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CPCU SOCIETY

From the Editor

by Donn P. McVeigh, CPCU

This issue includes three excellent articles (even if I say so myself), all from members of the national CLEW Section Committee. **Tom Veitch's** article on analyzing insurance coverage issues will be followed up in the next issue of *CLEWS* by another article discussing techniques involved in this process. **Charlie Shaddox's** article (written along with his partner, Stephen Walraven) discusses something dear to most of our hearts, qualifying and disqualifying insurance experts. And finally, my article on implementing the formation of a risk retention group is a follow-up to my article titled "Evaluating the Feasibility of Forming a Risk Retention Group" that appeared in the last issue of *CLEWS*.

It is my pleasure to announce two new members of the national CLEW Section committee: **Anna K. Bennett, CPCU,** and **Byron A. Gregerson, CPCU.** Anna is an attorney with the law firm of Dolbec, McGrath, Bennett & White of North Quincy, Massachusetts. Anna's firm represents insurance carriers. She received her CPCU in 1988. Byron Gregerson is a partner in the Modesto, California law firm of Thayer, Harvey & Gregerson and it also represents insurance carriers. Byron received his CPCU in 1978. We welcome both Anna and Byron to the committee and look forward to their contributions. ■

Analyzing Insurance Coverage Issues

by Thomas H. Veitch, J.D., CPCU, CIC

The analysis and explanation of insurance policy coverage are areas in which insurance consultants or expert witnesses frequently become involved. Clearly, most laypersons, and even judges, are confused by the complexities of insurance policy language. To understand the coverage presented under a policy, it is necessary to understand not only the applicable policy provisions but all of the terms and conditions of the policy that may impact the coverage. As a consequence, insurance coverage litigation or issues are a fertile ground for the services of CLEW members. This article discusses how courts go about reconciling disputes involving insurance policy interpretation or construction. A majority of the rules of insurance policy construction in the various court jurisdictions have evolved by case law. While the rules of construction may vary somewhat from state to state, the following general rules of construction will be helpful in analyzing and explaining coverage issues.

Rule 1: The interpretation of an insurance contract is governed by the same rules as the interpretation of other contracts.

Rule 2: When construing a contract, the court's primary concern is to give effect to the written expression of the parties' intent.

Rule 3: The court is bound to read all parts of a contract together to ascertain the agreement of the parties.

Rule 4: The contract must be considered as a whole.

Rule 5: Wherever possible, each part of the contract should be given effect.

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Rule 6: In all contract disputes, words that are subject to more than one interpretation are defined so that they are harmonious with the other provisions of the contract rather than being repugnant thereto.

Rule 7: The language in the policy should be accorded its plain, grammatical meaning unless the parties definitely intended otherwise.

Rule 8: Generally, the words and phrases in the contract should be given their ordinary, popular, and commonly accepted meanings.

Rule 9: Where the language in the contract is plain, it must be enforced as written.

Rule 10: When the controversy can be resolved by a proper construction of unambiguous language, the rendition of a summary judgment of the court is appropriate.

Rule 11: An interpretation of a contract that renders provisions meaningless is unreasonable and, therefore, not preferred.

Rule 12: A contract is "ambiguous" when its meaning is uncertain and doubtful or it is reasonably susceptible to more than one meaning.

Rule 13: Mere disagreement over the meaning of a provision in an insurance contract does not make it "ambiguous."

Rule 14: If the policy is so worded that it can be given certain definite legal meaning or interpretation, then it is not ambiguous and the court should construe the contract as a matter of law.

Rule 15: Whether a contract is ambiguous is a question of law for the court to decide by looking at the contract as a whole.

Rule 16: When a contract contains an ambiguity, its interpretation becomes a question of fact to be determined by the jury or trier of fact.

Rule 17: Conduct of the parties that indicates the construction they themselves placed on the contract may be considered in determining the parties' true intent with regard to any ambiguous provision.

Rule 18: When a contract provision makes a general statement of coverage and another provision specifically states the time limit for such coverage, the more specific provision controls.

Rule 19: When the insurance policy contains ambiguity there is a fact issue thus making it improper for the court to render summary judgment.

Rule 20: Since insurance policy forms are regulated by the state insurance department, the actual intent involved in the precise words reflects as much the intent of the insurance department as that of the parties.

Rule 21: Insurance policies must be interpreted liberally in favor of insureds, especially when dealing with exceptions and limitations.

Rule 22: "Patent ambiguity" in an insurance contract is ambiguity that is evident on the face of the contract.

Rule 23: "Latent ambiguity" arises when an insurance contract that is unambiguous on its face is applied to the subject matter with which it deals and ambiguity appears by reason of some collateral matter.

Rule 24: Parol evidence is admissible for the purpose of ascertaining the true intention of the parties if the contract contains a latent ambiguity.

Rule 25: The courts are allowed to admit extraneous evidence to determine the true meaning of policy language only where the contract is first determined to be ambiguous.

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Rule 26: Evidence of the intentions of the parties to the insurance policy cannot be used to create an ambiguity.

Rule 27: Evidence of the intentions of the parties is admissible only if the policy is first determined to be ambiguous.

Rule 28: Where the meaning of a insurance contract is plain and unambiguous, the parties' construction is deemed immaterial, and the insurance contract is construed as a matter of law.

Rule 29: When the language of an insurance policy is subject to two or more reasonable constructions, courts will construe the language to afford coverage.

Rule 30: When construing exclusionary clauses, the courts must adopt the insured's construction as long as that construction is reasonable, even if the insuror's construction appears to be more reasonable or to more accurately reflect the intent of the parties.

Rule 31: Once the insured offers a reasonable interpretation of the policy, any contrary interpretation must be rejected, even if the contrary interpretation is itself reasonable, or more reasonable.

Rule 32: Mere disagreement over the interpretation of an insurance contract does not make it ambiguous.

Rule 33: A policy that is otherwise clear is not rendered ambiguous simply because it requires the insured to read the policy thoroughly and carefully.

Rule 34: In determining whether a contract term is ambiguous, a court should consider the contract terms in light of the surrounding circumstances.

Rule 35: Uncertainty or lack of clarity in the language chosen by the parties is insufficient to render a contract ambiguous.

Rule 36: The insured bears the burden of proof establishing that the claimed loss is within the coverage of the policy.

Rule 37: The insured also bears the burden of proving that it complied with all conditions precedent to coverage.

Rule 38: The burden of apportioning the damages between covered and non-covered losses is on the insured.

Rule 39: Generally, insurers are required to both plead and prove the applicability of an exclusion.

Rule 40: The applicability of an exception to an exclusion in an insurance policy is a question of coverage, on which the insured has the burden of proof.

The foregoing rules are intended only to serve as guidelines for your consideration when you are analyzing insurance policy coverage issues. Certainly, there are other general rules that could apply, but these are the rules most frequently used by courts while interpreting insurance policies. Even with the benefit of these and other rules of construction, the application of insurance policy language to the fact situation at hand remains an ongoing challenge. Subsequent articles will discuss other issues and concerns involved in analyzing insurance coverage. ■

Qualifying and Disqualifying Insurance Experts

by Charles R. Shaddox, J.D., CPCU, and Stephen E. Walraven, J.D.

Introduction

Insurance litigation has often involved the testimony of experts in various fields related to insurance. Perhaps most often used are experts testifying about the proper handling and adjusting of insurance claims, and/or bad faith in doing so. Experts have also been used in the fields of underwriting, negligence by an insurance agent, reinsurance, taking life insurance applications, and other customs and specialized usage or practices in the insurance industry. The issues and practices involved in retaining, preparing, and presenting such experts, or seeking to disqualify them, have been significantly changed by recent developments. Both the United States and Texas Supreme Courts have held that all experts are to be closely scrutinized by the trial court, which is to act as a gatekeeper to exclude irrelevant and unreliable expert testimony from trial. Federal Rule of Evidence 702 has been amended, codifying a new standard for expert testimony admissibility. These new standards have not yet been expressly applied to insurance experts in any reported cases, but trial courts have recognized their obligation to do so. The application of these new standards to insurance litigation is now a fundamental concern for litigants retaining and offering experts, for those challenging experts, and is the subject of this article.

The recent decisions in *Daubert v. Merrill Dow Pharmaceutics, Inc.*[1] and *E.I. Dupont Nemours & Co. v. Robinson*[2] have changed the practice of qualifying or disqualifying expert witnesses. Both the United States and the Texas Supreme Courts have applied these new rules to all experts.[3] Litigating insurance cases now will often involve evaluating both one's own, and one's opponent's experts under the new standards set forth in those cases. (Obviously, much insurance litigation involves many areas of expertise, other than insurance. This article does not attempt to address specifically those fields of expertise, or the admissibility of expert opinions in other fields.)

Law Prior to *Daubert* and *Robinson*

Prior to these new standards (hereinafter sometimes referred to as the *Daubert* standards), a handful of cases discussed the use and misuse of insurance experts. While the new *Daubert* standards add to the issues affecting admissibility, the issues discussed in the earlier cases still also apply, and should still be considered. These cases will be mentioned briefly.

Courts still exclude testimony consisting of legal conclusions, including opinions as to legal duty and as to the construction of contracts, by experts or otherwise. Testimony concerning statutory requirements, an insurance company's statutory duties, or how an insurance policy should be construed have all been excluded as legal conclusions.[4] This law would not appear to change with *Daubert*.

Expert testimony has been admitted on the issue of proper claims handling, and whether or not claims handling conduct constituted bad faith.[5] However, two cases held that a jury needs no expert assistance to determine whether or not the insurance company's conduct was in bad faith.[6]

Expert testimony has been allowed on the custom and practices of the insurance industry, in a case of dealing with late payments on a life insurance policy.[7] Expert testimony has also been admitted regarding the technical issue of dealing with the various alternative forms of equivalent insurance endorsements.[8]

Another point clearly made in prior case law, which may apply with even more vigor today, is that a litigant needs to be careful in selecting his witness as to the proper field of expertise. In three cases, the expert testimony was found to be inadmissible because the purported expert had little or no experience with respect to the particular types of claims at issue, the specific geographic area of the claims, or the specific question at issue.[9] Similarly, an expert's affidavit that omits the foundation of his conclusions has been and probably will continue to be inadmissible.[10]

The principles articulated in these cases almost certainly will continue to be applied, with respect to the issues discussed in those cases, in addition to the new admissibility standards.

The New Practice Standards

The Rule

The Texas Rule of Evidence, Rule 702, has not changed. The Federal Rule of Evidence has been amended to incorporate the *Daubert* standards, as generally applied.[11] Practice under both Rules 702 has changed dramatically. Both the U.S. and the Texas Supreme Courts now interpret Rule 702 to require the trial court, if a party raises an objection, to conduct an inquiry into the expert's qualifications and methodology, before admitting his testimony at trial.[12] The trial court is to perform this gatekeeper function with respect to all types of experts.[13]

The trial court's new gatekeeping analysis, as

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explained in these cases, can be usefully divided into four categories. The first category focuses on the issue of expertise, and considers both the expert's qualifications in his or her field and whether that field of expertise is the correct field to specifically address the subject of the expert's opinions. Secondly, the methodology used by the expert to reach his or her conclusions is scrutinized, and his or her conclusions will be rejected if the court is not satisfied that the methodology is acceptable. Thirdly, while stating that the focus is on methodology and not conclusions, the court must require that the expert's conclusions and opinions be logically consistent with and follow from the articulated methodology; if not, the testimony will be rejected. There is also a fourth category, although not new, which focuses on whether the expert's conclusions really require an expert at all, or are within the collective common sense of the jury.

An Exception

It should be noted that both Supreme Courts have identified certain categories of expertise in which the new practice rules may not apply. Both the Texas Supreme Court in *Gammill*[14] and the United States Supreme Court in *Daubert*[15] note that some matters of expertise may be so firmly established as to "have attained the status of scientific law, such as the laws of thermal dynamics," and are "properly subject to judicial notice. . . ." In some cases, one might argue that the asserted principles of insurance are similarly well established and are subject to similar judicial notice. On the other side, the Texas Supreme Court has also mentioned that certain theories, no matter how well qualified the expert and no matter how acceptable his or her methodology, will be rejected without further consideration, such as the proposition that the world is flat, that the moon is made of green cheese, or that the earth is the center of the solar system.[16] When faced with a more extravagant or outlandish theory, one might argue that, like the moon and green cheese, the theory should be rejected out of hand without further consideration. Undoubtedly, most of the time neither of these principles will serve, and the *Daubert* analysis will be required.

Application of the Daubert Principles

The Proper Field of Expertise

While it may be obvious that an expert must be qualified in his or her field, the specifics of that field are being more closely scrutinized. As the Texas Supreme Court emphasized in *Gammill*:

> Just as not every physician is qualified to testify as an expert in every malpractice case, not every mechanical engineer is qualified to testify as an expert in every products liability case.[17]

In *Gammill*, the Supreme Court contrasted two mechanical engineers, one qualified in designing and testing fighter planes and missiles, but whose only automobile experience, while he was in college, was as a mechanic. On the issue of seatbelt failure, he was found not qualified. The other expert had considerable experience, was well published, had done considerable testing and research on the issue of seatbelts, and was found qualified to testify on seatbelt failure, but was not allowed to testify as to cause of death.[18] Similarly, not every person with some expertise in insurance will be allowed to testify on every insurance issue.

On the other hand, complete identity of background may not be required. In *Southland Lloyd's Insurance Co. v. Tomberlain*, the insurance agent challenged the opposing expert for offering opinions about an insurance agent's standard of care when the expert did not hold an insurance agent's license. The court held that since the expert was a state-approved instructor of insurance agents, he was qualified to testify despite his lack of an agent's license.[19]

A person with a license or experience in life insurance may not be qualified to testify as to casualty insurance, an underwriter may not be qualified on claims handling, and an insurance agent may not be qualified with respect to any of those fields. An expert with experience in some types of claims handling, or with experience in one geographic area, may not be qualified elsewhere.[20] Even a properly qualified expert in one field may not be qualified to address all of the insurance issues in a particular case, as in *Gammill*. Careful thought should be given to the issues, and the proper fields of expertise, in selecting and qualifying experts. In challenging an expert, one should consider showing that a different field of expertise is better qualified to address a particular issue.

The Proper Methodology

The primary focus of all of these key cases, including *Daubert*, *Robinson*, and *Gammill*, was on the expert's methodology. In each case, the testimony of a qualified expert was rejected because of flaws in that expert's methodology. The list of factors, identified as "nonexclusive" but emphasized nonetheless, in evaluating methodology, were:

1. The extent to which the theory has been or can be tested,
2. The extent to which the technique relies upon the subjective interpretation of the expert,

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3. Whether the theory has been subjected to peer review and/or publication,
4. The technique's potential rate of error,
5. Whether the underlying theory or technique has been generally accepted as valid by the relevant field of expertise.
6. The non-judicial uses that have made the theory or technique.[21]

Although these factors were identified in connection with the issue of medical causation, both Supreme Courts have encouraged their application, to the extent practical, to all experts.[22]

At first glance many of these may not appear useful in an insurance case, but all should be considered with respect to the admissibility of the expert's opinions. Several will often be applicable.

As to whether a particular claim handling or claim investigating technique can be tested or is subject to a known rate of error, for many claims the answer is no, since each claim has its own unique characteristics. On the other hand, an adjuster's technique in investigating and settling a claim is often subject to the ultimate test of litigation, which will verify whether or not decisions to settle or investigate further were the correct decisions or not. Perhaps the expert can testify as to the accuracy or success of his or her techniques and practices. Some insurance companies have even gone to the extent of computerizing their claims experience, and may have statistics on the success and failure of their claims-handling techniques. To the extent that any validation of a methodology can be shown, it should be, or the failure to do so may be raised.

The next factor, reliance on subjective interpretation, will be involved with almost any insurance expert. While the subjectivity is not fatal, it should be addressed. In *Kuhmo*, the tire expert indicated that the proper methodology was to base his conclusions of tire failure on a visual and tactile examination of the tire. The U.S. Supreme Court noted that this was a proper methodology, which could yield acceptable testimony.[23] However, the Court found that the expert's reasoning based on what he observed was flawed and unacceptable. The tire expert failed to satisfactorily account for all of the alternative conclusions based on his subjective observations, and his testimony was rejected. For any insurance expert, to the extent that his or her testimony can be given in reference to established norms with as much objectivity as possible, the proponent of the witness will want to do so. Any failure to do so should be emphasized by the opponents of such testimony. For example, in evaluating claims handling or a failure to settle case, while the witness might be inclined to testify that a particular venue was well known as either liberal or conservative in its verdicts, the better practice might be to reference publications that report jury verdict information by a particular location, or to criticize an expert for failing to rely on such published objective information.

The next two factors are peer review/ publication and general acceptance in the field. Since publication in a standard reference work is often the best evidence of general acceptance, these factors will be considered together. Although conclusions specific to an individual case may rarely be published, general techniques and methodologies for investigating and evaluating claims can be found in many publications, including claims manuals, materials for teaching insurance to adjusters, and standard reference works on insurance. The presence or absence of such supporting material should be a matter of concern for both proponents and opponents of an insurance expert. It should be noted that while "peer review" may be an indication of reliability in a scientific publication, publications in the field of insurance can be different. In particular, many publications tend to present a particular point of view (perhaps insurance industry oriented publications or publications for claimants), and so publications may not be indicative of reliability, but merely advocacy. However, to the extent that one's expert is supported by a publication, the matter should be considered and referenced. If the particular point is found in a standard insurance reference work, such as Appleman, most courts would find the matter to be "generally accepted." Appleman, *Insurance Law and Practice*, 4th 1999. Perhaps the ultimate peer review of a publication would be to have the publication cited with approval by an appellate court. Any other support for the general acceptance of the expert's methodologies and opinion, or the lack thereof, should be raised.

The last of the *Daubert* factors is referred to as the "nonjudicial use" of a methodology. Particularly in claims handling, all of the use is, or could be labeled, "judicial." However, if the particular technique is used throughout the industry, with respect to both contested and non-contested claims, it might be indicative of a reliable methodology, rather than one created for the express purposes of the lawsuit in question. The proponent of that witness' testimony would want to show that his or her witness' techniques are used in all claims of a similar type, regardless of whether they are contested, and perhaps before any of them are contested. If the issue is something other than claims, the use of a methodology in standard practice would be evidence of such nonjudicial use. The opponent of

that expert would want to show the expert's approach was newly created for the expressed purpose of that litigation.

Application of the *Daubert* Standards in Other Fields of Expertise

The analysis of methodology in other fields of expertise hopefully provides some indication as to the way courts will look at insurance experts' methodology. In *Kuhmo* and *Gammill*, the seatbelt and tire engineers were held specifically to the standard of practice of the fields of seatbelt failure and tire failure analysis, although general principles were discussed. Since the decision in *Daubert*, other courts have considered other disciplines, making similar reference to the standards and acceptable practice in that field.

The case of *United States v. 14.38 Acres of Land*, 80 F.3d 1074 (5th Cir. 1996) was an imminent domain action involving an issue of land appraisal. The testifying real estate appraiser was excluded by the trial court, which was grounds for reversal on appeal. The Fifth Circuit found that the appraiser's methodology, using the standard techniques of the real estate appraisal field, was acceptable and admissible. Id. at 1078. See also, *Jesse Ventura v. Titan Sports, Inc.*, 65 F.3d 725 (8th Cir. 1995) in which expert testimony as to the value of royalties for videotapes of the future governor of Minnesota was admitted as based on the accepted methodology, using a survey involving royalties. Id., at 734.

In *Frymire-Brinati v. KPMG Peat Marwick*, 2 F.3d 183 (7th Cir. 1993), the court found error in admitting the testimony of a corporate valuation expert who testified that he did not employ the methodology generally accepted in that field. Id. at 187.

In each of these cases, the expert to some extent set his own standard by describing the methodology appropriate in that field of expertise, and was admitted or excluded based on that standard. The admissibility of insurance experts would therefore depend not only on the specific listed *Daubert* factors, but on other specific practices and techniques in that field.

If the technique or methodology used for the lawsuit is the same, and is used with the same "intellectual rigor" that is used elsewhere in that particular field of expertise, it probably would be considered an acceptable methodology for the insurance expert.[24] The expert's methodology, and its general use by other persons knowledgeable in that field, would appear to be a fundamental requirement for admissibility. The opposite and defective approach would be the absence of any methodology; that is, for the expert to say that something is so simply because he is an expert and he says so.[25] An opinion created only for a particular case, and never used elsewhere, would also be suspect. The expert witness must explain his methodology, must explain why his methodology is appropriate, reliable, and generally accepted, and must explain why his conclusion logically follows or is consistent with the application of his methodology.

Logical Consistency of a Conclusion

The Texas Supreme Court has said that it is not the business of the courts to determine whether or not the conclusion is correct, only whether or not the expert's analysis was reliable.[26] However, the courts in *Gammill* and *Kuhmo* specifically did look at the conclusion, to see if it logically followed from the methodology. In both cases, conclusions and testimony were rejected. If some component of the exclusion is simply inconsistent with the methodology set forth by the expert, the conclusion and the testimony are rejected. For example, if a claims expert testifies that settlement value is based on analyzing, among other things, jury verdicts in similar cases in the venue at issue, but his conclusion is far outside the range of the reported verdicts in that venue, the opinion and testimony might properly be rejected, absent further explanation. Obviously, what conclusions follow from a particular methodology will often be the subject of expert dispute, and a proper matter for the jury to consider. However, in opposing the admission of an expert, one should evaluate this issue, and consider making the argument that the conclusion simply does not follow from the methodology described.

No Expert Needed

In *K-Mart Corp. v. Honeycutt*, the Texas Supreme Court reversed a Corpus Christi Court of Appeals and affirmed the trial court's exclusion of a human factors and safety expert.[27] The plaintiff was injured while sitting on the lower rail of a shopping cart corral when an employee failed to see her and hit her with a stack of shopping carts being pushed into the corral. The expert offered opinions about the consequences of a missing top rail (it made sitting on the lower rail more inviting) and failure to keep a lookout when pushing a stack of carts. The Supreme Court held that the Ph.D. safety expert was properly excluded, because missing rails and proper lookout were within the judgment of the jury applying its "collective common sense."

Similarly, courts in other states have held that juries were competent to determine bad faith, without the assistance of experts.[28] If an insurance company conducts no investigation, or offers no explanation of a delay in payment or denial of coverage, perhaps no expert on bad faith would

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be needed. From the other side, a delay caused by the death of an adjuster, or a fire destroying records, may also be within the jury's common sense as to its reasonableness. Not every insurance issue will need or allow expert testimony, if simple common sense will answer the question.

Procedural Considerations

While experts can be and often are challenged during trial, it is becoming more common for a court to have separate Rule 104 hearings, to determine the admissibility of witnesses.[29] Some trial courts have required submission of these issues based on affidavits, and other courts have conducted lengthy hearings lasting several days. In both the federal and state court practice, the burden of proof is on the proponent of the witness.[30] Whether before or during trial, separate attention should be given the admissibility issues, and the proof specific to admissibility.

The Texas Supreme Court in *Robinson* did note that "once the party opposing the evidence objects, the proponent bears the burden of demonstrating its admissibility."[31] This comment raises the issue of the specificity required in an objection. Is it simply enough to object that the testimony is inadmissible for failing to comply with the *Daubert* standard, or must the specific defects be identified, for the benefit of the court and the opposing party, to narrow the issues? Some trial courts now do require that the basis for challenging the expert be specified. For example, the Scheduling Order form, Appendix "B" to the Local Rules of Court for the Western District of Texas, Item 5, requires:

> An objection to the reliability of an expert's proposed testimony under Federal Rule of Evidence 702 shall be made by motion, specifically stating the basis for the objection and identifying the objectionable testimony within ____ days of receipt of the written report of the expert's proposed testimony, or within ____ days of the expert's deposition, if a deposition is taken, whichever is later.

The objecting party should be as specific as possible, or risk a claim of waiver. The safe approach for the proponent of the expert would be to complain of any lack of specificity in the objection, but be prepared to put on evidence as to each and every element required.

Rule 104 specifically provides that the Rules of Evidence do not apply to a preliminary determination of admissibility. Hearsay such as articles, affidavits, or other materials could be offered. However, some objections, such as relevance or cumulative, will probably be sustained, as well as objections based on noncompliance with discovery. In discovery, both proponents and opponents of expert testimony may want to ask for materials to be used to support or oppose the admission of expert testimony. In some situations, a litigant might consider using an expert on methodology, at the Rule 104 hearing, who would not testify at trial.

The appellate standard in both the state and federal practice is the "abuse of discretion" standard. The Texas Supreme Court has defined that standard as determining:

> Whether the trial court acted without reference to any guiding rules or principles and the reviewing court cannot conclude the trial court abused its discretion if, in the same circumstances, it would have ruled differently or if the trial court committed mere error in judgment.[32]

One would therefore assume (and the case law supports the assumption), that decisions of trial courts will generally not be overturned, whether admitting or excluding the evidence. It would appear that it might be easier to overturn the admission of an expert, whose presentation omitted some key element, than it would be to overturn the exclusion of an expert. However, courts have overturned a ruling against admissibility.[33]

The Lawyer as Expert

Lawyers have often been retained as insurance experts, particularly on bad faith and claims handling issues. In several of the cases reported, the expert on insurance matters has been a lawyer. Undoubtedly, a lawyer handling insurance cases learns much about insurance, just as a medical malpractice lawyer may learn a great deal about medicine. However, it appears unlikely that a medical malpractice lawyer would be allowed to testify in a medical malpractice case as an expert on some medical procedure. Similarly, a mere background in law may not be considered sufficient to testify in an insurance case.

Insurance issues, particularly claims decisions being scrutinized in *Stowers* and bad faith cases, will often involve complex issues of multiple disciplines. The denial of a fire loss based on arson may involve issues of policy construction, insurance practices, the physics and chemistry of fires, and the tactics and strategy to prove arson at trial. To be qualified to address such a mixed issue may require some background and knowledge in insurance, civil trial, and the cause and origin of fires. A person may come to a position of expertise in this field starting with a background in insurance, in law, in engineering, or someplace else. Lawyers often are required to be successful by combining different disciplines, although simply being a lawyer is certainly not

enough to establish interdisciplinary expertise.

Some lawyers have worked as claims adjusters, or otherwise worked in the insurance industry. Some lawyers may hold licenses as insurance adjusters or designations such as Chartered Property Casualty Underwriter, which could provide considerable background in insurance. Some lawyers may also be engineers, architects, or have medical degrees. As with the comment that not all doctors are qualified to testify in every medical malpractice case, the specifics of the background should be considered. A lawyer whose insurance experience consists of preparing coverage opinions may be extremely knowledgeable about coverage and the law as applying to policies, but may not be well qualified with respect to claims handling. In contrast, some attorneys are at the scene within hours of a loss, perhaps a fire or fatal automobile accident, and actively participate in the pre-suit investigation, negotiations, evaluation, and handling the claim through trial. Attorneys in the latter category may have considerable experience, and be qualified to testify regarding proper investigation, evaluation, and settlement of claims within their experience. The experience should be evaluated as to the type of claim, its venue, and the other key characteristics of that claim. Lawyers without the specific type of experience, like the aircraft engineer in the seat belt case *Gammill* may be excluded.

Any time a lawyer is proposed as an expert witness, the opponent may argue that the testimony should be excluded as the lawyer's field is law. Legal issues are for the court, and legal conclusions are not admissible. Expert opinions from lawyers or other experts, as to legal issues such as legal duties or the construction of an insurance policy, are routinely excluded.[34] The proponent of an attorney-witness will need to be careful to distinguish the proposed expert testimony from simply offering legal conclusions, and the opponent of such a witness will want to carefully evaluate and object to any opinions that are nothing more than legal conclusions. It is not an objection that the expert witness addresses an ultimate issue of fact, such as negligence or bad faith, although the objection has been raised.[35] Lawyers with specialized knowledge and experience in insurance can be valuable and qualified experts, but it takes more than a law license to be so qualified.

Conclusion

Some day, when many of these issues have been further addressed by the appellate courts, the rules and the procedure in this area may be much simpler, more clear cut, and quicker to apply. While the majority of the cases to date have been very strict in their application of these rules, they often contain dicta alluding to a much more liberal standard. In *Gammill*, the court mentioned a beekeeper, with many years of experience with bees but no formal education, as qualified to discuss certain aspects of the flight of bees. In contrast, it also acknowledges that an aeronautical engineer who has never seen a bee may be able to discuss certain general principles of flight, even as applied to a bee.[36] Either possibility suggests that a more relaxed standard may be acceptable in some circumstances. The court also mentioned that an experienced car mechanic may be qualified to discuss a car's performance, without resorting to engineering principles. Simply upon proof of his or her skill and experience as a car mechanic, with no discussion of methodology or its logical consequences, the testimony of the mechanic may be admitted.[37] Similarly, in *Kuhmo*, the Supreme Court mentioned that a perfume expert may be able to distinguish 140 different odors, and testify as to what he smelled, again simply upon proof of his background and expertise. The methodology is completely subjective, and perhaps beyond explanation. (That is, "it smelled like a rose.")[38] However, in most of these examples, the conclusion would be subject to some sort of independent verification: another perfume expert could also smell it, other beekeepers could be consulted, the flight of bees videotaped, or the automobile's performance could be diagnosed with more sophisticated, perhaps computerized, technology. When the matter is fairly easy to verify, or disprove, the expert's testimony may be more readily accepted than in a circumstance in which the facts at issue are alleged to be unique or beyond anyone's ability to further investigate or verify.

Proponents of an expert will no doubt regularly assert that their field justifies a more relaxed standard of scrutiny, and such views may often prevail. Opponents of those experts will continue to insist on a much more rigid standard and more thorough analysis. Until these issues are better defined by appellate courts, practitioners will be busy dealing with these issues; and the best approach is usually to be prepared for the worst, while hoping for the best.

Endnotes

1. 509 U.S. 579 (1993).
2. 923 S.W.2d 549 (Tex. 1995).

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Qualifying and Disqualifying Insurance Experts

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3. *Kuhmo Tire Company Limited v. Carmichael,* 119 S.Ct. 1167 (1999); and *Gammill v. Jack Williams Chevrolet, Inc.,* 972 S.W.2d 713 (Tex. 1998).
4. *Thompson v. State Farm Fire & Casualty,* 34 F.3d 932, 941 (10th Cir.-1994) (applying Oklahoma law); *Aetna Casualty & Surety Co. v. Dow Chemical Co.,* 28 F.Supp.2d (E.D.Mich. 1998); *TRW Title Insurance Company v. Security Union Title Insurance Company,* 890 F.Supp. 756 (N.D.Ill. 1995); *Breezy Point Cooperative, Inc. v. CIGNA Property & Casualty Company,* 868 F.Supp. 33 (E.D.N.Y. 1994); *M&E Manufacturing Company, Inc. v. Frank H. Reis, Inc.,* 692 N.Y.S.2d 191 (N.Y.A.D. 3 Dep. 1999); *Hatch v. State Farm Fire & Casualty Company,* 930 P.2d 382 (Wyo. 1997); and *Jefferson Insurance Company of New York v. Dunn,* 482 S.P.2d 383 (Ga. App. 1997).
5. *City of Hobbs v. Hartford Fire Insurance Company,* 162 F.3d 576 (10th Cir. 1998) (applying New Mexico law); *Reedy v. White Consolidated Industries, Inc.,* 890 F.Supp. 1417 (N.D. Io. 1995); *Hall v. Globe Life and Accident Insurance Company,* 968 P.2d 1263 (Ok. App. 1998); *Jefferson Insurance Company of New York v. Dunn,* 42 S.E.2d 383 (Ga. App. 1997); *Peiffer v. State Farm Mutual Automobile Insurance Company,* 940 P.2d 967 (Colo. App. 1996).
6. *Thompson v. State Farm Fire & Casualty Company,* 34 F.3d 932 (10th Cir. 1994); and *City of Hobbs v. Hartford Fire Insurance Company,* supra. (In the Hobbs case, while the court did hold that a purported insurance expert's testimony was inadmissible, because the expert was unqualified, and did state that a jury did not need an expert on the issue of bad faith; the court went on to say that a properly qualified expert might be admissible.)
7. *McKenan v. General American Life Insurance,* 899 P.2d 1124 (Nev. 1995).
8. *Aetna Casualty & Surety Co. v. Dow Chemical Co.,* 28 F.2d 440, 446 (E.D. Mich. 1998).
9. *City of Hobbs v. Hartford Fire Insurance Company,* supra; *TRW Title Insurance Company v. Security Union Title Insurance Company,* supra; and *Farmland Mutual Insurance Company v. Johnson,* 1998 W.L. 720947 (Ky. App. 1998).
10. *M&E Manufacturing Company, Inc. v. Frank H. Reis, Inc.,* supra.
11. *The Texas Supreme Court in Gammill v. Jack Williams Chevrolet, Inc.,* 972 S.W.2d 713, 727 (Tex. 1998), noted the similarity in the federal and state rules, and expressly held that authority construing the federal rule at the time would be instructive in applying the Texas rule. The amended Federal Rule 702 reads: "If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.
12. *Daubert* and *Robinson,* supra.
13. *Kuhmo* and *Gammill,* supra.
14. Supra at 721.
15. Supra at 592.
16. *Robinson,* supra at 558 and *Havner,* supra at 712.
17. *Gammill,* supra at 719.
18. Id.
19. 919 S.W.2d 822, 829 (Tex.App-Tex. 1996) (writ denied).
20. See Note 9, supra.
21. *Gammill,* supra at 720, citing *Daubert.*
22. *Kuhmo* at 1175 and *Gammill* at 727.
23. *Kuhmo,* supra at 117.
24. *Kuhmo,* supra at 1176, and *Gammill,* supra at 725-26.
25. *Gammill* at 726, *Havner* at 712. However, dicta in *Gammill* suggests an experienced automobile mechanic might be allowed to testify as to a car's problem, without discussing his diagnostic methodology. *Gammill* at 724. When this principle would apply to another field is difficult to predict.
26. *Gammill* at 727.
27. *K-Mart Corporation v. Honeycutt,* 24 S.W.3d 357 (Tex. 2000).
28. Id.
29. Rule 104, Federal Rules of Evidence and Rule 104, Texas Rules of Evidence.
30. *Daubert* at 593 and *Robinson* at 557.
31. Id.
32. Id. at 558. *Accord, Kuhmo* at 1176.
33. See *Honeycutt v. K-Mart Corporation,* 1 S.W.3rd 239 (Tex.App.-Corpus Christi 1999); reversed on other grounds, 24 S.W.3d 357 (Tex. 2000).
34. See prior Note 4.
35. *Louder v. DeLeon,* 754 S.W.2d 148, 194 (Tex. 1988).
36. *Gammill* at 724-25.
37. Id.
38. *Kuhmo* at 1176.

Implementing the Formation of a Risk Retention Group

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Domicile Visit

When the business plan is completed, the project manager and a small group of the prospective investors should visit the domicile of choice in order to visit with: (1) the domicile regulator (or representative), (2) prospective domiciliary attorneys, and (3) prospective captive managers. The meeting with the domicile regulator is critical. The draft business plan should be presented to him or her with a request for a critical critique. Without the approval of the regulator, the RRG will not be licensed. This is the opportunity for the RRG organizers to gain insight into the regulator's opinions and to finalize the draft copy of the business plan.

Unless a captive manager has already been selected, the domicile visit allows the RRG organizers the opportunity of interviewing two or three captive management firms and making a selection. This is also true of the domicile law firm.

Obviously, all of these appointments should be made before the domicile visit.

Preparation and Distribution of a Disclosure Document

Single parent captives don't require disclosure documents, but corporate (or mutual) group investments do. These requirements are found in the federal Securities and Exchange Commission requirements and individual state securities laws known as blue-sky laws. The potential investor must be apprised of the details and associated risks involved with his or her investment. It is not a selling tool and each investor should be made aware of this.

Some exemptions to these securities laws are found in Section 3904 of the federal Liability Risk Retention Act of 1986, but, particularly with the Securities Act of 1933 and the Securities Exchange Act of 1934, they are somewhat ambiguous. Most attorneys recommend preparing and distributing a disclosure document. It just makes good sense to provide potential investors with all the necessary information to make an informed decision. The last thing a new RRG wants is a lawsuit from an investor claiming fraud, misrepresentation, or concealment of pertinent information.

The disclosure document should be prepared by a local corporate law firm experienced with securities law and captives. If the RRG is to be a stock corporation, the disclosure document will be a stock offering—preferably a "Regulation D" private placement to keep legal costs down. A fully registered stock offering will increase legal costs well into the six figures.

If the RRG is to be a mutual corporation or a reciprocal, the disclosure document will be called an informational circular, which looks and acts like a private placement stock offering.

The business plan and appended financial pro forma should be attached to the disclosure document.

Preparation of Bylaws and Articles of Incorporation

Once the domicile attorney has been selected, he or she should be asked to prepare the bylaws and articles of incorporation for the RRG. The domicile attorney, rather than the local corporate attorney, should prepare these documents since he or she must conform to the laws and regulations of the domicile state.

Application for Admission

Depending on the dynamics of the group wishing to form the RRG, all of the above steps may take six months or longer to complete. But once completed, all of the necessary information should be at hand to complete the domicile's Application for Admission and submit to the domicile regulator. It should not then take more than 30 days for the regulator to issue a Certificate of Authority pending deposit of the required capital.

Capitalization

Upon issuance of the Certificate of Authority by the domicile regulator, the stock offering or informational circular is closed; the RRG is capitalized and is licensed to operate.

Conclusion

All of these steps may appear complex, and they are, but the glue that binds this process is an accomplished and experienced project manager, whether that project manager be an outside consultant, insurance broker, or qualified association staff person. The total cost of organization, including the feasibility stage discussed in last month's article, may approach $150,000 or more (which does not include capitalization costs). When the organizational costs are divided by the number of group participants, these costs are not as daunting. ■

Implementing the Formation of a Risk Retention Group

by Donn P. McVeigh, CPCU

Editor's note: *This article first appeared in the March 2001 issue of the* Risk Retention Reporter *and is reprinted here with the permission of the author and publisher, Insurance Communications, copyright 2001.*

Last issue's article, titled "Evaluating the Feasibility of Forming a Risk Retention Group," discussed the steps necessary in determining the feasibility of forming a risk retention group (RRG). If, after conducting the feasibility study, it is determined that the group wants to proceed with implementing the formation of an RRG, then the following steps will follow:

- preparation of a business plan
- domicile visit
- preparation and distribution of a disclosure document
- preparation of bylaws and articles of incorporation
- application for admission
- capitalization

Preparation of a Business Plan

A draft business plan is usually prepared by the consultant (or association staff member) assigned the responsibility of nurturing the formation of an RRG from beginning to end. The business plan is critical to the successful chartering of the RRG and should carefully outline all of the details of the proposed RRG. These details should include:

- a description of coverage
- reinsurance
- captive management
- outside professional service providers, such as claims adjusters, loss control engineers, actuaries, etc.
- choice of domicile
- investment income
- other financial information

Much of the financial information is contained in the financial pro formas (discussed in last month's article), which must be appended to the business plan.

In addition to being a detailed plan to be followed by the new RRG, the business plan must also be "sold" to the domicile regulator for his/her approval. The regulator's potential concerns must be kept in mind when drafting the business plan. Those concerns focus primarily on the future solvency of the RRG. While solvency is also a concern of the group, the regulator may tend to be more conservative, especially with projected premium-to-surplus ratios and retention-to-surplus ratios. The importance of the business plan cannot be overemphasized.

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