CPCU SOCIETY INSURING YOUR SUCCESS

Consulting, Litigation, and Expert Witness Section Quarterly

CLEWS

Volume 14 Number 1 April 2007

# From the Chairman

by Daniel C. Free, J.D., CPCU, ARM

■ **Daniel C. Free, J.D., CPCU, ARM,** is president and general counsel of Insurance Audit & Inspection Company, an independent insurance and risk management consulting organization founded in 1901 by his great-grandfather. He is past president of the Society of Risk Management Consultants (SRMC), an international association of independent insurance advisors.

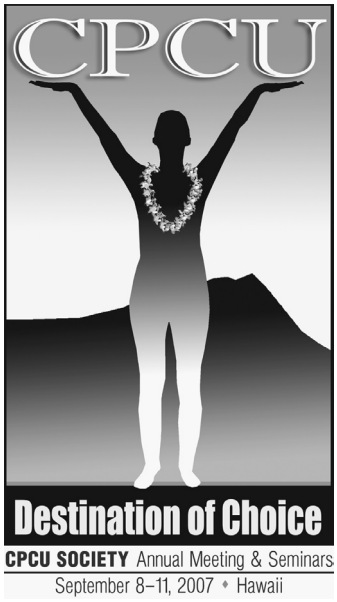
Free is also a founding member of the CPCU Society's CLEW Section.

I recently finished reading *The Seven Secrets of How to Think Like a Rocket Scientist* by Jim Longuski, Ph.D. Longuski has a Ph.D. in aerospace engineering, and is currently a professor in the School of Aeronautics and Astronautics at Purdue University. The book's title initially intrigued me because I actually *know* a rocket scientist. I wasn't as curious about how rocket scientists think as I was about how their thought processes differ from those of the rest of us.

Rocket scientists think big and dream big dreams. Their challenge is to plan and accomplish things that have never been done before. To be sure, they use all kinds of formulas and algorithms, models and tests, but there is little historical data to go on. Space exploration is anything but an industry steeped in age-old traditions. There is no "we've always done it that way" thinking to limit anyone. If it has occurred to you that no two endeavors could be more different in approach than rocket science and insurance, Professor Longuski would be pleased that you got one of his points.

He notes that, "the statistics of 100 million drivers give insurance actuaries far greater confidence than the statistics of hundreds of space missions give rocket scientists." This paucity of data means that rocket scientists spend much time thinking about things previously considered impossible. Their job is to overcome those impossibilities.

When I learned that **James Bradley** would be our keynote speaker at the CPCU Society's 2007 Annual Meeting and Seminars in Hawaii, and that he would be talking about overcoming impossibilities, it seemed like a surreal coincidence. Bradley is the author of *Flags of Our Fathers* and *Flyboys*. I've read both books and was very impressed with the thoroughness of his research into the individual characters and the enormity of their struggles, both on and off the battlefield. Though Bradley's address may be more about overcoming the impossibilities in our personal lives, there will doubtless be parallels that can be applied to our work, and the leadership of our industry.




By the way, while you're in Hawaii, don't miss out on our mock trial entitled, "Fun, Sun, and Umbrella Drinks," on Sunday, September 9, from 9:30 a.m. to 12:15 p.m., and our seminar on "D&O Liability Insurance 101: What You Need to Know and Why," on Monday, September 10, from 10:45 a.m. to 12:45 p.m. You've come to expect great things from the CLEW Section and we are always working to keep our productions fresh, informative, and entertaining. Mahalo, and Aloha. ■

# From the Editor

by Jean E. Lucey, CPCU

■ **Jean E. Lucey, CPCU,** earned her undergraduate degree (English) and graduate degree (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.

Upon moving to Boston in 1979, because of a career opportunity for her husband, she was delighted to find there actually exists an Insurance Library Association of Boston. Serving as director since 1980, Lucey attained her CPCU designation in 1986. She is a member of the CPCU Society's Consulting, Litigation, & Expert Witness Section Committee. The Boston Board of Fire Underwriters honored her as "Insurance Person of the Year" in 1995.

Lucey continues to learn on the job every day through constant exposure to insurance literature and the myriad of questions asked by people working in the insurance industry as well as lawyers, consultants, accountants, bankers, academics, consumers, and students.

I invite you to enjoy this issue of your section's newsletter and reiterate that your submissions for inclusion in a future issue are greatly encouraged. If you have something you'd like to say (within reason, of course, but I'll be the judge of that!), here's your forum. Please also keep in mind that it would be an excellent development if the newsletter were to prompt some interactive discussion. If you agree with, disagree with, or feel that you can add something useful to any of the items you read herein, please take the initiative to express your views. Your fellow section members are interested in what you have to say.

The member profile that **Vincent "Chip" D. Boylan Jr., CPCU,** has organized about CLEW Section member **James R. Mahurin, CPCU, ARM,** is most elucidating in several ways, not the least of which is the demonstration that very different career paths may reach the same goal. The fact that a person has attained an impressive degree or pursued what is traditionally viewed as a demanding educational program is no assurance that he or she will practice his or her profession with proficiency. I regret that I too, like Mr. Mahurin, have occasionally been witness to what seems an incredible dearth of understanding of basic insurance concepts by those who should know better—sometimes by claims people, which is particularly scary.

**Craig F. Stanovich, CPCU, CIC, AU,** is not afraid of hard and nitpicking work, and he does it very well. Yes, it may be somewhat onerous to comb through the language of insurance policies: when coverage disputes arise, however, such a process is absolutely necessary to determine what's what in any particular case. Craig is one of those people willing and able to undertake such a task. Many of you have no doubt read CLEW Section member Don Malecki's warnings about policy forms that contain a notation indicating they "include material [or language] copywritten by the Insurance Services Office." Such a notation is a pretty clear indication that the form at hand is not totally a "standard" ISO form. And even when a form is entirely that used by the industry as a whole, it behooves those settling such disputed cases to read them for themselves, not relying entirely on commentary or cases involving differing circumstances to reach a conclusion.

We greatly enjoyed meeting **Eleanor Barrett,** staff writer for the A.M. Best Company, when she was here in Boston to attend a meeting of the National Association of Insurance Commissioners—her "beat." Barrett's lighthearted reminisence of her start at A.M. Best may somewhat belie the more weighty subjects she writes about, but it helps to understand why she is able to communicate so well with the various state regulators and to impart their thinking so succinctly. For those of us who need to keep up with what is going on in the various states, it behooves us to read what Barrett and her colleagues have to say in the pages of *BestWeek* and *Best's Review*.

And finally, last (but never least) we have two questions and answers from **Donald S. Malecki, CPCU,** elucidating some complications of corporate yacht ownership and operation and the "sistership" exclusion. Talk about someone who is willing to slog through particular circumstances and make refined decisions, it is Don! Recently an agent inquired of us as to the advisability of listing less-than-policy-limits in the limits section of a Certificate of Insurance. Reading Don's opinion as expressed in a recent publicaton of the Independent Insurance Agents and Brokers of America, Inc. that such is not a good idea certainly convinced me. ■

# CLEW Section Member Profile: James R. Mahurin, CPCU, ARM

interviewed by Vincent "Chip" D. Boylan Jr., CPCU

*At high water, the first Class V rapid in the New River Gorge is audible from a mile away. The sound increases on approach to a pulsing roar, as if resonating with the core of the earth. The water volume is about 30,000 cubic feet per second. The river is 90 yards wide, compressed by a massive protruding rock narrowing the channel to about 20 yards. This compression is followed by a series of three drops in the riverbed totaling 35 to 40 feet within one-quarter mile. You tell your raft crew they are about to experience what Columbus expected to find when he reached the edge of the world.*

***How did your experience as an extreme whitewater river guide change your risk management and insurance consulting practice?***

On placement assignments it turned 180 degrees. I stopped providing bid specifications and created a document entitled, Summary of Operations and Activities. The objective is disclosure of risk in a document designed to test agent/broker skills.

Training to become a river guide was very challenging. My entry into the insurance industry was challenging. I was hired by the Aetna Casualty and Surety Marketing Department in 1973, and experienced a year of first-class instruction. At year-end I enrolled in CPCU and later ARM, finishing the last exam in 1982. I learn more every day about how much I don't know.

***How does your Summary of Operations and Activities differ from bid specifications?***

The focus is on client disclosure. We present a thorough and honest picture of the insured to the insurance industry. The document includes substantial underwriting information, plus material omitted in ACORD and other industry applications.

Eleven years as a company and agency employee taught me how underwriting information can skew pricing in favor of the buyer. It is important to provide pricing information. But information not requested in applications is often more important.

The agents and brokers are not told what coverage is desired.

***How does this process change the outcome?***

Agents and brokers make conceptual proposals in response to identified risk. The insured's decision is more focused on business acumen and technical knowledge instead of sales skills, friendship, business volume, or political influence.

As you enter the first section of the rapid, the roar is overwhelming—waves are six feet in height, and the water is flowing rapidly rightward toward a cluster of large boulders. There is only 20 yards of turbulent water between the first and second drop. You drive left, shouting to your crew to paddle hard, but careful to avoid a large suction hole on your upper left. Your objective is a vertical standing wave at the top of the second drop. The wave is 10 feet high and 30 feet wide, building and breaking, second by second.

***Are insurance buyers interested in program quality or price?***

Price wears heavy shoes. I find the discriminating insurance buyer wants to (a) protect his or her assets, and (b) do business with knowledgeable agents and brokers. The agents and brokers have a very, very important job. My process shifts the buyer focus in terms of both product quality and broker skills.

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# CLEW Section Member Profile: James R. Mahurin, CPCU, ARM

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***How do your consulting clients respond to your focus on disclosure?***
Quite well! General counsel and chief financial officers understand the importance of disclosure in insurance matters. Most firms are proud of their company and like to tell their story. A thorough disclosure process may also become very important if a carrier subsequently denies a claim. The process has a different feel from drafting bid documents.

***How do you respond to agencies and brokers whose procedures are structured to not make coverage recommendations, but instead have the insured tell them what coverage to purchase?***
There are exceptions for public entities complying with legal requirements on the bid process; however, we stick to our guns with everyone else.

***Describe your educational background.***
I entered the first grade at the intersection of a dirt road and a gravel road in rural Kentucky. I lived on the dirt road. Subsequently, I completed Coast Guard communications school and graduated from Western Kentucky University. I studied accounting at the University of New Orleans, completed the Aetna C&S program, CPCU, and ARM, and raft guide training.

***Why are you so wary of skill levels within the agent and broker community?***
The insurance industry has drastically reduced its focus on personnel development the past 20 years. I have delivered technical seminars to thousands of insurance personnel across the United States. A decreasing number appear well qualified. The percentage of the audiences with limited understanding of the business appears to me, unfortunately, to be increasing.

I was once part owner and president of an insurance producer license preparation school. The standard curriculum, which we used, was fifth and sixth grade level material. The course of instruction is 40 hours of classroom time. A substantial percentage of the instruction material involves coverage issues where the maximum liability is under $5,000. One day I gave my daughter, a third grader at the time, a practice test to see how well she would do. With no preparation whatsoever she scored 43 out of 100. The passing grade is 70.

***How can we expect to see a higher percentage of highly qualified people within the industry when the entry requirements are essentially nonexistent, and the industry commitment to professional education has been greatly diminished?***
You must hit the vertical wave hard to maintain control of the raft as you immediately enter a caldron of utter chaos. The river is pouring over broken rocks to form waves occasionally eight feet in height, breaking right and left. The guide is shouting instructions, some passengers scream while others cry, pray, curse, fall out of the boat—or all five simultaneously. Others are speechless.

***What about your involvement in professional organizations?***
I have been president of both the CPCU Society's West Virginia and the Middle Tennessee Chapters. I am a member of the Risk Management and CLEW Sections, plus serve on the *CPCU eJournal* Member Advisory Board.

I am a member of the Society of Risk Management Consultants. I currently serve on the Board of Directors and chair the Professional Practices Committee.

***Who has had the most influence on your career?***
Edwin S. Overman, Ph.D., CPCU. His emphasis on professional education and ethics has been invaluable.

***What is good about the insurance industry?***
A well-developed insurance industry is essential to the well-being of our economy. The industry provides many rewarding career opportunities.

***What is bad about the insurance industry?***
The business of insurance is incredibly complex. A small personal or small business account is complex. The industry too often fails to adequately train personnel. The cost of autonomous low-skilled men and women within the ranks is high.

A portion of my consulting practice is litigation support and expert witness work. Some of the depositions are astounding. For example, a successful agency principal with a four-year degree in biology could not define coinsurance in his deposition two years after the carrier had rightfully applied a 97 percent penalty to a seven-figure fire loss. A large claims adjuster with a law degree denied a fire claim by applying the water seepage exclusion—in clear violation of state law and the attached Standard Fire Policy. The insurance industry unnecessarily pays hundreds of millions, perhaps billions, of dollars each year because too many of its personnel lack basic skills.

Conversely, there are men and women who possess a high degree of business acumen and technical skills. I love working with this group. I see my job as a consultant to help find them—and let them exhibit their skills and abilities to the buyer.

At the bottom of the second drop you pause for a short break and let people catch their breath for a few seconds. The third drop is a monster-rated Class V plus. The river is pushed into a small area concentrating the action enormously. You speak to the crew and move forward. The water makes a pulsing roar and flows directly toward an enormous pinning rock. The waves and holes resemble a roller coaster.

***Why do you believe education and business acumen are so important?***
The business of insurance is too complex and volatile to involve amateurs. The stakes are too high. Within recent memory we have had catastrophic losses in Hurricane Andrew, Katrina, and the World Trade Center. Each incident tests an entire industry.

The average river guide had seven years experience. All were first-aid certified and about one-half were EMTs. The average trip leader had 14 years' experience. The beginning guides program involved about 1,000 hours under close supervision. They must know how to read water and assess risk. Lack of skill or poor safety practices were not tolerated.

There is no reason for an industry as large, dynamic, and complex as the business of insurance to operate in a manner designed to sustain and support men and women with the limited training and low skills. I strongly believe this practice results in an enormous cost to the industry.

We are now 12 miles into the New River Gorge and through our seventh rated rapid. The passengers are thoroughly soaked and adrenalin charged. There are five miles to go, and nine truly big rapids left to run. As the roar of one rapid fades in the distance the sound is quickly replaced by another, even more challenging and dangerous. It is now time to get serious.

Within the next 10 years, a very large group of baby boomers with strong technical skills will retire. It is time for this industry to get serious about developing professional, credentialed men and women on a large scale. There will be more hurricanes and other disasters. There is great need for highly skilled people to work with the challenging day-to-day aspects of this business. There is great need in anticipation of future national disasters.

For additional information about Mahurin's practice, go to www.risk-guide.com. ■

# Interpreting Insurance Policies—When Courts Take Shortcuts

by Craig F. Stanovich, CPCU, CIC, AU

**Craig F. Stanovich, CPCU, CIC, AU,** is co-founder and principal of Austin & Stanovich Risk Managers, LLC, a risk management and insurance advisory consulting firm specializing in all aspects of commercial insurance and risk management, providing risk management and insurance solutions, not insurance sales. Services include fee-based "rent-a-risk manager" outsourcing, expert witness and litigation support, and technical/educational support to insurance companies, agents, and brokers. E-mail at cstanovich@austinstanovich.com. Web site www.austinstanovich.com.

When a witness or deponent is being asked as to his or her understanding of a letter, e-mail, or other document, it is not uncommon to hear the objection "the document speaks for itself." I will admit that I take this too literally, but this objection (which usually means objecting counsel doesn't want to discuss the document) reminds me of the old joke:

"What time does your watch say?"
"It doesn't say anything; you have to look at it."

Any documents, in particular insurance policies, don't say anything—you do have to read them. The point, of course, is that the actual words used (when read closely) usually determine the coverage provided and excluded by the policy.

In interpreting insurance policy wording, courts are fond of making very clear that figuring out what the wording means is their business—and their business alone. Statements like "the interpretation of an insurance policy is a question of law for the courts to decide" are a testament to this unequivocal assertion of their authority. Some courts even go as far as to explain how they go about their work: "Our primary goal in interpreting a policy, as with any contract, is to ascertain the parties' intent as manifested by the policy's terms." *401 Fourth Street v Investor's Insurance Co.*, 879 A2d 166 (Pa 2005).

## Our Court System

Unlike many in the insurance and risk business, I do not consider our civil courts to be out of control or badly in need of repair. Despite sensational reports, plaintiffs do not always receive huge awards for the smallest of injuries. Likewise, judges do not automatically side with policyholders in all matters of coverage dispute.

In my opinion, our courts ultimately get it right much more often than they get it wrong, and get it right for the correct reasons. It is from this perspective that I offer the following observations.

## Defective Construction

Over the past few years, a disturbing trend has developed as to how some courts decide whether commercial general liability insurance applies to defective construction or defective work claims.

## Framing the Question

In some, but certainly not all instances, insurers have successfully denied coverage for defective work claims with some novel arguments, all of which have a common underlying strategy—direct the court's focus away from considering the wording of the *entire* CGL policy. Rather, the insurers attempt to reduce the coverage dispute to one question—is it the intent of the CGL policy to pay for "faulty workmanship"?

In other words, if insurers can, at the outset, convince the courts that such claims were never intended to be covered and, thus, fall outside of the CGL insuring agreement, there is no need for the courts to grapple with all of those messy property damage exclusions and their exceptions—rendering the policy exclusions and exceptions to those exclusions superfluous.

## Disregarding Policy Wording

While the CGL does not and should not provide coverage for claims that do not come within its insuring agreement, what is troubling here is the vague assertions and broad platitudes put forth by insurers that are embraced by the courts as sufficient legal interpretation of coverage. Typical contentions by insurers that defective work claims are never *covered* include the "business risk doctrine" or the CGL is not

a "performance bond." Even a superficial reading of the CGL reveals that these contentions are not based on actual policy wording. While such considerations may be valuable in determining the meaning of certain policy terms, particularly exclusions to coverage, such sweeping doctrines are not in themselves exclusions to coverage, and should not be treated as such by the courts.

## Faulty Workmanship Not an Occurrence

This problem is well illustrated by one of the more prominent cases—*L-J, Inc. v Bituminous Fire & Marine Ins. Cas. Co.*, 621 S.E.2d 33 (S.C. 2005)— in which the South Carolina Supreme Court overturned both the trial and appellate courts' finding of coverage, instead concluding that "faulty workmanship can never constitute an 'occurrence' under the CGL."

In this case, L-J, Inc. contracted to build roads for a real estate developer. L-J, Inc. engaged subcontractors to perform the roadwork, including compaction of the roadbed. The subcontractor's compaction work was done improperly, resulting in deterioration of the road. The developer (owner) brought an action against L-J, Inc. for the cost to repair the cracked and deteriorated road.

The South Carolina Supreme Court in its 2005 decision found that property damage to the road *did* occur as the result of the subcontractors' negligence in compaction of the roadbed.

Despite a finding of negligence, the court held that faulty workmanship cannot be an "occurrence" as defined under a CGL policy, as faulty workmanship is not something that typically is caused by an "accident." In the court's view, any other finding would convert the CGL into a performance bond.

In a footnote (number [4]), the court did conclude the policy *may provide coverage in cases where faulty workmanship causes property damage to other property*, not in cases where faulty workmanship damages the work product alone.

Even though the South Carolina Appellate Court found coverage for L-J, Inc. due to the subcontractor exception to the Your Work exclusion, the Supreme Court did not consider any exclusion or exception. Instead, the Supreme Court concluded that faulty workmanship cannot be accidental and, therefore, not an occurrence—no coverage existed and the court declined to read any further into the policy.

## Faulty Workmanship as an Accident

While it is certainly possible that faulty workmanship may be intentional, such as a contractor who chooses to cut corners and *knowingly* produces shoddy work, to presume that faulty workmanship *cannot ever* be accidental strains common sense.

As any "do it yourself" homeowner knows, projects can go terribly wrong—despite the best of intentions. It seems obvious that inadvertent errors combined with a lack of skill or competence is often at the root of faulty workmanship.

## Damage to Property of Others

The CGL policy *definition* of property damage is not limited to the property of others. Restrictions to whose property the CGL will respond to when damaged are found in the CGL policy's *property damage policy exclusions*, not in the basic insuring agreement, as the *L-J, Inc.* court found.

The footnote that states faulty workmanship, which damages third-party property, may be covered by the CGL is very curious indeed. The court seems to suggest that damage to the work itself is never accidental, but the same incident *becomes* accidental if the damage happens to extend to other property. This is roughly analogous to saying that if I damage my car by negligently colliding with another vehicle, it is only an accident if the other vehicle is damaged.

## Coverage Explanation—From 1971

A slightly different approach to no coverage for faulty workmanship can be found in the Supreme Court of Pennsylvania 2006 case of *Kaverner Metals et al v Commercial Union et al.*

The Supreme Court of Pennsylvania similarly decided that the definition of accident (and thus "occurrence") cannot be satisfied by claims based upon faulty workmanship. The oft-quoted law review article by Roger C. Henderson entitled, "Insurance Protection for Products Liability Completed Operations; What Every Lawyer Should Know," 50 *Neb. L. Rev* 415, 441 (1971) appears to be the prime basis (in addition to *L-J, Inc.* among other cases) for the court's understanding of the application and limitations of CGL policies.

While Henderson's law review article is no doubt very insightful, it should not be relied upon in lieu of actually reading the policy. Possibly more importantly, Henderson's commentary was based on a review of the 1966 edition of the Comprehensive General Liability policy, which bears little resemblance to today's CGL policy. The 1966 edition of the CGL policy was much more limited in scope and did not contain the subcontractor's exception to the Your Work exclusion that is a crucial element of coverage in today's CGL.

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# Interpreting Insurance Policies—When Courts Take Shortcuts

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Nonetheless, law clerks seem to dust off Henderson's article every time the phrase "faulty workmanship" appears, even though a closer look should reveal that the article is not only dated, but may be irrelevant to the case at bar considering it pertains to entirely different policy wording.

■ ***If courts continue to settle for analytical shortcuts in their interpretations of the CGL policy . . . a spate of poorly reasoned decisions will likely follow.***

Of course, there are other similar arguments made by insurers as to why faulty workmanship does not fall within the CGL insuring agreement, such as the CGL policy does not cover property damage that results from a breach of contract. The underlying reasoning is basically the same—a breach of contract is not accidental and, therefore, not an occurrence. As noted above, failing to correctly perform a contract may very well be inadvertent and accidental—the broad-brush shortcut doesn't fit here, either.

The "breach of contract" argument has an additional wrinkle, however. Insurers have argued that the CGL policy provides coverage only for liability imposed in tort, and that liability based on contract is not covered—despite the fact that today's CGL makes no such distinction in its insuring agreement.

The California Supreme Court in *Vandenberg v Centennial Ins. Co.*, 21 Cal. 4th 815, 982 P.2d. 229 (1999) overruled previous cases and found "legally obligate to pay as damages" refers to any obligation that is binding and enforceable under the law, whether by contract or tort liability. Nonetheless, some insurers continuously attempt to dismiss faulty workmanship claims based on the tort versus contract distinction.

## Conclusion

Insurers' attempts to divert the courts' attention away from reading the *entire* policy so the insurer may more expediently deny faulty workmanship claims has met with a growing amount of success. If courts continue to settle for analytical shortcuts in their interpretations of the CGL policy, such as relying on 36-year-old treatises that are commenting on entirely different CGL policies or on broad generalizations of intent that may not be reflected in the policy, a spate of poorly reasoned decisions will likely follow.

It is time to put into perspective Henderson's treatise; it is also time to critically examine the broad, vague, and sweeping generalizations of coverage intent urged by insurers. There is no substitute for *reading the entire policy* to understand the intent of the parties, regardless of how tedious it may be. Ultimately, such an analysis may find no coverage for faulty workmanship claims under the CGL—not necessarily because there is not an accident or there is no property damage or the property damage results from a breach of contract, but because the property damage is *excluded by the policy*. Denying coverage for the right reasons is far preferable to denying coverage for the wrong reasons. Shortcuts taken in coverage interpretation and construction are likely to leave the next policyholder without the coverage he or she purchased because a prior decision, incorrectly decided, is now broadly applied to a different set of facts. ■

## *CLEW* Breaking News


The Consulting, Litigation, & Expert Witness Section is developing two seminars to be held at the CPCU Society's Annual Meeting and Seminars in Hawaii. The first seminar, **"Fun, Sun, and Umbrella Drinks,"** will be held on Sunday, September 9, from 9:30 a.m. to 12:15 p.m. **"D&O Liability Insurance 101: What You Need to Know and Why,"** will be held on Monday, September 10, from 10:45 a.m. to 12:45 p.m.

**Register today** at www.cpcusociety.org and stay tuned for additional information!

# Oh Say, Can You NAIC?

by Eleanor Barrett

**Eleanor Barrett** is a senior associate editor covering state regulation for A.M. Best Company, located in Oldwick, NJ. She holds a bachelor's degree from Rutgers University, having majored in music and journalism. She began her career as an intern at *The Star-Ledger* of Newark, NJ. Following her internship, she worked the municipal beat at a weekly paper owned by *Forbes*. She later covered several central New Jersey towns for Gannett's *Courier-News*, in Bridgewater, NJ, before landing back at *The Star-Ledger*, where she was a staff reporter working out of the Somerset County bureau. She is most proud of her daughter, a Rutgers student, and enjoys travel, theater, opera, great books, and long walks in the woods with her ol' hound Noah.

When I first settled in at A.M. Best Company in Oldwick, New Jersey, in November 2004, I knew I was in for a lesson or two. That's when the highly esteemed insurance news publications of *BestWire*, *BestDay*, *BestWeek*, and *Best's Review* entered my life. Some might have called it a mixed marriage.

I was the reporter whose background at *The Star-Ledger* included scratching out off-beat human interest stories involving subjects that ran the range from New Jersey's haunted libraries; the fate of the King of Morocco's Somerset County estate; Donald Trump's endeavor at building a "world-class" golf course in Bedminster; and the general perpetuation of the landed gentry lifestyle in the Somerset Hills.

I had never, no, not in my whole life, owned a business suit.

Unknown to me were a myriad of concepts, such as "reinsurance," "captives," "universal life policies with secondary guarantees," and—how had I lived thus far without it—the "National Association of Insurance Commissioners."

Folks at A.M. Best were generous and kind. They patiently showed me the ropes, taught me all I needed to know, and gave consolation, assuring me that everyone in the newsroom had been in the same position as I was right at that moment. As nice as they were, it didn't stop one dear editor from handing me that first press release from the NAIC. It, apparently, was big news. The organization's "Executive Task Force on Broker Activities" was taking a "three-pronged" approach to tackling the "broker compensation" issue that had been unearthed just one month before by then New York State Attorney General Eliot Spitzer. Okaaay. One thing about being a reporter is that no matter how mundane—not to say the broker compensation issue was, by any means, mundane—or complicated, you dust the earth to reveal the basics: What's the news? What's the story? Who cares? At the NAIC, you know someone cares if a model law arrives to lasso a particular issue. Which is what happened in this case. I didn't attend the meeting that December, which had all sorts spilling into the hallways of some fancy hotel in New Orleans, where the task force held a public meeting on the matter. But I do know that as time progressed, those three prongs that the task force mentioned in its press release, indeed, did get put into place. Three years later, there has been some movement on the much-vetted broker compensation model law in states, but mostly the issue was resolved as a result of investigations by state attorneys general. That seems to be the case with many NAIC initiatives. They start out as one thing and end up as another—sometimes drifting off to obscurity altogether. Those that come to mind include the Sarbanes-Oxley-like "best practices" provisions the group put in place for mutual insurers; the shoring up of finite reinsurance transactions; establishment of a national fund for natural catastrophe, and the current push to ease collateral requirements for non-admitted reinsurers. Long-term, the broker compensation issue, for one, gave me a good handle on how things work at the NAIC, including the relationship shared by state insurance regulators, insurance industry lobbyists, and consumer advocates. I like to think of those NAIC compadres as being a deep-rooted family from Bayonne sitting down for a big bowl of pasta. At the table are a myriad of characters—cool calculators, alarmists, pragmatists, diplomats, and crazy uncles. Let the reader cast the roles. It's one thing to do this sort of reporting from my cubicle in Oldwick, but quite another to meet these suited, smiling, hand-shaking people up close and

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## Oh Say, Can You NAIC?

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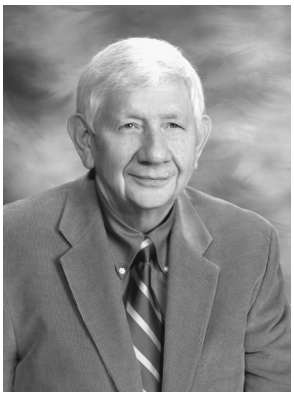
personal. I have to admit that I was in no way prepared when I attended my first national meeting in the spring of 2005 in Salt Lake City. I'd come to find later that not all NAIC meeting locales meet the definition of "Tony." But this one did. The former denim skirt-wearing reporter was now here, seated at the five-diamond Grand America Hotel, with its marbled and columned corridors, sunken bathtubs, fine-milled guest soaps all the way from London. I felt like Shirley MacLaine (living in the present) in "Sweet Charity." If they could see me now! The thrill faded quickly. After about five minutes of sitting in the Life and Health Actuarial Task Force meeting, I realized I was a lone novice in a sea of knowing nods and inquisitive minds. Following the meeting, a personable actuary—yes, there is such a thing—set things straight so I could accurately report on the proceedings. While I was never one for small talk or, perish the thought, "networking," I've ascertained that, at the NAIC, these are necessary survival skills. With these in hand, I have come to enjoy covering the beat. Here you have a gathering of the United States' insurance regulators, putting heads together to influence public policy on an industry that accounts for 8 percent of the gross domestic product and for 5 percent of all U.S. jobs. It's pretty important stuff. That old, denim skirt? I've lost track of it. Now, which suit shall I wear today? ■

# Q&A with Donald S. Malecki, CPCU

by Donald S. Malecki, CPCU



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*We have a corporate yacht we make available to our executives, employees, and their families for recreational purposes. It has become increasingly common for us, however, to also use it to entertain our clients.*

*We had a situation recently where we permitted two of our clients to operate the yacht. The result was not only damage to the vessel, itself, but also injuries to two of our executives. Since the injuries to our executives were serious and noncompensable, their only recourse for damages, apart from hospitalization insurance, was to file suit against the clients. The clients, in turn, looked to our yacht insurance for purposes of defense and indemnification as permissive users.*

*Much to our dismay, however, the insurer of our yacht policy denied defense and coverage based on an exclusion, which reads as follows: "We do not provide liability coverage for any person for bodily injury to you or any family members." Our insurer later withdrew its denial and currently is defending the clients. We nonetheless would like to know more about this particular provision cited by the insurer and what its potential impact might be. Any assistance you can provide would be appreciated.*

As a matter of interest, the above exclusion has become known as the "liability coverage exclusion," which technically falls within the category of an oxymoron (i.e., where contradictory words are combined). As best as can be determined, this so-called "liability coverage exclusion" was first used with automobile liability policies. With that regard, the exclusion is an expanded version of the "household exclusion" designed to prevent intrafamily suits.

Although the household exclusion is not approved in all states, its effect is to prevent a permissive user from obtaining protection under the policy of an owner-occupied auto who sues for injuries at the hands of the permissive user. One case involving this exclusion in a yacht policy is *United States Fidelity & Guaranty Company v Williams, et al.*, 676 F. Supp. 123 (E.D. La. 1987). The court in that case disallowed the use of that exclusion in similar circumstances to your case.

When reviewing yacht and other watercraft policies, one needs to be careful to review the whole policy, because this provision, to the extent it is applicable, does not always appear as an exclusion. It could also be couched within the definition of "insured," or elsewhere in the policy.

*We have a distributor (insured) who shipped material that was not ordered by the purchaser. After the purchaser heat-treated and machined this material, it shattered when put to its intended use. As a result, our insured agreed to recall all of the purchaser's product because of the defect.*

*The distributor's insurer wants to deny coverage under the "sistership" exclusion. My contention, however, is that once the insured's product was heat-treated (chemically altered), it ceased to become the insured's product. An example I gave to support my contention is that if sand is heated, it becomes glass. Is glass the product of the sand distributor? I do not think so.*

The fact that your insured's product was chemically altered is of no significance insofar as the "sistership" exclusion is concerned. This exclusion applies to the named insured's work, product, or impaired property. Your insured shipped a product that had to be recalled because it was incorporated into another product.

While the insurer is justified in relying on the sistership exclusion, this scenario raises some interesting points that might be considered to mitigate your insured's loss. One point is the extent to which the customer (purchaser) had any obligation over quality control as, for example, in checking the product before working on it. Another point to consider is the extent to which your insured's component product might have damaged the purchaser's product, since this exposure is not excluded under standard ISO CGL forms. ■

## What's In This Issue




***CLEWS*** is published four times a year by and for the members of the Consulting, Litigation, & Expert Witness Section of the CPCU Society.
http://clews.cpcusociety.org





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Consulting, Litigation, and Expert Witness Section Quarterly

CLEWS

Volume 14 Number 1 April 2007



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