive information involved in security breaches since January 2005.

Security Breaches in the News

The names and Social Security numbers of 5,000 Eastern Kentucky University faculty, staff and student workers were inadvertently posted on the Internet. This information was on display for one year.

A former New York State Tax Department worker was accused of stealing the identities of thousands of taxpayers. The former employee had obtained Social Security numbers, credit card accounts and lines of credit.

An organized crime ring targeted a high volume Redondo Beach, Calif., Arco gas station. The crime ring assigned a low-level person to infiltrate the business and waited eight months while he worked himself into a position where he could plant a high-tech device skimmer that gathered customers' credit information.

Identity Theft and Data Breach Defined

Identity theft occurs when someone steals personal information and uses it to assume an identity in order to commit fraud or other crimes and/or receive a service, information or merchandise. A data breach is the release of secure information to an outside environment. This may include incidents such as negligence, theft or loss of computer data, or laptop computers storing unencrypted information, such as a customer's name, address, credit card numbers or Social Security numbers.

This article takes the perspective of an insurance professional working as a consultant, litigator or expert witness. Whether in sales, underwriting, claims, legal, agency or brokerage, insurance practitioners should always leverage the "best practices" approach to doing business and must be aware of the insider threat of data breach. Just one data breach can cost a company or client ***big*** money. The following will provide an overview of the legislation relating to identity theft and data breach, as well as compliance requirements and tips on managing the threat from within.

Legislation

Federal regulations, as well as regulations in 45 states, the District of Columbia, Puerto Rico, the Virgin Islands and New York City (the only municipality), require that individuals be notified if their confidential or personal data has been lost, stolen or compromised. In addition, new state and federal laws will be enacted, and the courts will be interpreting these laws. With this in mind, the following should not be taken as legal advice but rather to provide a platform instituting a best practice, working within the company and/or with clients, to manage the threat.

Current regulations that can directly affect organizations or service providers are the Fair and Accurate Credit Transactions Act (FACT Act) of 2003/ Identity Theft Red Flag Provisions; the Health Information Technology for Economic and Clinical Health Act (the HITECH Act) and HIPAA Breach Notification provisions; the Gramm-Leach-Bliley Safeguards Rule; and Section 5 of the Federal Trade Commission Act.

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Insider Data Breach

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- The FACT Act pertains to businesses and individuals who collect public information for the purpose of doing business (namely credit-related data). If an organization should lose consumer information, it could cost the company in federal and state fines and civil liability.
- The HITECH Act/HIPAA Security Rule pertains to any company or individual who holds or collects health information. Medical information lost or stolen may result in fines and or imprisonment.
- The Gramm, Leach, Bliley Safeguards Rule mandates that financial institutions properly safeguard their customers' financial information. These regulations further require companies to design a written policy to protect customer information and hold training for employees having access to customer information. Information lost or stolen may result in fines, imprisonment and removal of management.
- The Federal Trade Commission (FTC) has increased its enforcement efforts on how businesses approach privacy, handle confidential consumer data and deal with identity theft. The FACT Act/Red Flag Provisions require all financial institutions (effective 11/1/08) and all nonfinancial institutions (effective 11/1/09) with certain types of accounts, referred to as "covered accounts," to put a plan in place to help recognize the Red Flag warning signs associated with fraud and identity theft. However, the FTC also has its own general enforcement powers when it comes to data protection. Its ability to bring enforcement actions under Section 5 of the FTC Act for the mere hint of a privacy violation, which the FTC categorizes as a "deceptive act or practice in or affecting commerce," can easily lead a company into seven or eight figures worth of legal and compliance costs.

Developing a Compliance Program

With the proper knowledge of current federal and state legislation, an organization can develop a compliance program that satisfies legislative mandates and minimizes the risk of identity theft and data breach. The compliance plan does not have to be perfect, but should show a reasonable approach to safeguarding NPPI. This can be accomplished by developing the following procedures:

- Establishing a written identity theft compliance plan.
- Holding mandatory employee meetings and training sessions on identity theft and privacy compliance.
- Conducting regular compliance reporting.
- Monitoring service providers.
- Reviewing and updating the identity theft program periodically.

Further consideration should be given to the risks of global outsourcing. Not all countries conduct background checks on employees, and not all countries consider identity theft a crime.

Contract and temporary employees should be held to the same standards as full-time employees when having background checks performed. Organizations should also fully train these employees on privacy issues involved in dealing with NPPI.

When there is a breach in security that results in the loss of NPPI, there needs to be a comprehensive breach response plan that includes damage assessment, consumer notification, news media and identity theft resolution, including credit monitoring for the victims.

According to "The Betterley Report Cyber Risk Market Survey 2009" (www.betterley.com), privacy coverage and associated remediation services have been the big news in cyber risk over the past year. Carriers have rolled out impressive new products, brokers have beefed up their expertise and insureds are getting proposals. But products aren't being sold in the volume that might be expected. Senior management seems to remain convinced that our systems are too secure for that to happen here. We frequently hear that without a claims history to support the purchase of coverage, management will wait and see. We hope they don't wait too long.

Business Privacy and Data Protection Tips (Courtesy of Identity Theft 911)

Take Care of the Basics

- **Lock Up Sensitive Data.** File storage, such as cabinets, file rooms or other areas, that store files containing private data about customers, clients, patients, accounts and employees should be locked.
- **Restrict Access to Data.** Sensitive information, whether physical or electronic, should be accessible only to those who have a need to know. Put written procedures in place defining who has access to restricted information. Set up computer networks permitting only designated people to have access.
- **Determine What Information Is Necessary.** Collect and keep only the data that is absolutely necessary. Collecting excessive personal information, such as Social Security numbers, can be more of a liability than an asset. What's more, storing sensitive information longer than necessary or legally required exposes companies to unwanted risks. Put a retention policy

in place and be sure to destroy outdated information in a secure manner.

- **Screen All Employees.**
  Implement hiring practices for all employees, especially those with access to sensitive information. Use criminal and background screening companies. All employees that have access to sensitive information, including cleaning crews, technicians, administrative assistants and temporary employees, should sign a confidentiality and security document.
- **Record and Regularly Review Data Practices.**
  Distribute and explain data protection protocols to all employees. Review and revise these practices on a regular basis (at least once a year). Retrain staff when protocol changes are made or on an annual basis, and train all new hires during their orientation.
- **Conduct Routine Audits.**
  Put best practices and polices in place. Routinely audit them, by making sure:
  (a) Sensitive files are locked up when not in use.
  (b) Only authorized users can access confidential information.
  (c) Sign-in logs are being maintained.
  (d) Sensitive documents are being stored properly.

How to Deal with Technology

- **Limit the Use of Portable Technology.**
  Restrict the transfer of sensitive information from on-premises computers to portable devices such as cell phones, PDAs, laptops, USB flash drives and removable hard drives. If it is necessary to put confidential data on these devices, make sure information is encrypted and password protected.
- **Don't Use Wireless Networks.**
  Even when properly secured, off-the-shelf wireless networks do not provide adequate enterprise-level security to safeguard confidential data. As a standard rule, refrain from using wireless networking technology (Wi-Fi) to access systems storing sensitive personal information.

- **Utilize Password Protection and Encryption.**
  Always encrypt sensitive information. Inexpensive or even free encryption technologies are readily available. All systems users should be assigned unique user names and passwords, changed quarterly.
- **Install Anti-virus, Anti-spyware and Firewalls.**
  To prevent the loss or mining of sensitive information by worms, Trojan Horses, viruses, etc., run all systems with the most recent enterprise-level anti-virus, anti-spyware and anti-malware applications. Use firewalls to lock out hackers.
- **Regularly Update All Systems and Software.**
  To maintain the most up-to-date protection, download recently issued system "patches," anti-virus and anti-malware registries containing the newest forms of viruses, Trojan Horses and other malicious software.
- **Evaluate Contractor Access to Information.**
  Review and consider any and all access that outside contractors or vendors have to sensitive data and determine the need for such access. For example, access to employee personally identifiable information should be for payroll or benefit purposes only.
- **Properly Dispose of Outdated Technology Tools.**
  Implement policies on how to destroy old computers, disks, tapes, CDs, memory devices and other equipment that may contain sensitive information. Often, these devices can provide access to sensitive information, even if the information is deleted. Do not rely on the "delete" or trash function to remove files containing sensitive information. It is often best to physically destroy the devices when they are no longer needed.

Conclusion

As employees exit, so can corporate data. Employees can be negligent. The resulting data breach is something that can't be completely avoided. However, with knowledge of federal and state legislation and the development of a compliance plan, a comprehensive breach response plan and the implementation of pertinent business privacy and data protection tips, companies and clients will be prepared to mitigate the potential damages. ■

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Q&A with Donald S. Malecki, CPCU

by Donald S. Malecki, CPCU

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We have an insured who purchases primary products liability coverage. Excess coverage comes through a captive layer and with a commercial excess layer above it. At renewal, the primary insurer proposed an exclusion for one of the insured's "riskier" products. The insured, therefore, decided to assume the entire primary products risk in the captive and continue the excess commercial liability layer.

The insurer of the primary products liability policy, which is on a claims-made basis, has offered a tail, but with the added condition that the coverage provided by the tail will apply excess over any other insurance, including insurance on a primary, excess, contingent or any other basis, that begins or continues after the date the tail coverage begins. We contend that this makes what was primary liability insurance illusory, and also materially alters the intention of the contract that was in place. Is this common practice?

It must be noted, first of all, that a claims-made tail is not coverage, but rather a late-reporting provision. That is to say, the duration of the expiring primary policy is not being extended and no new policy is being issued. The tail simply allows the insured to report claims during the tail period, which are based on the occurrences taking place on or after the expiring policy's retroactive date. Wording that makes coverage under the tail excess over other insurance would have application only where there is another primary layer of coverage applicable to the tail period. For example, if the insured were to purchase a renewal claims-made policy that utilized the same retroactive date as the expiring policy, both policies might be argued to apply to a claim made during the second policy period, but based on an event that took place during the expiring policy period.

Typically, however, primary claims-made policies state that if a tail is purchased, it will not provide the late notice feature for claims that are covered under subsequent insurance purchased by the insured and that coverage is excess over valid and collectible insurance available under policies in force after the tail period begins. The purpose of the tail is to provide a gap filler for claims not covered by subsequent policies because: (1) they are excluded, (2) the subsequently purchased coverage will not provide the same retroactive date, or (3) no subsequent policy is purchased. It is not the intent of insurers issuing claims-made coverage to provide tail coverage for claims the subsequent policy is underwritten to encompass: It may be, though, that the subsequent policy has a retroactive date going back to the expiring policy's inception date or earlier.

In your scenario, the tail would never apply on an excess basis because there is no other applicable insurance that would apply first. The insured did not purchase a renewal policy, and, thus, the only primary layer of coverage in existence is the extended notice provision of the tail. Claims for events occurring after the expiring policy period ends would be uninsured under your facts, since the tail does not extend the policy period and no subsequent primary layer of coverage was purchased. Claims made during the tail period, based on events taking place on or after the retroactive date and prior to the policy's expiration, would apply on a primary basis.

The captive excess policy would not apply because it is an excess (as opposed to umbrella) layer and the extended notice provision of the expiring policy cannot avoid its obligation by stating it is excess of the excess layer. That would defeat the essence of a primary layer of coverage and contradict the terms of the other insurance condition, which states that the policy to which the tail is attached applies on a primary basis.

Another issue is whether the excess layer is considered even to be insurance, given that in your facts it is referred to as a captive. If it is deemed to be self-insurance, it may not be viewed as other insurance and, therefore, would only apply after all other "insurance," including that provided by the policy to which the tail is attached, has been exhausted. ■

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