CPCU SOCIETY INSURING YOUR SUCCESS

Consulting, Litigation, & Expert Witness CLEWS

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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.

By the time this reaches you, we will have completed our mid-year CLEW Section Committee meeting. Our spring section committee meeting is a planning and strategy session where we develop ideas into the seminars and symposia that we produce throughout the year. Our goal is to offer topics that are interesting, educational, and timely. Freshness is very important. We look for those things that haven't been "done to death" by other industry groups. This is where you come in.

We ask that you take a few moments to consider subjects that pique your interest. You can probably come up with several things that you would like to know more about, especially given the accelerating speed of change in our industry. Drop me a note or e-mail me your ideas to dfree@insuranceaudit.com. The CLEW Section Committee can draw upon the Society's abundant resources to turn your idea into a winning educational program.

We are already preparing for our mock trial at the Annual Meeting and Seminars in Nashville. This will be a joint effort of the CLEW and Claims Sections, and involves an arson case with a runaway jury verdict. **Nancy D. Adams, J.D., CPCU, Gregory G. Deimling, CPCU, Stanley L. Lipshultz, J.D., CPCU,** and **Robert L. Siems, J.D., CPCU,** are already working on our part of the program, which will be held on Monday, September 11. The Claims Section piece will follow on Tuesday. You can register for the Annual Meeting and Seminars at www.cpcusociety.org. Our mock trials are interesting, informative, and filed for CE credits. Many thanks to all of the "CPCU Players" who have agreed to participate. See you in Nashville! ■

The Gaylord Opryland Resort & Convention Center is known for its indoor gardens, world-class spa, and first-class entertainment.

What's In This Issue

CPCU CHARACTER & CONFIDENCE

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.

It was my great pleasure to read the following contributions to this issue of the *CLEWS* newsletter, and I trust that other readers will have the same experience. I hope that they inspire others (you?) to make submissions for publication.

The writers represented herein are very capable practitioners as well as writers, and I'm sure that they would welcome a give-and-take process with others. If you should disagree with something they've said, or feel that expanded discussion of their subject matter is appropriate (or necessary), please do not hesitate to make your opinions known to me and to them.

- How do insurance brokers differ from salespeople? They have responsibilities that are considerably broader than simply taking and transmitting purchase orders. **Akos Swierkiewicz, CPCU,** discusses the roles of all parties to the insurance application process and alerts us to possible consequences of failures in this realm.
- It may be that some insureds know more about potentially problematic (claims-provoking) situations than others. When can the knowledge of one party be dangerous to the insurance coverage of others? What risk management approaches might help avoid or ameliorate this sort of situation? **Frank Licata, CPCU,** makes some cogent observations.

When reading Akos's and Frank's items, you may recall that the CLEW Section mock trial presented at the Annual Meeting and Seminars in Atlanta explored many of the same issues they address.

- My husband and I once had occasion to go car shopping right after reading a consumer publication about the methods (tricks?) used by car salesman. When we heard the same words we had read being used with us, and the exact techniques described were employed, we had fun—our exchange of significant looks might have confused the salesman, but that only made it more fun.
  An excerpt from a book written by Steven Babitsky, J.D., and James J. Mangraviti Jr., Esq., *How to Become a Dangerous Expert Witness: Advanced Techniques and Strategies*, gives a glimpse into what techniques opposing counsel might be trying to use with you.
- **Craig Stanovich, CPCU, CIC, AU,** gives insight into the expert witness world from a practical perspective. If his observations are considered and his suggestions taken to heart, many a potentially professionally embarrassing situation might be diffused.
- We are indeed fortunate to have contributions from **Donald S. Malecki, CPCU,** that relate to coverage issues: read why an exterminator should have coverage under his or her CGL form when negligently failing to detect the presence of termites at a property, and how "voluntary parting" policy language might eliminate coverage under a property floater. ■

All Should Use Greater Care Handling Underwriting Information

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 and 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 omissions 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.

Editor's note: This article highlights the interdependent roles of insureds, brokers, and insurers in the insurance application process: brokers are not simply writing up sales slips.

One of the tenets of insurance law is that parties to an insurance policy are expected to deal with each other in utmost good faith. Applicants for insurance or their brokers must disclose all relevant underwriting information fully and accurately to prospective insurers. If the application contains any misrepresentation or omits information that could affect the underwriting decision of the insurer, the standard of utmost good faith is not met, and the insurer may deny coverage for claims or rescind the policy.

Allegations about misrepresentation or omission usually surface in the course of claim investigations by insurers. In some instances ensuing litigation may result in denial of the claim or rescission of the policy. Even if misrepresentation or omission is not proven, litigation inevitably causes significant delays in claims adjustment as well as direct and indirect expenses to the parties.

Misrepresentations or omissions primarily originate from negligence by the applicant or broker during the course of obtaining underwriting information and completing the application.

One of the major functions of brokers is to obtain accurate and complete underwriting information. They should have active involvement in the process of gathering, preparing, and communicating such information to the insurers, rather than just being the conduit to pass information from applicants to insurers. Brokers should also take the initiative and explain major provisions and conditions of policies to applicants to minimize negative surprises when a claim arises.

State insurance laws generally allow the insurer to deny claims or rescind the policy for misrepresentation or omission, including concealment of facts or incorrect statements, if:

- It was material either to the acceptance of the risk or to the hazard assumed by the insurer.
- A reasonable insurer would have acted differently had it known the true facts, e.g. would have charged higher premium, restricted coverage, or declined to issue the policy.

While most misrepresentations or omissions are unintentional, under a number of state laws the insurer's right to deny claim payments or to rescind the policy is not limited to intentional or fraudulent misrepresentation if either of the above two criteria applies.

The following are situations in which alleged misrepresentations or omissions resulted in litigation:

- The broker asked the applicant to sign a blank application form, completed and released it to the insurer without providing a copy to the applicant.
- The applicant did not review an application prepared by the broker, which contained a misrepresentation or omission.
- The broker did not ask the applicant about past losses and provided the wrong answer in the application.
- The applicant and broker did not communicate clearly about the scope of coverage and limits sought in the application.
- An application question was ambiguous to the applicant and the answer was incorrect.
- The insurer did not seek clarification of an ambiguous response to an application question.

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All Should Use Greater Care Handling Underwriting Information

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The need for greater care with the handling of underwriting information is not limited to applicants and brokers. Insurers should ask all pertinent questions in the application form because, in many instances, the applicant may be aware of important underwriting information but does not disclose it simply because a pertinent question was not asked.

Application questions should be limited to seeking factual information rather than eliciting the opinion or judgment of the applicant. For example, when the applicant answered "no" to a professional liability application question as to whether future claims were expected, based on the applicant's opinion or judgment, the insurer concluded that the response was a misrepresentation or omission just because a claim later occurred.

In some instances, there may be an appearance of misrepresentation or omission due to the failure by the insurer to clarify responses to application questions. When presented with ambiguous or conflicting information, it behooves insurers to seek clarification prior to binding coverage or issuing the policy. For example, when an applicant found an application question inapplicable to his business, he amended it in a good-faith attempt to provide accurate and complete information, and the insurer issued the policy without seeking clarification. When a claim occurred, the insurer denied it, citing the answer to the modified question as evidence of misrepresentation.

In certain circumstances only litigation can resolve allegations of misrepresentation or omission. However, the exercise of greater care in obtaining and preparing underwriting information by applicants and brokers, and clarification of ambiguous information by insurers, can substantially reduce the number of cases requiring litigation and the resultant delays and costs. ■

Preserving Coverage for Innocent Insureds

Insurers Try to Hold All Responsible for Actions of One

by Frank Licata, CPCU

Frank Licata, CPCU, is president of Licata Kelleher Associates. He has more than 20 years of experience in the risk management field, including a decade-long engagement with one of the country's largest independent risk management consulting firms. Past and present positions held by Licata include the following: president, Massachusetts Society of Licensed Insurance Advisers; member, board of directors, CPCU Society's Boston Chapter; president, Casualty and Property Underwriters Association of Boston; and adjunct faculty, Finance Departments, Babson College in Wellesley, MA, and Bentley College in Waltham, MA.

Editor's note: Care in the insurance application process is crucial, but not foolproof. What about when some people know more than other people do?

Group identity may be the social issue du jour, but insurers have a purely business reason for treating their insureds as group members rather than individuals. . . .

A basic principle for risk managers has always been preservation of coverage for the innocent insureds (including the insured firm itself) in the face of intentional or dishonest acts that may void coverage for the perpetrator. The principle ("severability") is that each insured is an individual, and none of us deserves to have our coverage impaired due to acts over which we had no control and with which we had no connection. Until recently, the insurance industry generally agreed. But now coverage terms themselves, and the way insurers fight to interpret them in court, are most definitely undergoing revision.

Blame Enron, WorldCom, and the Catholic church for this new attitude. Having been stung by what it has viewed as "institutionalized" corruption, the insurers now attempt to hold all responsible—the implication being "you knew or you should have known what was going on." The idea is that without the insurance security blanket, all in the firm will be diligent in uncovering and eliminating the corruption. This may work in some cases where the bad behavior is in fact pervasive, but at the same time it will expose many innocent people and firms to uncovered loss.

Case Studies

1. Insurer attempts to "rescind" directors and officers (D&O) coverage because of untrue statements made on application. One person filled out and signed the application. That person knew about but did not disclose a past event that could lead to a claim, but the fact that it was omitted was not known by any other directors or officers in the firm. The possible outcomes from this (depending on policy language and/or court decision) include:
   - no coverage for the individual completing the application, but coverage for the firm and all other individual insureds
   - no coverage for the guilty individual **or** the firm
   - policy rescinded—no coverage at all for any individual or the firm

   The trend is clearly toward the last in both current construction of policy language, and in the number of cases where insurers will fight their insureds in court.

   This environment argues for the involvement of all interested parties in completion of the application. That is, although one person will sign the application, all directors and officers should "sign on" to the information being presented. At least, each individual, for his or her own protection, should insist on reviewing applications for coverage under which that person will be an insured.

2. Insurer revises its private school general liability policy so that there will be no coverage for anyone, innocent insured or entity, in the event that an "officer" commits sexual abuse. These punitive terms may motivate individuals to try to root out institutionalized corruption if it exists, but the price for that is very steep for uninvolved and unaware innocent parties. Sexual abuse can be committed by a rogue individual in an environment where there is no history of such activity. Good management means trying to prevent such happenings, and taking strong action when presented with an event. Prevention by itself is no guarantee of success; insurance is all about loss control to minimize loss potential, and **then** insuring to protect against the odd loss scenario, which may prevent itself in spite of the effort.

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Preserving Coverage for Innocent Insureds

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What can be done when faced with policy language like this?

- Shop/negotiate for more favorable terms and conditions.
- Establish a screening process including background checks for all people in sensitive positions. In addition to possibly preventing an event, this will provide a defense in the event there is a lawsuit against the firm or the innocent individual (for which there is no coverage).
- Consider whether or not the firm will indemnify key individuals in cases where innocently uninsured; draft indemnification agreements.

Erosion of the severability concept is showing up in numerous other types of coverage and kinds of situations. This is a reaction by the insurance industry to current events only. Because of its inherent unfairness, it will not be maintainable; competition will ultimately force the insurers back to a more reasonable position. It's incumbent on us to keep testing the market on this point.

Given the inevitability of losses, you'll be judged not by whether you were the victim of an event, but by how well you planned for it. ■

How to Become a Dangerous Expert Witness: Advanced Techniques and Strategies

by Steven Babitsky, J.D., and James J. Mangraviti Jr., Esq.

■ **Steven Babitsky, J.D.,** is a former trial lawyer, and was the managing partner of the law firm of Kistin, Babitsky, Latimer and Beitman. He has successfully represented thousands of injured workers and others with disabling conditions for more than 20 years. He has been involved extensively in the arenas of workers compensation, personal injury, and Social Security disability. He is a founding director of the American Board of Independent Medical Examiners. Babitsky is also the founder and president of Customized Forensic Consulting, a service dedicated to educating expert witnesses about the legal arena. He can be reached at (508) 548-9443 or via e-mail at sbabitsky@aol.com.

Editor's note: This article contains text extracted from Babitsky's and Mangraviti's book, *How to Become a Dangerous Expert Witness: Advanced Techniques and Strategies,* and is reprinted here with permission from the authors.

The process hasn't worked just exactly right, and a dispute has ended up in court. Being forewarned about opposing counsel's tactics may enable expert witnesses to be forearmed.

Chapter 5: Defeating Opposing Counsel's Deposition Tactics

5.1 Introduction and Executive Summary

Dangerous experts understand the significance of their depositions. They recognize that:

- Opposing counsel will use the deposition to discover as much information as possible about the expert (for example, his qualifications, bias, assumptions, investigation, opinions, reports, and likely trial testimony).
- At the deposition, counsel (both opposing and retaining) will evaluate the strength of the expert as a witness.
- Most cases are won or lost at deposition.
- After the depositions conclude, counsel will evaluate the case for settlement or trial.
- Well over 90 percent of cases are settled prior to a trial.

Dangerous experts recognize that counsel will employ completely different strategies and techniques when cross-examining an expert at deposition than they would at trial. When trial lawyers were asked, "When cross-examining a witness during depositions, do you use different tactics and strategies than you would use during the trial?," the unanimous answer was "yes."

. . . To be truly dangerous, experts must recognize and defeat counsel's deposition tactics. This includes the following techniques:

- Asking crucial questions immediately at the start of the deposition, as opposed to beginning with preliminaries, such as the expert's background.

- Making the expert physically uncomfortable during the deposition.
- Asking the expert to waive his rights to read, sign, and correct the deposition transcript.
- Locking down the factual assumptions upon which the expert based her opinion.
- Playing games at a videotaped deposition, such as:
  - Setting the camera angle in an unflattering fashion (for example, in an extreme close-up) to make the expert look unfriendly and angry.
  - Pacing by counsel during the deposition so that the camera catches the expert shifting his eyes back and forth (a classic untrustworthy behavior).
  - Trying to agitate the expert to force him into an angry outburst that will not play well to the jury.
- The silence gambit, which answers an expert's reply with silence in the hope that the expert will start speaking again and volunteer damaging information.
- Offering to hold the deposition in the expert's office in order to use information informally "discovered" there against the expert.
- Trying to wear down the expert with a very lengthy deposition.
- Trying to get the expert to lose her temper and say something that was not carefully considered.
- Encouraging the expert to reach opposing counsel.
- Questioning the expert about any notes the expert takes at the deposition.
- Setting the expert up for a later Daubert challenge by asking pointed questions that focus on the reliability of the expert's methodology.
- Finding out what the expert uses as resources to set the expert up for a "learned treatise" cross-examination at trial.
- Jumping around on various topics to confuse the expert and keep her off balance.
- Asking the expert about notes made to the documents in the expert's file.
- Inquiring about conversations the expert had with retaining counsel during any breaks.
- Asking if the expert or anyone else has removed anything from the expert's file.
- Intimidating the expert with an aggressive demeanor and tough, accusatory questions.
- Questions designed to elicit a response that is inconsistent with the expert's report or the retaining party's interrogatories.
- Trick questions designed to get the expert to unwittingly adopt what a document says.
- Questions about documents the expert has not previously seen.
- Trying to get the expert to unintentionally vouch for a document's authenticity.
- The "fumble and bumble" gambit, which attempts to get the expert to tell opposing counsel which questions he should be asking.
- Getting the expert into the opposing counsel's rhythm.
- Asking compound questions in an attempt to sneak admissions into the expert's answers.
- Asking broad catchall questions in an attempt to lock down the expert.

5.2 Deposition Tactics and Defense

Tactic 1: Going for the Jugular

Tactic: In this tactic, opposing counsel will try to capitalize on the fact that many experts anticipate introductory questions at the beginning of their depositions. These experts are caught off guard by counsel selecting the crucial question and asking it right out of the box.

Defense: The expert should anticipate that he will face the most difficult question(s) at the outset of his deposition. He should prepare for the question and his reply and not permit himself to be caught off guard.

Example 5.22: Why?

Why do you say that the defendant engaged in bad faith?

It is my opinion that they undoubtedly acted in bad faith toward their policyholder, Mr. Jones, for failing to settle this case when they had the opportunity to do so and by forcing it into litigation and exposing him to personal bankruptcy.

Analysis and Discussion: The expert in this bad-faith case was fully prepared to answer the "key question" right out of the box in his deposition.

Example 5.23: Biggest Weaknesses in Opinion

What are the biggest weaknesses in your opinion?

Well, the question of a mental illness is a complex one. I did not find that he was paranoid, schizoid but just anti-social. This I would admit is inconsistent with my Axis 2 diagnosis. However, on the other hand, he was in remission in the sense that he was substantially improved. . . .

Analysis and Discussion: The expert in the above example was ill prepared to answer a crucial difficult question at the onset of his deposition. Had he thought the issue through he might have answered differently.

There are no weaknesses in my opinion. ■

Observations of an Expert Witness—The View from Behind a Pile of Depositions

by Craig F. Stanovich, CPCU, CIC, AU

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Editor's note: Personal observations support theoretical ones.

After dozens of cases, scores of attorneys, multiple contusions, and various traumas, I have put together some thoughts on what a consulting expert or expert witness might consider important. Aside from the never-ending challenge of getting paid on a timely basis for your services (to borrow a line from a colleague, experts are like Kleenex®, once you are done with them, they can be tossed away), here are a few observations.

Where to Start

You are likely one of the last to be involved—you have not been working the case for months or years as have the attorneys. Suddenly, six bulging banker's boxes of documents arrive. Your challenge? Understand the case in short order. But where do you begin? First step—sift through the documents to identify some logical flow or order to your review. In other words, create a table of contents of sorts to follow, similar to what you might consult in reading a difficult textbook. This approach may help you to both understand and remember the issues more easily.

Preparation

You must gain command of the issues in the case. Considering the reams of material that you need to review, read, examine, compare, and weigh, this may seem very daunting indeed. Yet, understanding is a must—the overriding goal. Whatever documents, exhibits, reports, or depositions you have been given, presume they are important. Read them all and understand as much as you can—which may involve re-reading parts or all of certain documents. Know what evidence is in dispute, what evidence has been agreed upon, and what evidence has yet to be challenged. Maybe most importantly, understand how all the pieces fit together.

A View of the Dark Side

Attorneys can be so persuasive in their arguments and briefs, you may find yourself starting to think your case is a sure thing. Stop right there. No matter how weak you may think the arguments are for the other side, make sure you fully appreciate their reasoning and conclusions. It may be worthwhile to think about how you would expand upon, improve, or even add to the opposition's arguments. In other words, anticipate what other or better arguments could be made or where their current arguments might lead so you can head them off—and avoid a nasty surprise later.

It Cuts Both Ways

Continue to ask yourself these questions—what are some of the logical implications of your arguments and conclusions? Where might they lead? Don't be complacent or arrogant; you should have a full appreciation of how your arguments may be made to seem absurd or untenable. Nothing lowers credibility as quickly as being trapped by your own words.

Cross-Examination

You are ready to do battle. Confident and prepared, you are eager to get in there and set things right. Convinced of your position, you are happy that it is finally your turn. Yet, as the deposition or trial goes on, the opposition is not asking the questions you want to answer. You haven't yet been able to dazzle them with your compelling opinions. Afraid that you might not get the chance, you begin to give your opinions regardless of the question. Not a good idea. While a great deal has been written on how to testify, you do have to answer the questions being asked. Trying to force in what you want to say on cross-examination does not usually work to your client's benefit. And remember, direct examination will bring out the important points. This is not to say you can't editorialize on open-ended questions (i.e. wouldn't you agree with me that . . . ?), but resist the temptation to answer the questions you prepared for and not what was actually asked.

Keep It Simple

With the exception of the federal government, the insurance industry may use more jargon than any other industry. To be of value to your clients, and to avoid that dazed and confused look that you are getting, convert insurance speak into plain English. While there are undoubtedly times to be technical, it is generally your job to take complex issues and boil them down so they are understandable. Expert reports that no one but you can understand don't help either. Worse yet is using insurance speak in front of an unprepared jury or judge (or both)—your credibility suffers and so will your client's. While there is always the danger that some of the subtleties may be lost in the translation, unless the case is about the tiny distinctions, it is generally better to be understood than to demonstrate everything you know.

Understand the Basics of Law

You ought to understand the basics of the law at least in areas in which you are testifying or consulting. This is not to suggest arguing law with the opposing attorney, but if you are, for example, testifying on the standards of conduct of an insurance agent or broker, you ought to know a little about the law of agency. Insisting that an insurance agent cannot, under any circumstances, have liability to his or her principal is not going to be effective. Conversely, insurance brokers are not all absolutely liable to his or her customers, even if you did once hear a broker describe his or her E&O insurance to customers as the customer's contingent insurance.

A working understanding of court proceedings, tort law, contract law, agency law, and insurance law will help you understand the context in which you are consulting or testifying—increasing your worth as an expert.

Advice to Attorneys

Unless you or your firm regularly practices insurance law, high-stakes insurance litigation should involve the guidance of an insurance expert. Too often, attorneys lock themselves into positions regarding insurance that simply do not comport with how insurance works. Seeking the advice of an expert early in the process on the complex and rapidly changing insurance business is usually money well spent. At the least, involve the expert early enough to allow time for preparation. To avoid the rather common problem of having expert testimony or expert reports that turn out to be useless, attorneys need to not only pick the right person as their expert, but engage him or her early enough to allow for the all-important preparation. ■

Q&A with Don Malecki, CPCU

by Donald S. Malecki, CPCU

Donald S. Malecki, CPCU, is a principal at Malecki Deimling Nielander & Associates L.L.C., based in Erlanger, KY. During his 45-year career, he has worked as a broker, consultant, archivist-historian, teacher, underwriter, and insurance company claims consultant; and as publisher of *Malecki on Insurance,* a highly regarded monthly newsletter. Malecki is the author of 10 books, including three textbooks used in the CPCU curriculum. He is past president of the CPCU Society's Cincinnati Chapter; a member of the American Institute for CPCU examination committee; an active member of the Society of Risk Management Consultants; on the Consulting, Litigation, & Expert Witness Section Committee of the CPCU Society; and a past member of the Commercial Lines Industry Liaison Panel of the Insurance Services Office, Inc.

Editor's note: From the real world—how do the CGL exclusions for "damage to your work" and "impaired property" apply to the operations of service industries; and where does "faulty workmanship" fit in?

We are in the termite and inspection business. Recently, a claim was filed against us alleging negligence in failing to detect the presence of termites in a residence. Coverage under our commercial general liability (CGL) policy was flatly denied on the basis of the "damage to your work" exclusion (l), and impaired property exclusion (m).

We do not feel that exclusion (l) applies, because we did not perform any work. By merely inspecting the premises, we performed a service. We did nothing that could be construed as work, because nothing was added, altered, removed, or repaired. The CGL policy definition of "your work" suggests that the work or operation in question is going to produce some kind of tangible result. Such is not the case with termite inspection services.

We also feel that the impaired property exclusion likewise does not apply based on the explanation of this exclusion in an article that appeared in the 1994 issue of Claims *magazine entitled "Impaired Property Exclusion: Using Discretion to Make It Work." Your opinion would be appreciated.*

You are correct that the "damage to your work" exclusion has no application in your circumstances, because failure to detect the infestation of termites is not work as defined in the policy. This is reinforced by subpart (b) of the definition of "your work," which encompasses "materials, parts, or equipment furnished in connection with such work or operations." This wording clearly refers to work or operations that go beyond a service.

It also should be mentioned that there is a tendency for some people to refer to exclusion (l) as the faulty workmanship exclusion. There is a distinct difference, however, between faulty work and faulty workmanship. In fact, these two terms generate a considerable amount of dialogue with respect to builder's risk and other property insurance forms. Briefly, and generally speaking, faulty work, for purposes of insurance coverage, refers to the process of the work itself. Faulty workmanship, on the other hand, refers to the quality of the finished work or product itself. Thus, if one were able to say that exclusion (l) applies to the faulty workmanship of the insured, rather than the faulty work itself, there may be wider application of the exclusion.

The impaired property exclusion likewise is inapplicable. The fact there was physical injury to the residence premises stemming from your failure to detect termites is sufficient to nullify the application of this exclusion. Impaired property is defined to mean tangible property other than the named insured's work (the residence premises) that cannot be used or is less useful because the residence premises incorporates the named insured's work that is known or thought to be defective, deficient, inadequate, or dangerous. It would be difficult to argue the applicability of this part of the definition, because nothing you did was incorporated into the residence premises. Also the repair, replacement, or adjustment of your service will not restore the use of the property. Once the termites cause damage, only repair of the premises can do that.

The second criterion of the impaired property exclusion is that the residence cannot be used or is less useful because the named insured failed to fulfill the terms of a contract or agreement. Let's assume for sake of argument that you did warrant that if there were to be an infestation, it would be found. This contractual assumption, onto itself, also is not sufficient to trigger the impaired property exclusion, for the same reason as discussed above. Replacing the service you provided, i.e., fulfilling the terms of the contract or agreement will not

restore the use of the residence premises. Only repairing or replacing the damaged property can do that. Since the services you performed cannot be repaired, replaced, adjusted, or removed, the impaired property (residence premises) cannot be restored to use.

Fortunately, there are some cases that have involved termite inspection services companies that might be of some assistance to you. In *Isle of Palms Pest Control Company v Monticello Insurance Co.*, 459 S.E.2d 318 (Ct.App. S.C. 1995), an insured exterminator sought coverage for a claim alleging that negligent preparation of a termite inspection report resulted in continued termite damage from active infestation.

The insurer argued against coverage in part on the basis that what the insured did was faulty workmanship, which was not covered by the policy. In doing so, the insurer relied heavily on the case of *Western Exterminating Company v Hartford Accident and Indemnity Co.*, 479 A.2d 872 (D.C. 1984). The court here held that the insurer had no duty to defend a claim brought against the insured as a result of an inaccurate termite inspection letter. In this case, however, the complaint contained no allegation that the insured's negligence caused an accident resulting in damage to tangible property. The claim was limited solely to economic damages. For this reason this case was not relied on by the court in the *Isle of Palms* case.

The court in the *Isle of Palms* case, instead, held that, while a general liability policy typically does not cover claims of faulty workmanship only, it does cover claims of faulty workmanship that cause an accident, as the court found in this case; that is, the improperly performed inspection that resulted in continued termite damage. Had there been pre-existing termite damage without active termite infestation at the time of the inspection, the plaintiff's claim against the insured would have been one for faulty workmanship resulting in only economic damages. Under that scenario, there would be no possibility of coverage, the court went on to say, because Isle of Palms' improper inspection would not have caused the pre-existing property damage. Because the claimant in this case did allege that Isle of Palm's negligence resulted in property damage, the policy did provide coverage.

Not to be outdone, the insurer also maintained that the policy's professional services exclusion applied. The insurer's position, with respect to this exclusion, was contradictory. The insurer argued that even though "professional services" was not a defined term, the inspecting of homes and the issuance of termite letters were professional services excluded from coverage, whereas the actual process of exterminating is not a professional service. The court rightfully reasoned that if the process of inspection is a professional service, then the subsequent extermination would also be a professional service—given that the same specialized knowledge would be required to properly perform both acts, and given that any extermination would involve an inspection as well.

The court also explained that there was no policy language supporting an inspection/extermination distinction, nor could it find any principled reason to label "inspection" a professional service, while labeling "extermination" something other than a professional service.

In the words of the court, "[T]o give effect to the professional liability exclusion would render the policy virtually meaningless, because it would exclude coverage for all claims arising from Isle of Palms' exterminating services, the very risk contemplated by the parties."

Other jurisdictions have likewise determined that damage caused by the negligence of a termite inspector is within the scope of a general liability policy. Consider *Del Posing d/b/a Del's Pest Control v Merit Insurance Co.*, 629 N.E.2d 1179 (Ill. App. 1994),

where an exterminator was sued alleging it negligently conducted improper inspections and failed to discover termite infestations. The court held that the termite infestation constituted an occurrence, and the damage caused by the termites was property damage, within the meaning of the policy.

The case of *Fowler Pest Control & Insulation, Inc. v Hartford Insurance Co.*, of Alabama, 512 So.2d 88 (Ala. 1987), held that an insurer had a duty to defend an exterminator against claims of fraud in connection with the issuance of a termite letter. Coverage also was held to apply for property damage in the case of *Hurtig v Terminix Wood Treating & Contracting Co.*, 692 P.2d 1153 (Hawaii 1984), where an exterminator improperly performed a contract to inspect and treat a house for termites.

To be frank, exterminators who perform services to detect termites are fortunate insofar as commercial general liability insurance is concerned. Short of the exterminators' making any physical changes to tangible property of others, there do not appear to be any exclusions in the standard ISO CGL forms and many umbrella liability policies, that can be relied on by insurers. (The same cannot be said of policies written in the excess and surplus lines market.) This opinion is not necessarily limited to termite inspection companies. Any business that performs services, rather than producing a tangible piece of work or a product—a general contractor whose sole role is to read plans and specifications and supervise construction work, for example, may fall into this same category as termite inspection companies.

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Q&A with Don Malecki, CPCU

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Editor's note: "Voluntary parting": another good reason to know your customers!

We have a tool rental company that rented a backhoe and attachments along with utility trailer for a period of three days. The customer signed the rental agreement and paid the charges plus the deposit. After three days had expired, the customer did not return the equipment. Apparently, the customer used a fictitious name and never intended to return the items. The local police were called, and a claim was made with the insurer.

After review of the circumstances, the insurer denied the claim based on two exclusions of the insured's scheduled property floater. The first exclusion applies to loss caused by or resulting from criminal, fraudulent, dishonest, or illegal acts alone or in collusion with another by the named insured, and others to whom the named insured has entrusted the property. The second exclusion applies to loss caused by or resulting from voluntary parting with title or possession of property because of any fraudulent scheme, trick, or false pretense.

Do you think the insurer is on solid ground in denying coverage?

Yes. It appears the second exclusion is the appropriate one, referred to as "voluntary parting." The tool rental company was tricked into renting equipment to someone who, as was said, never intended to return it.

Something similar to this event occurred recently involving a company (seller) that sold 12 computers. The seller shipped them by common carrier to a fictitious person at an actual company but where that person was not employed. The seller is now out the cost of those computers. The inland marine floater contained the same exclusion for voluntary parting. The common carrier could not be faulted here, since it picked up and delivered the computers according to the seller's shipping specifications.

In both of these cases, the only solution to reducing the chances of these kinds of losses is to take added measures to ensure that those who are renting or selling property are not tricked or deceived, particularly with respect to big-ticket items. Voluntary parting is a business risk and one insurers do not wish to cover. Loss control measures can reduce these kinds of losses but not entirely. ■

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