CPCU SOCIETY INSURING YOUR SUCCESS

Consulting, Litigation & Expert Witness Interest Group

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Message from the Chair — 'Stayin' Alive'

by Vincent "Chip" Boylan Jr., CPCU

Vincent "Chip" Boylan Jr., CPCU, is senior vice president of Willis of Maryland Inc. 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 board vice chair of the Insurance Agents & Brokers of Maryland, that state's affiliate of the National Association of Professional Insurance Agents.

These words may remind you of the 1977 disco-era film "Saturday Night Fever" theme song, written and performed by the Bee Gees. For me, they serve as a reminder of both the image of a check that rests on my office desk and the need for professionals to constantly invigorate their skills, talents and careers.

The original check, cashed by a trade association for compensation from a significant business interruption claim, represents a six-figure sum and dates from the mid-1990s. A photocopy of the check is always in my office within view. The importance to me is that without the vital protection provided by the insurance policy I had recommended at the time, my association client would have been out of business. In short, it would not have been "stayin' alive."

Many CPCUs, including CLEW Interest Group devotees, can share similar successes they have experienced in helping clients stay alive by guiding them toward appropriate risk management and insurance decisions. Learning about (whether in person or in print — as in this publication) how these professionals develop solutions for clients is not only educational but also often outright inspiring. It's educational in that these accounts from peers suggest ways that we can assist other customers, and inspirational by serving as a reminder of the import of our work when others face worst-case scenarios.

Continually seeking new and different solutions that enable clients to keep their organizations alive will also prolong our own careers. To do otherwise will have the opposite effect. If we aren't the source of appropriate advice that helps others survive and prosper, someone else will be. What then will be our professional prospects of "stayin' alive"?

My association client eventually went out of business, but only after its reason for "stayin' alive" no longer existed. The association was established in the early 1980s to encourage the use of a new technology — electronic messaging, that is, e-mail. Less than two decades later, it had succeeded magnificently but closed up shop because it no longer had a purpose. While the world around the association evolved and embraced its mantra, the association did not move forward to provide new and better ideas for those it served.

With the help of, and participation in, the CPCU Society, CLEW and other interest groups, we will be on the right path to ensure we're "stayin' alive." ■

What's in This Issue

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.

CLEW Chair **Vincent "Chip" Boylan Jr., CPCU,** has once again demonstrated a grasp of the "big picture" that is too often not seen, or not recognized, when we get overly involved in the minutiae of everyday life. His words are well worth heeding.

We all know that there's too much abuse being inflicted in the world, whether it is upon children, elders, animals or any other group. Expert witnesses are not immune to such problems.

SEAK Inc. has published a volume that, among other things, categorizes the types of abuse that are often visited upon professionals working in the expert witness field. This newsletter reproduces that list, and we invite you to add to it or to report on instances you have suffered or observed that may be related. Sometimes, a little griping can help other practitioners avoid the difficulties you have encountered by alerting them to patterns and warning signs of trouble to come.

Thomas M. Braniff, CPCU, J.D., and **Robert P. Gaddis, J.D.,** have written on the subject of "Wrongful Designation," a sort of expert abuse that was addressed in a 2010 annual meeting session of the American Association of Insurance Management Consultants. There are numerous objections that apply to this practice, and the authors state them very clearly, along with suggestions for combating it when it raises its ugly head. It is an excellent expanded treatment of SEAK Inc.'s first listed form of abuse, that of "pirating an expert's name and reputation."

What are the problems caused by late notice to, and engagement of, expert witnesses, specifically forensic accountants? **Charles W. Carrigan, CPCU, CPA, CFF, AIC,** elucidates just how devastating lateness can be to a successful defense of claims and resolution of controversies. He also offers some suggestions for the avoidance of such impediments to successful consultation in this field.

An issue of the Consulting, Litigation & Expert Witness Interest Group newsletter would not be complete without a contribution from **Donald S. Malecki, CPCU.** This newsletter is complete! Please note that Don asks readers to provide comments in the context of this particular Q&A that may be from a different point of view than his.

And while we're on the subject of Don Malecki's ability to elucidate us all by commenting on particular situations described by practitioners, he and I encourage you to pose such inquiries that you think might be of interest to our CPCU community. Surely many of you have encountered tricky coverage circumstances more than once, and we'd like to hear about them from you! ■

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Once you've logged in, you can narrow your search by title, author, year and/or subject in a specific publication or in all publications.

You can view articles by year of publication or in alphabetical order by title. Dive in to explore a wealth of archived information.

For the Bookshelf

by Jean E. Lucey, CPCU

Editor's note: Portions of *The A-Z Guide to Expert Witnesses* are reprinted in this article with permission.

The A-Z Guide to Expert Witnesses was written by **Steve Babitsky, Esq.; James J. Mangraviti Jr., Esq.;** and **Alex Babitsky, MBA**. (© 2006 by SEAK Inc., Falmouth, Mass.)

> "The need for expert witnesses has never been greater than it is today. Litigants rely on expert witness testimony in the vast majority of all civil cases. Unfortunately, few experts receive formal training in such subjects as the expert's proper role in the legal system; how to communicate opinions effectively at deposition, at trial and in a written report; the law and procedure dealing with expert witnesses; ethics; how to deal with attorneys; and how to better manage the business aspects of a forensic practice. This book has been written to provide information in all of these areas."

... thus do the authors summarize the purpose of their 626-page volume.

In Chapter 24, "Handling Abuse," the authors list 17 common forms of abuse experienced by expert witnesses. Most of the forms are illustrated by way of an example and most include the authors' comments. This chapter of the book concludes with suggestions on how to fight back when experiencing such abusive behavior.

The 17 forms of abuse listed are as follows:

> "Abuse 1 — Pirating an expert's name and reputation. (Note: This is a condensed version of the discussion in the article contributed by Mssrs. Braniff and Gaddis on pages 4–7 of this newsletter.)
>
> Abuse 2 — Nonpayment or slow payment of fee.
>
> Abuse 3 — Missing records or information.
>
> Abuse 4 — Pushing the expert outside his area of expertise.
>
> Abuse 5 — Unrealistic time demands.
>
> Abuse 6 — Tying preliminary opinion to being retained.
>
> Abuse 7 — Refusal to prepare the expert for deposition or trial.
>
> Abuse 8 — Providing an uncomfortable environment for deposition.
>
> Abuse 9 — Repetitive questioning at deposition.
>
> Abuse 10 — Threats of counsel for failing to answer improper questions at deposition.
>
> Abuse 11 — Lack of breaks at deposition.
>
> Abuse 12 — Harassing questions at deposition.
>
> Abuse 13 — Hostile personal attacks at deposition.
>
> Abuse 14 — Nonpayment of deposition fees.
>
> Abuse 15 — Wasting the time of the expert at deposition.
>
> Abuse 16 — Abusive questioning at trial.
>
> Abuse 17 — Trying to "steal" the expert's opinion by calling him as a fact witness and then asking his opinion."

If you can describe an experience fitting into one of these categories, we'd love to describe the circumstances in the next newsletter. Or perhaps you'd like to add another category of abuse, which we'd also be happy to publish.

Those of you, who might be abusers, feel free to give us your side of the story! ■

Wrongful Designation — Attorneys' Designation of a Testifying Expert without the Expert's Knowledge

by Thomas M. Braniff, CPCU, J.D., and Robert P. Gaddis, J.D.

Thomas M. Braniff, J.D., CPCU, is an attorney/insurance consultant in Houston, Texas, providing management, regulatory, legal and technical assistance to the insurance industry and others faced with insurance-related problems or opportunities.

Robert P. Gaddis, J.D., has practiced law for more than 27 years, concentrating in insurance and insurance agent's litigation; he is AV Rated and is board certified in personal injury trial by the Texas Board of Legal Specialization.

Special thanks are extended to **Isabel G. Vaquera,** a student at the University of Houston–Downtown in the College of Business, majoring in the insurance and risk management degree program, for providing the research and organization associated with this article.

At the 2010 annual conference of the American Association of Insurance Management Consultants (AAIMCo), the agenda included a session on what could be an emerging issue to be dealt with by testifying experts that AAIMCo refers to as "Wrongful Designation." Wrongful Designation is when an attorney designates an individual as a testifying expert without the expert's knowledge.

While some attorneys seem to see nothing wrong with designating an expert without the expert's knowledge, those attorneys are likely committing violations of the Code of Professional Conduct in their respective states. And, while the expert is hurt by the obvious direct financial loss of missing his or her expert witness fee, the problem goes well beyond that.

This article will explore the types of Wrongful Designation that are known to exist, the harm to experts and potentially to the opposing parties and their attorneys, as well as ways experts can address the problem both before it occurs and after it is discovered.

Types of Wrongful Designation

At present, AAIMCo has identified two major categories of this conduct as reported by its members. The first category is as follows:

(1) **Without ever talking to the expert,** the attorney makes a written designation identifying the expert as a testifying expert to the court and/or opposing counsel, stating the opinion the expert is expected to give. The case settles before the expert is needed to provide a written report, or give a deposition or trial testimony. Sometime later is when the expert first learns of his or her designation as an expert in the case.

The most egregious scenario in this category is where the attorney does not know the expert, but has obtained the expert's information from the Internet, from another attorney or some other source. The attorney likely believes that the case is going to settle before the Wrongful Designation comes to light, so the attorney makes the designation without ever talking to the expert.

Another scenario that exists in this category is where the attorney knows and possibly has used the expert witness in other cases. The attorney has such a comfort level from familiarity or prior working experience in other cases that the attorney feels the expert will not mind if the attorney designates the expert, just in case he might need to later use the expert. So, the attorney designates the expert without ever discussing the case with the expert.

The second major category of Wrongful Designation is as follows:

(2) **After talking to the expert** to get the expert's initial thoughts, but before engaging the expert or providing any tangible information, the attorney makes a written designation to the court and/or opposing counsel naming the expert as a testifying expert and stating the expert's opinion to be that which the expert may have indicated in the preliminary telephone conference. The case settles before the expert is needed to provide a report or give a deposition or trial testimony. Sometime later, the expert first learns that he or she was designated as an expert in the case.

One scenario under which this category develops is where the attorney has used the expert on prior cases and calls to get the expert's initial thoughts on the case, ending the conversation by telling the expert that the attorney needs to get engagement authorization from the client and will then get back with the expert. Thereafter, the attorney designates the expert, representing that the initial thoughts of the expert are the expert's opinion — or, even worse, the attorney modifies or misrepresents the expert's initial thoughts to support the attorney's position in the case. Usually, the attorney believes that if the case goes as far as needing to produce the expert for a report or a deposition or trial testimony, then the attorney can engage the expert at that time.

Another scenario in this major category is that the attorney has never dealt with the expert previously, but contacts the expert stating that he/she needs to hire an expert and wants to get the expert's initial thoughts on the case before recommending that his client engage the expert. After some discussion, wherein the expert gives his or her initial thoughts, the attorney tells the expert that he/she is going to discuss it with his client to get authorization to engage the expert. At this stage,

the expert has not been provided any tangible information. The attorney thereafter designates the expert, using the expert's initial thoughts as the opinion. However, the attorney never tells the expert that he or she has been designated.

In virtually all jurisdictions, court rules are interpreted to prohibit any attorney in a lawsuit from contacting an expert that another attorney has designated as a testifying witness. Because of that strict prohibition, the attorney who made the Wrongful Designation is able to keep opposing counsel from possibly retaining the expert, or even learning the truth from the expert of his or her opinion. In addition, it prevents the expert from learning of the Wrongful Designation from the opposing counsel.

Some jurisdictions and some courts require that a written report, signed by the expert, accompany the expert designation. In those jurisdictions, Wrongful Designation is far less likely to occur, since the attorney would need to file a report from the expert with the designation.

Impact on the Expert Witness

Financial Impact

The first reaction many experts have is that they were cheated out of the fees that they were not paid. That is because there are two primary things that an expert has to offer:

(1) His/her knowledge.

(2) His/her reputation for being a credible witness.

Clearly, anytime an attorney uses an expert's name or purported opinion without compensating the expert, then the expert has had a direct monetary loss due to the attorney's conduct.

In addition to the direct financial loss of not being paid, the expert arguably has also suffered an indirect financial loss. Because of the prohibition barring communication between the expert and any other counsel in the case, when an attorney designates an individual as a testifying expert witness, the door is closed on the possibility of the expert being engaged by any other attorney in that case — thus losing the benefit of any corresponding income from such potential engagement.

Impact on Reputation

In the words of **Warren Buffet**, "It takes 20 years to build a reputation and only five minutes to ruin it." This is true for expert witnesses when an attorney misstates an expert's opinion to the court and/or opposing counsel. The degree of impact on the expert's reputation depends on how far removed the Wrongfully Designated expert's purported opinion is from both what the expert's real opinion would have been and what the consensus of other experts in the same industry reasonably could have been. In other words, if the designation states an opinion that is a wild variance from both what the expert would have testified to and from what one would expect that other industry experts would reasonably conclude, then the impact on the reputation of the Wrongfully Designated expert is the greatest.

Bypassing Conflicts Check

Another problem that is created by an attorney's Wrongful Designation of an expert is that it prevents the expert from having the opportunity to do a conflicts check. Experts normally inquire as to the involved parties and attorneys in the case to determine whether or not they have a potential or actual conflict of interest. Experts are concerned about situations where they either have a legal conflict of interest, or where there is not a legal conflict but because of whom the other parties or attorneys may be, or for business or personal reasons, it is contrary to the expert's interest to testify on behalf of the particular client or the attorney that Wrongfully Designates the expert.

Impact on Opposing Counsel and Client

The expert witness is not the only one impacted by the designation or use of that expert's purported opinion without his or her knowledge. The Wrongful Designation is being done for the purpose of making the opposing counsel and his or her client believe that a respected and credible expert witness will testify against them if the case does not settle on terms that the attorney is advocating and that great harm will befall the opposing counsel and client should the matter have to go all the way to trial. In those cases where the opposing counsel and client settle the case on terms less favorable than they would have if the expert's name and purported opinion not been used, then that has caused harm to the opposing counsel and client. This would be particularly true in a situation where there are only a limited number of properly qualified experts available.

What Can the Expert Do?

"An ounce of prevention is worth a pound of cure" — This time-honored saying by **Benjamin Franklin** has never been more true. The nature of Wrongful Designation is one that regardless of how often it may occur, it will seldom come to light. That means in order for the expert to minimize the possibility of its happening, he or she should take measures available to deter its happening. A wide array of risk-avoidance measures are not available; however, there are a few things an expert can do.

Since the first category of Wrongful Designation happens without any contact with the expert, practically speaking, very little preventative action can be taken to avoid being the victim of that type of Wrongful Designation. However, with regard to the second type of Wrongful Designation, there are things that can be done that will discourage an attorney from engaging in that conduct, as well as documenting the file in the event it occurs, and providing evidence should it be necessary to prove it occurred. As such, the prevention measures discussed below only apply to prevention of the second category of Wrongful Designation.

First, the expert should have a procedure for creating a file, noting the day and time a call is received from an attorney, identifying sufficient specifics in the event the notes need to be relied upon at a future date. The notes should include the names of all the parties to the case; the attorneys (including the firm name) for all parties to the case; the deadlines that are in place by a court's scheduling order/docket control order; and other judicial deadlines. In addition, the notes should include the precise request of the attorney as well as any initial thoughts the expert related to the attorney. Most

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Wrongful Designation — Attorneys' Designation of a Testifying Expert without the Expert's Knowledge

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importantly, however, is that it include whether or not an agreement was reached to be engaged by the attorney and particulars on how and when that agreement would be memorialized.

If no engagement occurs from that conversation, and neither party intends on pursuing further discussions, this should be specifically noted. If there was no engagement reached, but there is potential that one might be reached, depending on further discussions that are to occur in the future, then the expert should note who is to do what and when the follow-up is expected.

It is also a good idea to ask the attorney whether or not the expert's initial report must be submitted at the time of the designation. If so, it will be difficult for the attorney to Wrongfully Designate the expert, because the expert's report will be due with the designation.

The above notes provide documentation and serve to enable the expert to set "action" deadlines with clarity and precision. From those notes, the expert should draft a written communication to the attorney that lays out the fact that the expert has not been engaged and the actions that are left to be done in order to be retained as an expert.

If in a reasonable amount of time an agreement is not consummated, then a final written communication could go to the attorney stating that the expert has not received confirmation of engagement from the attorney and is therefore closing his or her file. This is a particularly good idea if you believe there is a real possibility that you might be contacted by one of the other attorneys involved in the case.

These communications will document the non-engagement of the expert by that attorney so that the attorney knows there is a paper trail of the non-engagement, which should have a chilling effect on the attorney's deciding to Wrongfully Designate the expert. It would further be documentation to use in the event the expert was later to choose to file a complaint with the state bar association.

The website of AAIMCo at www.aaimco.com/index.html provides some suggested wording that can be included in the expert's confirmation to the attorney that the expert has not been engaged.

Report Attorney Misconduct to the State Bar Association

Every state has a bar association that prosecutes misconduct of attorneys. The American Bar Association (ABA) has a Code of Professional Conduct (Code) that every state's bar association can adopt, either identically or with modifications. The references below to Code sections refer to sections of the Code, with state bar association variances in content by the states footnoted. The provisions of the Code are enforced by each state's bar association. While many states have their own assigned Code and Rule numbers that differ from the Code, all 50 states, except one, have adopted the ABA's Code.[1]

James M. McCormack served as general counsel and chief disciplinary counsel for the State Bar of Texas and now is in private practice in Austin, Texas, concentrating in counseling major law firms on how to avoid the pitfalls that can lead to grievances being brought against them. When asked about whether or not the Texas State Bar Association has prosecuted any complaints based on Wrongful Designation, McCormack stated that he "could not confirm that any grievances or disciplinary actions have been pursued in Texas or other states against attorneys for wrongfully designating an expert; but the bar associations certainly should pursue a legitimate claim of that nature."

The Code has at least three Rules that can come into play relative to Wrongful Designation. Those are as follows:

(1) Rule 3.4 Fairness to Opposing Party and Counsel[2]

A lawyer shall not:

(c) knowingly disobey an obligation under the rules of a tribunal except for an open refusal based on an assertion that no valid obligation exists

Rule 3.4(c) prohibits an attorney from knowingly disobeying an obligation under the rules of a tribunal. This would include any rules of the court, including State Rules of Procedure that require that the attorney designate testifying exerts and provide a summary of the expert's opinion. In a case where an attorney gives that information to opposing counsel and/or the court, a strong argument could be made that providing false designation information is tantamount to failing to make a designation as required by the court rules.

(2) Rule 4.1 Truthfulness in Statements to Others[3]

In the course of representing a client a lawyer shall not knowingly:

(a) make a false statement of material fact or law to a third person

Rule 4.1(a) states that the attorney shall not make a false statement of material fact or law to a third person. A third person, in this case, would be the court or opposing counsel. So, an attorney providing false information on his or her designation of a testifying expert witness is very arguably making a false statement of material fact to a third person.

(3) Rule 8.4 Misconduct

It is professional misconduct for a lawyer to:

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation

(d) engage in conduct that is prejudicial to the administration of justice

Rule 8.4(c) prohibits a lawyer from engaging in conduct involving dishonesty, fraud, deceit or misrepresentation. It is difficult to believe that falsely designating a testifying expert witness would be anything but dishonesty, fraud, deceit or misrepresentation.

Rule 8.4(d) prohibits an attorney from engaging in conduct that is prejudicial to the administration of justice. The administration of justice contemplates that an attorney's designation of a testifying expert would be true and correct, so as not to mislead all others in the judicial arena. When an attorney falsifies testifying expert information, a strong argument exists that such falsification is prejudicial to the administration of justice.

The requirements of who can press a state's bar association to prosecute a violation of the Code, and how it is done, can vary from state to state, as virtually all bar associations have an established procedure for receiving complaints about attorneys.

Should an expert learn of an attorney's engaging in Wrongful Designation, then the expert should consider contacting the bar association in the state where the incident occurred to report the conduct of the attorney. At that time it would help if the expert had the above-mentioned Code sections to refer to when discussing the matter.

It would be preferable for the expert to first call the offending attorney to find out the facts as stated by the attorney. This will allow the expert to determine the correctness of the information he or she received from another source, before deciding whether or not to report it to the bar association. Should the expert decide to report the attorney after talking to him/her, then making the call to the attorney should give the expert's case greater credibility.

The expert should understand that his or her reporting the conduct to the bar association should not be done with the expectation that doing so will cause the bar association to act in a manner so as to help the expert collect a fee that the expert believes is owed. In fact, there is a cautiousness on the part of a bar association when it receives a complaint from a "vendor" to attorneys, since they do not want to be used as a collection device for vendors.

In most states, if the bar association senses that it is being used to collect a fee (or at least leverage to aid the expert to collect a fee), then the bar association will not likely take the complaint to prosecution. So, the expert must understand that his or her status as a "vendor" to attorneys puts the expert in a category to make the bar association scrutinize his or her motives.

Not only can the expert's purpose of contacting the bar association not be for the purpose of scaring the attorney into paying the expert a fee, but in the eyes of the bar association, the expert cannot even appear to have that idea. And, under no circumstances, should the expert, in his or her telephone conversation with the attorney, threaten to file a grievance with the bar association if the attorney doesn't pay the expert a fee. Such comments could undermine any future pursuit of prosecution by the bar association.

Judicial Remedies

While this article does not attempt to explore the various legal options available to experts in the civil court system of the various states, suffice it to say that laws in most states are likely to enable an expert to recover a judgment against an attorney committing Wrongful Designation, depending on the facts on any given case. In order to accurately assess the availability of such a civil remedy, the expert should contact a qualified civil attorney licensed to practice law in that state.

Conclusion

The problem of attorneys committing Wrongful Designation could have been going on for years and just recently has become known, or it may have only started occurring recently. Whichever is the case, it is conduct that the Code of Professional Responsibility prohibits. And, it can be very damaging to expert witnesses, and possibly clients and attorneys on the opposite side in a case. For that reason, AAIMCo is continuing to gather information on occurrences from both its members and nonmember expert witnesses.

If you have any information about specific acts of this type of conduct, please notify AAIMCo with the specifics of any such incidences at info@aaimco.com. AAIMCo is not interested in the names of the attorneys or experts involved. They only want verifiable information on the type of incidences and frequency of Wrongful Designations that are occurring. ■

Endnotes

(1) California Bar Association is the only bar association that did not adopt the ABA Code of Professional Conduct. California Bar Association has its own rules that include the following:

Rule 5-200 Trial Conduct

In presenting a matter to a tribunal, a member: (b) Shall not seek to mislead the judge, judicial officer, or jury by an artifice or false statement of fact or law.

(2) New York City Bar Association has a slight variance in its wording which is:

Rule 3.4: Fairness to Opposing Counsel

A lawyer shall not knowingly:

(a)(1) Suppress any evidence that the lawyer or the client has a legal obligation to reveal or produce.

(3) New York State Bar Association has a slight variance in its wording which is:

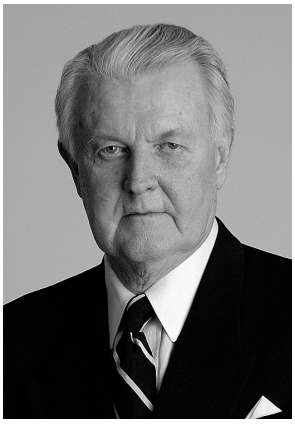
Rule 4.1: Truthfulness in Statements to Others

In the course of representing a client, a lawyer shall not knowingly make a false statement of fact or law to a third person.

Misrepresentation: [1] A lawyer is required to be truthful when dealing with others on a clients behalf, but generally has no affirmative duty to inform an opposing party of relevant facts. A misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false. Misrepresentations can also occur by partially true but misleading statements or omissions that are the equivalent of affirmative false statements. As to dishonest conduct that does not amount to a false statement or for misrepresentation by a lawyer other than in the course of representing a client, see Rule 8.4.

The Potential Repercussions of 'Late Notice' — A Forensic Accountant's Perspective

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.

When we ponder the potential defenses for an insurer or reinsurer, we usually consider the failure to report potential liabilities timely (i.e., within a reasonably short period of time after the potential liability becomes apparent). Late notice may be the result of a policyholder who is extremely slow to report a claim, or it may come as the result of a primary insurer not keeping excess insurers and/or reinsurers current on the progress of a particular large claim (or group of claims), which may ultimately attach the excess insurer or reinsurer. The traditional definition of "late notice," as described above, is, actually, not the subject of this article. Rather, the following discussion addresses late notice from a forensic accountant's perspective.

The Problem

Late notice, heretofore, refers to the unnecessary, albeit unintentional, delay by an insurer or its counsel to recognize the need to engage professional consultants and experts to assist in the claim/loss evaluation. In addition to external legal counsel, there often is a need for other specialists to assist with certain aspects of the claim.

For first-party property claims, the outside resources often include independent adjusters; investigators (cause-and-origin); building contractors; machinery and equipment experts; and, for time element and other financial aspects of the claim, forensic accountants. Generally, on first-party property claims, the insurers are quick to approve and engage in the use of such outside resources.

The problems associated with the late engagement of experts are exacerbated when a claim is obviously complicated or likely to be difficult to settle with the insured. When a claim is in litigation, arbitration or mediation, the need to engage experts early on in the process is paramount. Once a Complaint has been filed, the need to engage experts is greatly accelerated, and certainly should be confirmed as soon as possible during discovery when interrogatories are exchanged and depositions taken.

Subrogation Defense

As forensic accountants, when we receive a call, usually from legal counsel with a new assignment sometimes relating to a subrogation, often, after describing the nature of the claim, the attorney will ask if we have ever worked on a similar claim, followed by, "How does your schedule look? I have some documents that I need you to review and provide us with your opinion on ASAP because I have a settlement conference with the court next Thursday." We then ask the question (and anticipate the dreaded answer), "Is discovery still open?" Usually the response is something like, "Not really! I may be able to get few items, if we don't already have them, but basically discovery ended several weeks (or months) ago."

Several days later, after we have reviewed four or five file boxes of documents provided to us by counsel, we present our observations, generate a list of questions and issue a formal document request list. However, as discovery is usually closed at this point, the document request list is more likely to be a "wish list." This is so unfortunate! These documents are often an essential component of our claim evaluation process. While we may have many documents to start with, they are of limited use for our financial analysis. Late engagement of experts can be like tying a hand behind the back.

Deposition Transcripts and Interrogatories

In addition to the obvious requests for financial statements, tax returns and related relevant financial documents, we request a copy of the pertinent coverage sections of the insurance policy, a copy of the Complaint, interrogatories and transcripts of depositions.

Going back 20 years or so, quite often when we were engaged on a troublesome claim, we would be engaged early on and work closely with the attorney and other members of "the team" in a coordinated effort to provide the attorney with input from each of our respective areas of specialization. As the attorney prepared to depose the claimant, CFO, treasurer or controller, we would prepare a list of questions of a financial nature to be included in the deposition. There were many times when I would actually sit in during the deposition of the financial officer, who in turn would have his or her representative present during my deposition. This was a fruitful endeavor. For example, if a response to a question from the attorney sounded incomplete or inaccurate, I would make a note or discuss the answer with the attorney during a

recess and then the attorney could re-address the issue when we reconvened.

In the present environment, by the time we receive the engagement, the depositions have been taken and the interrogatories have been responded to, such as they are, and at our late entry date, we simply get to read the transcripts, sometimes cringing because the really pertinent financial questions have not been addressed. We will then be limited to doing the best we can with what we have. Even then, late engagement beats no engagement.

Late assignments to assist in a subrogation defense can often result in many more documents to review than would be required in a first-party claim, given that the insured's original claim documentation and file as well as the insurer's file and that of all the experts involved in the investigation, analysis and adjustment of the loss will likely have been requested, many of which were followed with interrogatories and depositions. Often, the date of loss was five or more years earlier, creating a separate set of problems to locate documents and overcome lapses in memory.

Furthermore, in addition to concentrating upon the time element claim and loss calculation (i.e., sales trend, suspension period, saved or discontinued expenses), we sometimes find misclassifications and/or duplications within the payments made as reflected in the Statement of Loss. For example, items normally classified under the building coverage may appear as "Maintenance and Repairs" and/or claimed as continuing, post-loss expenses or, if the insured had extra expense coverage, perhaps some of these building and equipment related expenses may have been classified as extra expense. This is sometimes likely to happen when the building and equipment coverage has been exhausted. As forensic accountants, we want to get details for all such overlapping categories, but with a late engagement, we would be limited or precluded from obtaining these pertinent documents.

In addition to scrutinizing for duplications, any items relating to capital expenditures, such as those covered under the building or personal property coverage (i.e., machinery and equipment) could be indemnified under maintenance and repairs or extra expense. In our subrogation claim, if the original insured had, and was indemnified for, capital expenditures at replacement cost, in many states the subrogee is only responsible for actual cash value (ACV). Therefore, items that are classified as "expenses" (indemnified at 100 percent), which can be identified as capital expenditures, may be reclassified as such and paid at ACV *(not at 100 percent)*.

Casualty Claims — A Different Set of Late Notice Problems

For a casualty claim, late engagement provides a different set of circumstances and potential problems. For example, on large toxic-tort claims, often with tens of thousands of claimants, usually there is a third-party administrator (TPA) engaged by the primary and excess insurers. The TPA oversees the processing of claims and defense costs, and then issues periodic reports to the excess carriers. At times, there is very little audit work performed by the excess carriers to verify the liability, expenses and allocation between years, layers and carriers. It is not until an excess carrier is notified, or otherwise becomes aware that it is about to attach, that the excess carrier realizes it must inform outside counsel and perhaps engage a forensic accounting firm to verify the exhaustion of the underlying policies.

In such a situation, the audit would take several weeks, perhaps a few months from start to finish. The reasons for the delays relate primarily to obtaining documentation from the TPA or underlying claim management facility. Then, after reviewing the claim and expense payment history, a selection of specific claim files for review would be made, many of which may be housed in off-site storage, making locating and retrieval a slow process. A copy of the

coverage chart, treaties and facultative certificates would need to be obtained from the attorney with whom we would be working, all of which would take time before the audit was even started. The audit, post-loss analysis and report draft would take several weeks, including a review of the allocation methodology and "burn-rate." At the completion of the cycle, the client may have already attached, and there is mounting pressure for immediate payment.

A more expeditious, informative and often less expensive approach would be to perform periodic reviews by selecting small transaction samples for testing, as taken from the periodic TPA reports. Pertinent claimant documents could be obtained, usually electronically, for specific payments; claimant specific documents such as the complaint, work and exposure history; "trigger" documentation; release and payment manifest; and check or wire transfer documentation.

Suggestions for Avoiding Late Notice in Engaging Expert Assistance

Subrogation Defense

First-party property claims seem better organized and staffed early in the claim/loss

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The Potential Repercussions of 'Late Notice' — A Forensic Accountant's Perspective

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evaluation. In an effort to get the insured back in business quickly, which works to everyone's benefit, the adjuster assembles a team of experts promptly, including a salvor, a building contractor, a machinery and equipment expert (if large equipment has been damaged or destroyed) and a forensic accountant to assist with the time element aspects of the claim.

The need for the early engagement of experts, perhaps with the exception of outside counsel, is not recognized as quickly in defending a subrogation claim or liability claim involving many excess carriers and reinsurers. This may be attributable to the carrier relying upon the outside counsel to be the responsible party for finding strong defense arguments. By performing a thorough review of the coverages and the issues, such as statutes, jurisdiction, precedent, etc., the attorney will be well prepared to advise the client of the legal defenses.

But, what about damages and valuations, and, if applicable, contributory (or at least comparative) negligence? If the subrogation relates to real and personal property as well as loss of earnings and extra expenses, then surely a building expert can assist in scrutinizing before and after construction comparisons. Have there been substantial, unnecessary enhancements? Is the period of restoration reasonable? Has the equipment been upgraded? Most importantly, is the building and equipment available for expert inspection? These are questions that the defense attorney will need assistance with and perhaps require testimony should the case proceed to court or arbitration. Early engagements are essential to the success of the case.

Likewise, early engagement of a forensic accountant can prove to be very beneficial, especially if discovery is still open and depositions have yet to be scheduled. In coordination with the building expert and the machinery and equipment expert, the accountant can share his or her findings with them after scrutinizing the documents made available to date, and, if necessary, request additional details and documentation based upon conversations with the other "team members." By obtaining source documents, like third-party invoices, the accountant can verify or challenge certain items classified as expenses that may be related to building and/or machinery, resulting in a lower valuation (ACV) for the defense. Pre-loss details, compared to post-loss replacements, may reflect substantial enhancements, which can be reviewed and discussed with the builder and equipment experts.

These are some of the potential discovery techniques, which can be obtained and provided to defense counsel, that may otherwise have been lost if engagements had not been issued prior to the close of discovery. Additionally, any significant discovery can be submitted to counsel for use when scheduling depositions. The message is, "He/she who hesitates to engage experts early in the defense process, has lost some of the benefits that the experts can provide."

Casualty-Liability Defense

The defense in large toxic-tort cases is much more attorney-oriented. When experts are engaged, they are usually drawn from the medical profession or are individuals familiar with the types of products to which the claimant(s) have been exposed and where the exposures took place. On older class-action cases, the claim handling was often performed by the primary carrier, and then as the volume of claims became overwhelming or perhaps after the primary carrier(s) exhausted, a TPA may have been engaged to process the claims. In some cases, a large law firm becomes the acting TPA, usually under the guidance of the insured after obtaining consent from the excess carriers.

The larger, more serious and troublesome claims are often reviewed by a committee of attorneys and claim personnel, who decide on settlement strategy and whether to try the case. Claim-specific reporting is usually provided to the excess carriers depending upon the agreement with claim administrator. Periodically, usually monthly or quarterly, the excess carriers are provided with summary claim and expense payment history, which also reflects the allocation to each of the insurers who have attached and reflects the remaining limits before exhaustion. It is at this phase when the forensic accountant can provide a service to the carriers that have attached and also to the next layers of carriers that may be attaching in the near future. In these instances, the "Late Notice to Engage" refers to those underlying carriers, say on the first excess layer that have already, or are about to, exhaust.

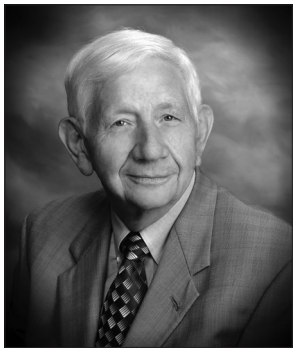
The audit process takes time for the TPA to provide the detailed reports from which the auditor will make a selection of claim files to review. Because of this time delay, it is important for the audit engagement to be scheduled with sufficient lead-time, ideally prior to the client carrier attaching. That way, indemnity and expense payments can be tested, "trigger dates" and exposure histories can be verified, and most importantly, allocation methodologies can be identified for compliance with settlement agreements between the excess carriers. This can be beneficial when performed before payments begin by the client excess carrier. Periodic follow-ups can later be scheduled as the need dictates.

Conclusion

If an expert is going to be needed at some point, whether it be on a property or a casualty file, conventional wisdom dictates that the engagement occur sooner rather than later. The client will receive a quicker response as to the findings and the reports will be more complete and informative as the expert will have more data available than may be the case if you are "late to notice." ■

Q&A with Donald S. Malecki, CPCU

by Donald S. Malecki, CPCU



Donald S. Malecki, CPCU, is a principal at Malecki Deimling Nielander & Associates LLC, based in Erlanger, Ky. During his more than 50-year career, he has worked as a broker, consultant, archivist-historian, teacher, underwriter, insurance company claims consultant and as publisher of *Malecki on Insurance,* a highly regarded monthly newsletter.

One of our insureds is a general contractor who contracted with a project owner to construct a large residential complex. Under the contract between the two, which appears to be similar to the provisions of the 2007 American Institute of Architects, General Conditions A201 Form, the owner agreed to cover the insurable interests of others.

More specifically, the provision in question states that the owner's obligation is to obtain insurance that must include the interests of the owner, contractor, subcontractor and sub-subcontractors of all tiers.

Instead of purchasing a builders risk policy covering the interests of the general contractor and subcontractors, the owner is relying on its commercial property policy. This policy not only provides coverage for all of the owner's existing properties but also new construction. Unlike a builders risk policy, however, it does not name contractors as named or additional insureds. This commercial property policy, instead, says under the subhead "Property and Interests Insured" that it insures "[t]he interests in all real and personal property of every kind and description for any entity that the named insured has agreed to insure."

This policy also contains a section entitled "New Construction, Alterations and Repairs," *where it again states that coverage also applies to the* "interests of contractors and subcontractors in such property to the extent the Insured has assumed liability therefore."

What broaches the question here is that the general contractor sustained a major loss at a project brought about by the elements of weather (act of God). As it turned out, the pre-selected adjuster of the insurer denied coverage based on the faulty workmanship exclusion and on some conditions of the owner-contractor agreement. With a large policy deductible being the responsibility of the owner, this decision undoubtedly made the owner very happy. In fact, the owner decided not to pursue the issue following coverage denial.

It is not the purpose here to prolong the discussion with some interesting coverage arguments involving, for example, the efficient proximate cause of loss, and the rationale for the faulty workmanship exclusion. The question, instead, is the extent to which the insurer is obligated to adjust the loss directly with the contractor, even though the owner does not appear interested in pursuing the matter.

More to the point, a consultant for the insurer has maintained that if the owner decides it does not want to pursue the claim being made by the contractor under the owner's policy that is its prerogative and the end of the matter. In effect, unless the contractor has its own insurance for the work done on this project, which is unlikely, the contractor has to go bare!

It is our opinion that even though contractors, including the general contractor making the claim, are not insureds under the owner's policy, the owner still has the obligation to pursue this matter. What do you think, and how would you go about answering this question?

The short answer (opinion) here is that the owner has the obligation to pursue this claim in the interests of the general contractor, no matter how distasteful it may be for the owner to assume that large deductible first. Let's face it, the owner could have (and in retrospect probably should have) made the deductible the general contractor's obligation insofar as new construction work was concerned.

Although a more expansive answer in legal terms abounds, the opinions expressed here are solely from an insurance person's perspective and not those of a lawyer. In fact, this subject is not something an insurance person has to avoid because the legalities raised here are taught in the Chartered Property Casualty Underwriter curriculum and need to be understood. If this is a matter that is going to be pursued with fervor, however, retaining a competent attorney would be a good idea.

Having said that, the reason the owner has an obligation to pursue this matter is twofold: first, the owner was obligated by contract to protect the insurable interests of the contractors and, in fact, had an insurance policy in force that agreed to do just that in the two places you pointed out. It cannot be any clearer than that; second, the general contractor appears to be an intended third-party beneficiary. Legally, that term can be described in a number of ways. Strictly from an insurance person's perspective, intended third-party beneficiary can be defined as a person who, or entity that, by agreement of the parties to a contract, stands to benefit from the contract's execution.

In nonlegal and simple terms, this means that when the owner-general contractor agreement was signed, the obligation of the owner to protect the interests of the contractors was imbedded in concrete. The

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CPCU Society
720 Providence Road
Malvern, PA 19355
www.cpcusociety.org

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Q&A with Donald S. Malecki, CPCU

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owner, therefore, cannot ignore its promise and simply leave the general contractor hanging without protection. The term commonly used to describe this situation is breach of contract!

This situation dealing with an intended third party beneficiary may appear a little strange since the general contractor that is the beneficiary is also one of the parties to the contract with the owner. It is likely to take a court to determine if the general contractor is a third-party beneficiary, but it would be a surprise if it were not — given that the owner was obligated to protect the general contractor's interests and the policy reflects that intent.

The advantage of being an intended third-party beneficiary is that the general contractor not only obtains coverage even though the owner has not made any claim for loss or damage to its property (to the extent the policy applies of course), but also obtains the right to sue the insurer. The general contractor, in other words, is comparable to a policy named insured, since it has the same rights as a named insured in pursuing a covered loss affected by it. What other rights the intended third-party beneficiary may have will depend on matters that are unnecessary to explore here.

To conclude, it is the opinion here that the owner cannot simply ignore its promise to provide insurance covering the general contractor's insurable interests. Although bad faith also is a legal conclusion, it is not something reserved solely for insurers. Insureds, as well, can be (and have been) assessed damages for failing to fulfill their promises regarding insurance matters.

It would be nice if some members of CLEW who are well versed in this subject or who are lawyers could provide some comments based on the opinions expressed here, just so that you (and others who may encounter similar situations) are given a more rounded perspective of what this subject entails. ■

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Consulting, Litigation & Expert Witness Interest Group
http://clews.cpcusociety.org

Chair
Vincent "Chip" Boylan Jr., CPCU
Willis of Maryland Inc.
E-mail: vincent.boylan@willis.com

Editor
Jean E. Lucey, CPCU
Insurance Library Association of Boston
E-mail: jlucey@insurancelibrary.org

CPCU Society
720 Providence Road
Malvern, PA 19355
(800) 932-CPCU (2728)
www.cpcusociety.org

Director of Program Content and Interest Groups
John Kelly, CPCU

Managing Editor
Mary Friedberg

Associate Editor
Carole Roinestad

Design
Susan B. Leps