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Consulting, Litigation, and Expert Witness Section Quarterly CLEWS

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From the Chairman

by Donn P. McVeigh, CPCU, ARM

By the time you receive this issue, the CLEW Section Committee will have met during the Leadership Summit meeting in Tampa, Florida. The next issue of *CLEWS* will fill you in on the details of that meeting. In the meantime, there is little to report from what appeared in the last issue of this column.

We are all looking forward to the Annual Meeting and Seminars in Los Angeles, which will be held from October 23 through 26. Our section committee meeting will be held on Saturday, October 23, and, if you plan to be in Los Angeles, you are invited to attend our meeting. The CLEW Section is also developing two seminars to be presented in Los Angeles. The first, Mock Trial: Who Pays When the Sky Falls? will be held Sunday, October 24, from 8 a.m. to 12:30 p.m. The second seminar, The New World of Claims Handling and Insurance Relations is scheduled for Tuesday, October 26, from 2 to 4 p.m. More details about these seminars is available on page 11.

The Los Angeles Annual Meeting and Seminars looks to be one of the best and we all hope to see you there. ■

Editor's Corner

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

It has been almost two years since I took the job as your newsletter editor. This may be my favorite edition so far. Oh sure, the content is great, but it's always great. What makes this one special is that the contributors are among the Society's most colorful people.

Prolific author Donald S. Malecki, CPCU, offers: "Insurance Experts: The Traps of Citing Excerpts from Authoritative Publications." I recently learned that Don has a new picture to go along with his bio because the last one was more than 15 years old. He looks younger now and besides, we all already know what he looks like anyway.

Attorney Brian E. DeVilling, J.D., contributes: "Beware of the Coverage 'Expert'—Legal Conclusions *Are* Inadmissible in Coverage Cases Despite Federal Rule of Evidence 704." This piece reminds us that, as experts we may know what the law is but it's the judge's job to instruct the jury on legal issues.

And then there are articles from two of our Texans known for "telling it like it is"—Joseph A. Wilkerson, CPCU, AIC, ARe, CIC, and Charles R. Shaddox, J.D., CPCU. Joe's article, "The Unfounded Myth of All Risk of Loss Property Insurance Coverage and How to Avoid Bad-Faith Lawsuits," underscores the virtue of direct and straightforward communication, even if it's bad news.

After nearly four decades in the courtroom, I knew Charlie would have some good war stories and I have been trying to pry them out of him for some time. "Trial by Jury" is a must read for anyone who has spent time in court.

I hope you enjoy this issue as much as I do. ■

Insurance Experts: The Traps of Citing Excerpts from Authoritative Publications

by Donald S. Malecki, CPCU

Donald S. Malecki, CPCU, is chairman and CEO of Donald S. Malecki & Associates, Inc., an insurance and risk management consulting firm, and president of Malecki Communications Company, the publisher of a monthly newsletter entitled *Malecki on Insurance.* He has been in the insurance and risk management business for more than 44 years and authored 10 books, including three textbooks used in the CPCU curriculum. Malecki is currently serving on the Examination Committee of the American Institute for CPCU, is a past president of the CPCU Society's Cincinnati Chapter, and is an active member of the Society of Risk Management Consultants. Malecki is a United States Air Force veteran of the Korean War.

Once in a while, experts on insurance, in attempting to make a point or to support an opinion, will refer to some publication and quote from it. They may even go so far as to say or to imply that the publication is authoritative. The motive for adding "puff" about the publication is usually for purposes of lending credence to the expert's own opinion. What better way is there to influence someone than to show an example of where a fine, long-standing publication widely used in the insurance and risk management industry actually says something that corresponds to the expert's opinion.

Even though this is done with some regularity, it is not wise to do so, unless the expert knows for a fact that the publication does not contain a contradiction that will diffuse the very point the expert is trying to make.

Anyone who has given a deposition has likely heard the question posed of whether a given publication is considered to be authoritative from the expert's perspective. This question was posed to an expert in a trial involving insurance coverage. On cross-examination, the lawyer held up a legal treatise involving insurance matters and asked whether the expert thought the treatise was authoritative. It unquestionably was a well-known treatise, commonly referred to by insurance practitioners, and its success measured by its longevity.

When the expert responded that the treatise was not authoritative, the lawyer challenged that response with the question: Why? The expert was quoted as saying that the fact this publication may be referred to by some lawyers and insurance practitioners as an excellent source of reference in finding court cases supporting their opinions does not make it authoritative. The reason, as expressed by the testifying expert, was that the treatise consists of a compendium of state and federal court decisions that illustrate varying rulings on the same issue, often combining life insurance with casualty insurance and relying on cases involving old policy language that has long been replaced.

Driving the point home, the expert testified that what this treatise did not do was to contrast the various rulings not

only in relation to like policy language, but also in relation to custom and practice in the insurance and risk management industry. Of course, these types of legal treatises cannot fulfill these objectives, unless the authors are practitioners of the business and they commonly are not.

The question is whether it is okay for an expert to quote from one of these publications and to go out on a limb and say this kind of publication is authoritative. The answer is that the expert truly will be going out on a limb to do both, unless the expert has read the entire treatise and has concluded that everything written therein corresponds to the expert's opinions or to what the expert would agree to if asked to render an opinion. That is a tall order!

Taking the Precarious Step

Some experts, however, will go out on a limb and attest, or imply by descriptive words of praise, to the effect that a publication is authoritative when he or she does not know for sure. For purposes of illustration, let's take the issue over the meaning of the word "subsidence," as it appears in a property policy as a cause or result of loss that is covered, and the word "settling," which also appears in that property policy as not being covered.

To make his or her point that coverage does not apply because it is "settling" (excluded) and not "subsidence" (covered) that is the appropriate condition existing in the given fact pattern, the expert quotes from a well-respected insurance publication, a commentary about the word "subsidence." Its meaning as stated there is further quoted as coming from some other publication of another discipline, engineering, for example.

Leafing through this entire insurance publication, however, one finds that there is yet another section on the same subject. This time, however, its writer, in explaining and confirming the meaning of "subsidence" quotes from a dictionary that states that "subsidence" means in part "to settle." Thus, if subsidence is covered and settling is not covered, but subsidence means settling, then coverage should apply. At the very least there is a contradiction in the same publication.

For those experts who quote from publications, this is an opposing lawyer's dream and the very reason why they ask experts if the publication from which documentation is extracted is authoritative.

Having found a contradiction, however, not always is the end of the matter. The question is which of the opinions expressed in the same publication can be relied on. Let's pursue this a little further and ask the readership here which of the statements in that publication might a court rely on.

■ *Actually, determining the difference between "subsidence" and "settling" is not even a question for an expert.*

Even though the answer is an easy one and even may appear to be a trick one, a hint is that a purchaser of insurance probably does not know that the highly respected insurance publication from which the expert extracted the quoted passage even exists. More to the point, it is doubtful that most purchasers of insurance have access to an engineering manual or even know one exists.

If readers do not have the answer yet, and most assuredly they do, a second source of reference is the dictionary. The primary reason is that the dictionary is the common source of reference used by laypeople in determining the meaning of words, a dictionary is readily accessible to most people, and it is commonly referred to by the courts.

Actually, determining the difference between "subsidence" and "settling" is not even a question for an expert. The reason is that an expert witness is one who possesses knowledge not within the ordinary reach or understanding and who, because of this knowledge, is specially qualified to address a particular subject. When a witness is offered as an expert, the court is likely to ask the question whether the subject to be addressed is so distinctly related to some science, profession, business, or occupation that it is beyond the understanding of the average layperson. Many disputes involving insurance are, but the dictionary definition of a word would not likely fall into that category.

Words of Wisdom

The moral of this story is that it is perfectly acceptable to refer to publications to keep up with the times and trends, and to cite them when one feels it is appropriate.

Experts need to keep in mind, however, that it is not how he or she perceives what an undefined term in an insurance policy means but, instead, what the expert perceives what a purchaser of insurance thinks the term means or should mean in custom and practice.

When it comes to preparing reports and testifying, experts should not rely on publications as sources to confirm their points unless the publications are fully understood in compliance with the expert's opinion, and do not contain any contradictions. To do so otherwise is to place the expert's credibility in jeopardy. ■

Beware of the Coverage "Expert"—Legal Conclusions *Are* Inadmissible in Coverage Cases Despite Federal Rule of Evidence 704

by Brian E. DeVilling, J.D.

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Introduction

Federal Rule of Evidence 704 governs the proper scope of expert testimony, providing that an expert opinion may be admissible even if it embraces the ultimate issue to be decided by the trier of fact. In a number of insurance coverage cases, litigants have sought under Rule 704 to introduce expert testimony as to the applicability of policy exclusions and the existence of coverage. Courts have overwhelmingly held that such opinions are inadmissible, despite Rule 704's language permitting expert opinions to embrace ultimate issues of fact.

Rule 704 abolished the former prohibition on rendering opinions on ultimate issues. The former rule was unduly restrictive, difficult to apply, and often deprived jurors of useful information. The revised rule, however, "does not open the door to all opinions . . . [Questions] which would merely allow the witness to tell the jury what results to reach are not permitted. Nor is the rule intended to allow a witness to give legal conclusions." *Owen v Kerr-McGee Corp.*, 698 F.2d 236 (5th Cir. 1983). Federal Rule of Evidence 704 must be read in conjunction with Federal Rule of Evidence 702 to determine the proper scope of an expert's opinion. These rules provide as follows:

> **Rule 702**
> 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.

> **Rule 704**
> (a) Except as provided in subdivision (b) testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact.

Reading Rules 702 and 704 together yields the proper rule applicable to expert testimony: an expert may testify to "ultimate issues" under Rule 704 if the testimony "will assist the trier of fact" under Rule 702. See *Mauet* and *Wolfson*, trial evidence, 290 (2nd 24 www.clausen.com 2001). The Advisory Committee Notes to Federal Rule of Evidence 704 further clarify this point: The abolition of the ultimate issue rule does not lower the bar so as to admit all opinions. Under Rules 701 and 702, opinions must be helpful to the trier of fact, and Rule 403 provides for exclusion of evidence that wastes time. These provisions afford ample assurances against the admission of opinions that would merely tell the jury what result to reach.

Limiting the Bounds of Admissible Insurance Expert Testimony

A number of cases establish that an insurance expert may testify to the meaning of terms in an insurance policy or industry custom and practice where terms of a policy are ambiguous. See, e.g., *Aetna Casualty & Surety, Co. v Dow Chemical Co.*, 28 F.Supp.2d 440, 447 (E.D.Mich. 1998). However, insurance experts may not testify as to legal conclusions or whether a particular matter is covered under an insurance policy. Several cases underscore this point.

In *Montgomery v Aetna Casualty & Surety Co.*, 898 F.2d 1537 (11th Cir. 1990), an insurer refused to pay for counsel for its insured after the insured was sued for breach of fiduciary duty. The court recognized that "the central question in the trial was whether the scope of [defendant's] duty to defend was broad enough to encompass the suit [at issue]. This was a question of contractual interpretation, which the judge should have decided." The trial court allowed the testimony of an insurance expert that the defendant had a duty to provide legal counsel under the policy language. The Eleventh Circuit Court of Appeals held that such testimony "was a legal

conclusion, and therefore should not have been admitted. The District Court abused its discretion by allowing [the expert] to testify about the scope of the [defendant's] duty under the policy."

In *Young v State Farm Mutual Automobile Ins. Co.*, 1999 WL 3357177 (N.D. Miss. 1999), the plaintiff sued his insurer after his daughter was struck by a car and injured. The plaintiff's insurance policy covered all persons related to him and living with him. There was an issue of fact as to whether the daughter was actually living with the plaintiff at the time of the injury. The plaintiff sought to introduce expert testimony of an insurance expert that "in his opinion [plaintiff's daughter] was covered under the insurance policy and the defendants had no arguable basis to deny coverage." The court held that such testimony "is nothing more than a legal conclusion as to the ultimate issue in the case." The court acknowledged that Rule 704 allows testimony as to an ultimate issue, but reasoned that the rule "does not allow an expert to render conclusions of law." The court granted the defendant's motion to strike the expert's testimony.

In *Employers Reinsurance Corp. v Mid-Continent Casualty Co.*, 202 F.Supp.2d 1212 (D. Kan. 2002), a reinsurer sued its reinsured, seeking a declaratory judgment as to whether the applicable reinsurance agreement required it to reimburse the reinsured for litigation expenses. The defendant designated an expert witness to testify to his understanding of certain terms in the reinsurance policy, his understanding of industry custom and practice regarding claims settlement, and his conclusion about whether litigation expenses were covered under the reinsurance policy. The court held that the expert's opinions regarding contractual terms and industry custom were admissible if the insurance contract was ambiguous. However, the expert's opinions regarding whether litigation expenses were covered under the policy were inadmissible. The court held that such testimony was not helpful to the trier of fact, reasoning "the normal experiences of layjurors will allow them to draw their own conclusions on these issues, based on the evidence at trial."

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In *Breezy Point Cooperative, Inc. v Cigna Property and Casualty Co.*, 868 F. Supp. 33 (E.D.N.Y. 1994), an insured brought suit against a liability insurer after the insurer denied coverage based on notice provisions in the insurance policy. The defendant sought to introduce expert testimony that failure of the insured to provide timely notice violated the insurance policy's terms and that such delay was unreasonable. The court held that both opinions were inadmissible, reasoning "an expert is prohibited from offering his opinion as to the legal obligations of parties under a contract." The court concluded that "the expert testimony defendant plans to introduce usurps the function of both the jury and this Court."

In *North River Ins. Co. v Employers Reinsurance Co.*, 197 F. Supp.2d 972 (S.D.Ohio 2002), a reinsurer sought to introduce expert testimony about whether particular claims procedures were within the scope of the insurance policy at issue. The court held that "to the extent that it may be read as an opinion on the ultimate legal issue before the court, it is not admissible and will be disregarded." The court reasoned "expert opinions which express a legal conclusion are inadmissible."

Learning Point

These cases make clear that an insurance expert may not testify as to the ultimate issue of whether or not coverage is afforded under the terms of an insurance policy. The case law also demonstrates that experts may not testify as to any legal conclusion that may trigger coverage. Just as the expert in *Young*, for example, was prevented from testifying regarding the residency status of the party seeking coverage, an expert would not be permitted to testify as to whether an accident was caused by employee negligence where an insurance policy contained such an exclusion. Similarly, a court would be unlikely to allow an expert to testify that an act was caused by an insured's criminal act or willful and wanton conduct in cases involving such exclusions.

Case law interpreting Federal Rules of Evidence 702 and 704 in insurance coverage cases demonstrates an effort to prevent experts from invading the traditional province of juries. Such "expert" coverage opinions merely tell jurors what conclusion to reach and are generally based on the same knowledge and evidence already available to and understandable by jurors. Such opinions do not "assist the trier of fact" under Rule 702 and are inadmissible despite Rule 704's permissive language regarding opinions on the ultimate issue. ■

Trial by Jury

by Charles R. Shaddox, J.D., CPCU

■ **Charles R. Shaddox, J.D., CPCU,** is a former trial lawyer, representing insurers and insureds. He now consults and testifies as an expert witness on insurance coverage and bad-faith issues.

As a trial lawyer for almost 40 years, I have had my share of interesting cases and "happenings." These following are a few of my experiences.

I was in the process of trying my first consequential jury case as lead lawyer. A senior partner of my firm dutifully sat behind me, no doubt ready to nudge my ribs forcibly if I stammered too much or went mute. It was mid-afternoon of the second day of trial. My client was on the witness stand, having been called as an adverse witness by the plaintiff's lawyer. As I finally started relaxing a little, after jury selection and opening statements, my client died on the witness stand. More accurately, he had a heart attack, during non-strenuous questioning, did a 90° turn, and fell to the floor in fibrillation. At the time, I didn't know what that meant, but my senior lawyer knew. He knew the man was essentially dead when he hit the floor. The judge was professional, the bailiff in control, and EMS was there in seconds. The man was still dead and I was left to consider whether or not this idea of being a trial lawyer was a good one.

Trial law has been good to me. After my somewhat halting start, I have tried more than 200 jury cases to verdict. While a majority of those were insurance coverage and personal injury cases, I've also tried anti-trust cases, securities cases, and even a few court-appointed criminal cases. Let me say at the outset, I am a staunch believer in the jury system and I believe I have the background and experience to justify my beliefs.

The "public," our warm, close non-lawyer friends, constantly want to talk about O.J., Martha Stewart, the infamous coffee scalding case, and other media-promoted purported "injustices." I tell them all that I was not on those juries, did not hear all the admissible evidence, and was not (nor were they) competent to render reliable opinions about what happened or should have happened. But let me say that I have never seen a news report of a case that was remotely accurate about the issues or even the decisions in cases. All in all, "you had to be there."

In another case I tried, the sympathies were so great, they almost can't be articulated. The plaintiff was a young widow with two infant children, whose father had been a young and carefree, though not careful, 20-year old. He worked for a metal fabricating company. One day he, and a young co-worker, unsupervised, were playing "cowboy and indian," while on the job. The friend loosely tied our young father to a "stake," also known as a support column of the building. He then built a small fire around his feet, using some waste product as fuel. All was fine and fun until a nearby can of paint thinner was accidentally kicked over. At that point, he truly was "burned at the stake." I'll forgo the gruesome facts of the injury. Let it suffice to say that he lived three days.

It was a workers compensation case, and the insurer, which I represented, had a defense of "horseplay." And, of course, it *was* horseplay. Still, you envision yourself arguing to a jury, with the widow-child and her two children sitting at the table, saying, in effect, that the 20-year old child-husband-father had committed suicide. Friends, that causes one, in the lawyering business, to grow a new set of skin. Fortunately for me, the jury was already clad with that "skin" of reason and duty.

I've had jurors turn their backs to me in argument, call me post-verdict to congratulate me, or simply render the verdict they were charged to render, but in 95 percent of the cases, if the trial judge let me properly present my case, I felt they were fair. Not that I always won, certainly, but that, in retrospect, the jury saw through all the blarney and obfuscations we lawyers put out, and rendered "a true verdict, so help them God."

While this was supposed to be an article about some of the unusual/incredible experiences I have had as a trial lawyer, it has, of its own volition, evolved or degenerated into praise of the jury system. A lot of states have gotten away from that system, except in criminal cases, but I still believe, after almost 40 years of experience, that like democracy, it is imperfect, but it's still by far the fairest system on earth.

There is theory that justice delayed is justice denied. Otherwise stated, a rush to justice is paramount to that justice. Au contraire, I say, depending on the circumstances.

I once tried a case, as attorney, for a group of employees whose pension profit-sharing plan had been discriminated against in the sale of the company's stock. Employees through their pension profit-sharing plan owned a substantial share of the company's stock. When the company was bought out, the founder of the company received more for his shares of stock than did the plan. I'll not bore you with the legal maneuverings and machinations of the case. Suffice it so say that we tried the case for two full weeks, resulting in a $2,000,000 plus jury verdict for the pension profit-sharing plan. My trial strategy was to keep the founder, also a substantial owner of the company's stock, on the stand until his character came across to the jury. In a two-week trial this man came across as a bullying, controlling, and domineering person.

On appeal, the Circuit Court of Appeals ordered that the case be retried, and it was transferred to another judge who prided himself on a "rocket-docket." Instead of two weeks, he allowed us two days to present all witnesses, testimony, and

evidence, which had taken two *weeks* in the prior trial. The sad result was, the chief witness for the defense was able to maintain his "grandfatherly" demeanor for the brief period I was allowed to keep him on the stand. This "control" on the part of the judge kept us from showing the jury the true face of the man, and the "new" two-day jury rendered a take-nothing verdict in favor of the defendant "grandfather." In my opinion, the restrictions placed on us in the second trial caused an improper rendition of justice.

I had a court-appointed criminal defendant one time who was a 69-year-old diabetic with one leg. The charge was that he attempted to smuggle a 19-year-old "niece" into the United States. She was an undocumented citizen of Mexico, and the old man's crime was primarily an attempt at an affair of the heart. Still, at the border, his story about his "niece" fell apart and he was charged as an attempted "coyote," trying to smuggle an illegal alien into the United States. The intended fee for such assistance was never established, for she was caught and returned to Mexico. My client was caught and incarcerated. The range of the penalty for the offense was severe for a disabled 69-year-old with a short life expectancy.

The negotiated resolution was fabulous. My client was willing to plead guilty, so long as he was transferred to Chicago for sentencing. It seems that *he* knew, not his enterprising Texas lawyer, that in Chicago, probation was always granted in this type case—no additional jail or prison time served. And so, we agreed to plead him guilty in Texas, with the agreement/proviso that he would be transferred to Chicago (his home) for sentencing. He pled, was transferred, granted probation, and may still be casting about for a 19-year-old maiden to "import."

You know, I really could go on with this. One of the benefits of a trial lawyer is that he or she experiences things far stranger than fiction, and on a daily basis. If you made these stories up, you'd get no Grisham- or Turow-type sales, for the truth is too unreal to sell as "real." Still, it's been a hell of a ride. Maybe I'll write another chapter someday. ■

War Stories

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, and currently serves as editor of *CLEWS*.

Editor's Note: Several alert readers who picked it up off of the Internet have forwarded this story to me. Accordingly, its truth and accuracy are virtually guaranteed.

The best lawyer story of the year, decade, and probably the century. . . .

A Charlotte, NC, lawyer purchased a box of very rare and expensive cigars, then insured them against fire, among other things. Within a month of having smoked his entire stockpile of these great cigars and without yet having made even his first premium payment on the policy, the lawyer filed a claim against the insurance company.

■ *. . . the lawyer stated that the cigars were lost "in a series of small fires."*

In his claim, the lawyer stated that the cigars were lost "in a series of small fires." The insurance company refused to pay, citing the obvious reason: that the man had consumed the cigars in the normal fashion. The lawyer sued . . . and won!

In delivering the ruling, the judge agreed with the insurance company that the claim was frivolous. The judge stated nevertheless, that the lawyer held a policy from the company in which it had warranted that the cigars were insurable and also guaranteed that it would insure them against fire, without defining what is considered to be unacceptable fire, and thus the insurer was obligated to pay the claim.

Rather than endure a lengthy and costly appeal process, the insurance company accepted the ruling and paid $15,000 to the lawyer for his loss of the rare cigars in the "fires."

Now for the best part. . . . After the lawyer cashed the check, the insurance company had him arrested on 24 counts of arson! With his insurance claim and testimony from the previous case being used against him, the lawyer was convicted of intentionally burning his insured property and was sentenced to 24 months in jail and a $24,000 fine.

This is said to be a true story and was the first-place winner in the recent Criminal Lawyers Award Contest. ■

The Unfounded Myth of All Risk of Loss Property Insurance Coverage and How to Avoid Bad Faith Lawsuits

by Joseph A. Wilkerson, CPCU, AIC, ARe, CIC

Joseph A. Wilkerson, CPCU, AIC, ARe, CIC, is principal consultant of Wilkerson Associates in Carrollton, Texas, and is a past chairman of the Senior Resource Section Committee. A graduate of the University of Texas at Austin (bachelor of business administration), Wilkerson began his career as a claims adjuster in 1952. Along the way, he has attained additional professional designations—including the Associate in Claims; Associate in Reinsurance; and Certified Insurance Counselor; and was a course leader for CPCU and IIA courses for more than 15 years. Wilkerson is a past chairman of the CPCU Society's Claims Section and a past president of the Dallas Chapter. He and wife Shirley—a former corporate risk manager—have been married for more than 18 years and work together in the insurance consulting practice.

Author's Note: This article is written in response to an e-mail request I received from the *CLEWS* editor. I am writing while on a 54-day cruise—now in Antarctica—based solely on my memory of "Chance of Loss" dating back to 1955. I have no policy contracts or other research material with me. So, I invite my peers, professors, and others to comment on the contents of this article. Yes, I know about the 1978 MGM Grand fire in Las Vegas, which was *insured* after the fire took place (and other oddball insured situations, usually involving reinsurance). But, similar to life insurance, the risk or chance of loss for the MGM fire was based on the time element of liability claims being paid. The insurers thought they would have use of the premium money in reserves for investments some 10 to 15 years before the claims would be settled and paid. They guessed wrong!

For many years, the property (fire) insurance industry has issued what most of us refer to as "All-Risk Policies" sometimes called "Open-Peril Policies." Generally, the insuring agreement will include such terms as, "We will insure against all risks of physical loss to the property unless the loss is excluded; or we will pay for risk of direct physical loss of or damage to Covered Property unless the loss is excluded under Exclusions or limited under Limitations." This *all-risk* coverage was first written because of competition from the inland marine insurers, who wrote broader coverage than the fire companies.

But this undefined, but unambiguous, terminology causes some confusion among uninformed insurers, their agents and adjusters, policyholders, attorneys, regulators, and even consultants and expert witnesses. Whereas, the explanation and meaning of the coverage is really rather simple. "Fire" and other terms are not defined in the policy because the law and common use have defined them for us. This is also true of many other policy terms. Even "claim" and "loss" are not defined in many policies.

You will recall that in your CPCU studies, you learned (really learned) the requisites of an insurable risk (or loss). One important thing you learned was the *loss* must be caused by a *fortuitous* (or accidental) *event*. This is now often referred to as the "Doctrine of Fortuity." In other words, to be insurable, there must be "chance" of loss rather than "certainty" of loss for the loss to be insurable. Furthermore, "pure loss," involves chance of loss but no chance of gain such as in over-insuring the property and intentionally allowing the loss to take place. Chance of gain is uninsurable (with a few exceptions such as RCC). Thus, insurance is not gambling because there is usually no chance of gain. Again, there must be *chance* of loss for there to be an *insurable risk*.

An exaggerated example of uninsurable risk would be leaving the roof off of a building in Houston or New Orleans for the month of August, knowing that the weather bureau is reporting heavy rain showers every day. Obviously, any rain damage to the interior of the building would not be a fortuitous covered cause of loss. A less obvious non-covered cause of loss would be a situation where the insured did not properly maintain the building over several years, to the point that rain and other perils started causing loss and damage to the insured property, and continued to do so over a period of time. Both of these loss examples are uninsurable because (among other reasons) there is no *chance* of loss. The damage to the property is *certain* to happen. Although (as indicated below) I don't recommend it, if the loss is *certain* to happen, you do not need to spend much legal time analyzing the policy exclusions and limitations. But make sure

your investigation *proves* the loss is *certain* to happen as part of your coverage investigation.

If an insurer is faced with this type of reported loss, it should make a prompt, timely, and thorough investigation, including visiting the insured in person, and taking of statements of the insured and/or EUO as soon as reasonably possible. This investigation should include pictures, maintenance, and other records, as well as visits with friends, relatives, neighbors, contractors, and others familiar with the insured property. Explain the coverage problems to the insured, then as soon as reasonably possible, send a "Reservation of Rights" letter with *all* the *specific* reasons concerning the questions of coverage (including any applicable exclusions) and the delay in payment. Then promptly ask in writing for all the information and documents you need from the insured in order to promptly pay or deny the claim.

Send any amendments to the ROR letter, as necessary; and by all means, work with the insured rather than against him or her—and keep the insured up to date as to what is going on—including any reports from engineers and other experts. Give the insured the benefit of the doubt. Comply with any contractual, statutory, common law, or industry standards as to time limitations for payment or denial of the loss.

As soon as you are sure the loss is not covered, meet with the insured and explain why. Then promptly confirm the denial in writing confirming all these reasons. If there is any possible doubt as to whether the loss is covered, you may want to consider promptly filing a Declaratory Judgment Action. In any event, do whatever you do promptly, with courtesy and empathy in a businesslike manner. Given that most honest insureds will understand your reasoning, most of these non-covered claims will go away. Under the circumstances, the average insured will not hire an attorney to file a bad-faith lawsuit.

But, if a lawsuit is filed against the insurance company (and others); insist that your lawyer makes a *prompt review and evaluation* as to coverage, liability, damages, and then give his or her best legal advice as how to proceed with the claim. The attorney should be required to outline any investigation or other action that needs to be taken by the adjuster or the attorney. If, in his or her best opinion, there is a possibility/probability of losing the lawsuit, then you/he/she should promptly meet *in person* with the insured's lawyer in an attempt to settle the claim for a reasonable amount before incurring legal expenses, costs, and prejudgment interest. There is an old saying that, "Lawsuits don't improve with age." Moreover, promptly settling the lawsuit gets the case off of the adjuster, supervisor/manager's desks as well as underwriter, actuaries, engineers, and others that are concerned about open claims and the reserves. Even the state regulators won't find it necessary to review an open lawsuit at the time of their regular audit. Furthermore, there will be no need for expert witnesses.

■ *There is an old saying that, "Lawsuits don't improve with age."*

But if the lawsuit is a "winner," promptly take the case to trial, and appeal, if necessary. Unless there is a *very* good reason, do not let your lawyer change his or her mind or request settlement at that late date just before trial so as to save legal expense. Given that settlement of claims *not owed* encourages other lawsuits to be filed, this drives up the cost of insurance to the consumer as well as the cost of a loaf of bread. We read in the newspapers about the cost to the public of "consumer fraud." Of course, this is very true, but much consumer fraud can be prevented by proper investigation. I challenge you to disprove my theory that cost of insurance to consumers is driven up even more so by gross mishandling of claims and lack of trained claims professionals necessary to promptly respond to the insured's needs. There will still be enough bad-faith lawsuits to keep consultants and expert witnesses and defense lawyers busy. *Prompt personal contact* helps prevent lawsuits. Moreover, this *control of claims* causes plaintiff lawyers to look for another way to make a living. Plaintiff lawyers know which insurance companies investigate claims and which do not. They also know the number of cases the defense lawyer tries and wins each year, as well as his or her settlement habits and practices.

Some claims professionals teach that when reviewing an *all-risk* policy, you look to the policy exclusions first. But on a *named-peril* policy, one looks to the insuring agreement first. In my opinion this is a hazardous, shortcut practice in making a coverage determination. The safe practice is to look at any endorsements as well as the insured's requests, agent promises, and the underwriters' intent. As Chartered Property Casualty Underwriters, the CLEW Section members follow this safe practice in making a coverage determination.

Remember: No *chance* of loss, no *risk* of loss. *Certainty* is not insurable loss. ■

Insurers: To Rescind or Not to Rescind?

by Akos Swierkiewicz, CPCU

■ **Akos Swierkiewicz, CPCU,** is founder and president of IRCOS LLC (Insurance & Reinsurance Consulting & Outsourcing Services) in Morrisville, PA, which offers property/casualty insurance and reinsurance services, including arbitration, company startup and runoff, expert witness and litigation support, feasibility studies, product research and development, policy reviews, and underwriting audits. He holds a B.A. in economics from Temple University. Swierkiewicz has been retained as an expert witness on behalf of plaintiffs and defendants, in litigation involving automobile, property, general liability, workers compensation, medical malpractice, and professional errors and omission policies. He has been a presenter for RIMS and the International Risk Management Society, and has been published in *National Underwriter* and *Business Insurance.* He is a member of the CPCU Society's Consulting, Litigation & Expert Witness Section, and can be contacted at akos.s@ircosllc.com.

Rescission of an insurance policy is serious business. Such action could result in serious financial difficulties to insureds, especially if it occurs after a major loss. Furthermore, costly and protracted litigation almost inevitably follows to contest the rescission.

Fortunately, insureds and their brokers can minimize the potential for rescission by simply exercising greater care to ascertain the accuracy of underwriting information, and by providing all material information to insurers. Also, rescission decisions are made by insurers only if they are convinced that they have adequate justification for them.

An insurer may rescind its policy in the event of material misrepresentation or concealment of a fact by the insured. Misrepresentation is false statement of a fact by the insured. Concealment is the neglect to reveal a fact that the insured knows and ought to communicate to the insurer.

Misrepresentation or concealment is material if it affects the underwriting decision of the insurer. For example, the premium may have been higher had the insurer been aware of the true and complete facts.

Property and casualty policies typically include conditions pertaining to the subject of rescission, such as:

- The policy is issued in reliance upon the truth of representations made by the insured.
- The policy is void if the insured intentionally conceals or misrepresents a material fact.
- The insured, by accepting the policy, agrees that the statements in the policy declarations are accurate and complete.

In most cases, rescission is based on materially misrepresented facts in the policy application, or in underwriting information provided by the insured or its broker. However, unless there is a satisfactory answer to each of the following questions, the rescission is not justifiable:

- Is the fact known only to the insured?
  If the insurer possesses a fact that differs from what the insured had provided, then it must attempt to reconcile it before proceeding further with consideration of rescission.
- Is it false?
  The insurer must have incontrovertible evidence to demonstrate that the fact obtained from the insured is false.
- Is the falsity material?
  Materiality is determined within the context of probable and reasonable influence on the insurer by the false fact. Consequently, if the insurer's underwriting decision is not affected, then the falsity cannot be deemed material.
- Is it reasonable to rely on it?
  The insurer cannot reasonably rely on a fact received from the insured alone if it is aware of a conflicting fact.
- Did the insurer rely on it?
  There must be clear evidence to demonstrate that the insurer did rely on materially false facts when making its underwriting decision.

State insurance codes and legal precedents also have an impact on the insurer's decision-making process concerning rescission.

For example, the California Insurance Code allows policy rescission even in cases of unintentional misrepresentation or unintentional concealment, and it provides that materiality is to be determined solely by the probable and reasonable influence of the facts on the insurer.

Also, case law precedent prevents insurers from relying solely on representations contained in the policy application or underwriting information if an inspection of the insured's property is conducted.

A policy may be rescinded even after a loss that would otherwise be covered by the policy. Since rescission could have severe negative financial impact on the insured, the insurer must be certain that the reasons for rescission are based on solid grounds and able to withstand potential legal challenge.

In a 2001 case, an insurer rescinded its policy following a major fire loss, alleging material misrepresentation and concealment by the insured, pertaining to several matters, including square footage of the premises.

The pre-trial discovery proceedings included examination of ambiguous

questions contained in the insurer's application form, and the accuracy of the inspection report provided by an independent inspection company retained by the insurer.

Major weaknesses emerged in the insurer's justifications for its decision to rescind the policy, including:

- The insurer previously issued policies for a previous owner, covering the same premises, and therefore it had prior knowledge of the underwriting information, including square footage, which differed from what the insured had provided.
- Just because the square footage information provided by the insured differed from the prior information in the insurer's underwriting files, it was not sufficient for the insurer to conclude that the insured's statement is false, especially since its insurer failed to make any attempt to reconcile the difference.
- The square footage figures provided by the insured and its broker in the application were lower than the figures in the inspection report that was ordered by the insurer after it issued the policy. In asserting materiality, the insurer disregarded another inspection report subsequently ordered by the insured, which confirmed the original figures in the application for the policy.

Based on the above points, it was not reasonable for the insurer to rely on the square footage information provided by the insured, and the insurer's contention that it did rely on the square footage data provided by the insured was questionable.

Although this case was resolved and the insured received payment for its claim, the pre-trial discovery process took over a year, with detrimental financial consequences to the insured.

The lesson from cases like this is that all parties should take thorough measures to ensure the accuracy and completeness of underwriting information, and that conflicts or ambiguities are promptly resolved before coverage is bound. ■

The CLEW Section Is Proud to Announce that It Will Sponsor Two Informative Seminars at the 2004 Annual Meeting and Seminars in Los Angeles!

Mock Trial: Who Pays When the Sky Falls?

Sunday, October 24, 8 a.m. - 12:30 p.m.

What You Will Learn

Before a policy is issued, many professionals conduct "business as usual" without realizing the far-reaching consequences of small, even well-intentioned actions. Seemingly "innocent" mistakes or lapses in good business practices are compounded under the spotlight of litigation, and may become a fulcrum for shifting responsibility for huge losses to many parties. In this mock trial, attendees will learn how such actions may play out during realistic direct- and cross-examinations of a variety of insurance professionals involved in pre-and post-loss services related to the catastrophe.

Presenters

Stanley L. Lipshultz, J.D., CPCU
Lipshultz & Hone Chartered

Donald S. Malecki, CPCU
Donald S. Malecki & Associates, Inc.

James A. Robertson, CPCU
Interisk Limited

Charles R. Shaddox, J.D., LL.M., CPCU

Steven A. Stinson, J.D., CPCU
Gregory J. Willis and Associates

Lawton M. Swan III, CPCU, CLU
Interisk Corporation

The New World of Claims Handling and Insurance Relations

Tuesday, October 26, 2 - 4 p.m.

What You Will Learn

The world will never be the same after the U.S. Supreme Court's decision in *Campbell v State Farm*—the exposure of every corporation and wealthy individual has forever been altered (for the better!). The way in which many categories of cases has been changed greatly benefits the defense—no longer will plaintiffs be able to introduce evidence that the defendant is generally a "bad actor" because of other conduct in which the defendant has engaged. Attendees will learn about these legal developments plus the tactics and strategies needed to take advantage of this great decision. You'll also hear about the re-evolution in punitive damages, tort reform, arbitration, mold, the changing face of construction defect claims and litigation, and new insurance products on the market.

Presenters

Mark G. Bobino, J.D.
Ropers, Majeski, Kohn, & Bentley

Michael J. Brady, J.D.
Ropers, Majeski, Kohn, & Bentley

Stephen J. Erigero, J.D.
Ropers, Majeski, Kohn, & Bentley

John A. Koeppel, J.D.
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