CPCU SOCIETY INSURING YOUR SUCCESS

Consulting, Litigation, & Expert Witness Interest Group Quarterly

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 Interest Group.

As spring begins, I am proud to relate to you that the CLEW Interest Group has not been hibernating. You have come to expect a lot from your colleagues and we like it that way.

The CLEW Interest Group symposia, "How to Start Your Own Consulting Practice" and "Order in the Court! (The Insurance Professional as Expert Witness or Litigation Consultant)" are being prepared for back-to-back presentations by veteran lecturers Stanley L. Lipshultz, J.D., CPCU; Donn P. McVeigh, CPCU; Steven A. Stinson, J.D., CPCU; James A. Robertson, CPCU; George M. Wallace, J.D., CPCU, and Lawton Swan III CPCU, CLU.

The dates have yet to be finalized, but look for these to be in mid to late April in Los Angeles and late May in Washington, DC.

We also have a directors and officers liability symposium planned in Boston this June. This is being organized and planned by Nancy D. Adams, J.D., CPCU, who has put together a fine presentation. As a die-hard Patriots fan, Adams now has time to refocus her energy, so don't miss this one!

We are already planning our Annual Meeting efforts, which will include our

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What's In This Issue

From the Chairman

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now traditional mock trial, created by usual suspects **Gregory G. Deimling, CPCU; Stanley L. Lipshultz, J.D., CPCU, Nancy D. Adams, J.D., CPCU,** and **Robert L. Siems, J.D., CPCU.** Being busier than Tom Brady when the blitz is on, Adams will also be conducting a directors and officers liability seminar in addition to her CPCU Society duties and the mock trial.

It's time to submit your nominations for this year's George M. Gottheimer Memorial Award. I am pleased to be a part of the subcommittee that will consider the nominations, along with **Donn P. McVeigh, CPCU,** and **James A. Robertson, CPCU.** This is a really great way to honor the memory of our good friend and colleague, **George M. Gottheimer Jr., Ph.D., CPCU, CLU,** so don't wait—send your nominations in now! The award will be presented at the CPCU Society's Annual Meeting and Seminars in Philadelphia, Pennsylvania.

Finally, I would like to wish a hearty welcome back to **James A. Robertson, CPCU,** who has accepted my request to rejoin our committee. We can hardly wait to put his creativity back to work. ■

Editor's Notes

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.

Serving as director of the Insurance Library Association of Boston since 1980, Lucey attained her CPCU designation in 1986. She is a member of the CPCU Society's Consulting, Litigation, & Expert Witness Interest Group Committee.

I hope that many of you had the chance to attend the CLEW Interest Group's mock trial presentation at the CPCU Society's Annual Meeting and Seminars in Hawaii. Those of us who participated had fun, but we also kept firmly in mind the substantive nature of the issues that were being addressed. I'm not sure that I would feel terribly comfortable engaging the services of Attorney Huey D. Louie, so aptly played by **George M. Wallace, J.D., CPCU,** but engaging the services of Wallace himself, whether in the legal arena or the writing one—such as his account of the trial included in this newsletter—engenders absolutely no crisis of confidence.

My sincere thanks go to **Richard C. Lofberg, CPCU,** of Teaneck, New Jersey for sending his most cogent comments on items appearing in the newsletter of November 2007. It is apparent that Lofberg's experience and competence have prepared him well to contribute on the subject of OCIPs, as well as related additional insured concerns, and I thank him for sharing his thoughts for our benefit.

Michael P. Roche, Esq., CPCU, 2007 designee, of The Cytokine Institute, LLC helps us appreciate how new CPCUs add value to our organization, and in particular to the CLEW Interest Group, through his contribution regarding the future of the use of DNA evidence in civil litigation. Such cases may (or may not) end up on *CSI*, but we are the better for knowing more about this science.

Mark C. Brockmeier, CPCU, ARe, received his M.B.A. degree from one of Boston's venerable collegiate programs (see his biography). But having achieved that degree did not blind him to the need for more specialized knowledge on the part of insurance executives. His points are well made and well taken.

Our chairman **Daniel C. Free, J.D., CPCU,** demonstrates that he does more than work on CLEW business when he so eloquently describes his experience with clients being rather aggressively pursued to consider participation in a risk-sharing pool. Free steps back from the immediate situation to give us a bit of perspective on the problems that may arise from such arrangements. He elucidates why in this particular situation buyers should keep in mind that they get what they pay for.

No issue of the *CLEWS* newsletter would be complete without a question and answer item from **Donald S. Malecki, CPCU.** In this issue he explains some of the nuances of additional insured endorsements, with reference to particular states.

You will also find in this issue a profile of your fellow CLEW Interest Group member **Andrew J. Barile, CPCU,** who has in the past been a contributor to your newsletter; my thanks to **Vincent D. Boylan, CPCU,** for eliciting the information from our "profilee."

I look forward to receiving your comments about and submissions to our interest group newsletter! ■

On the Beach with Shifting Sands Mutual

Insurer Prevails (for once) in CLEW Mock Trial

by George M. Wallace, J.D. CPCU

George M. Wallace, J.D., CPCU, is a partner in the small Pasadena, California law firm Wallace & Schwartz. His practice concentrates on property and casualty insurance coverage issues. He received his juris doctor degree from the University of California, Los Angeles, School of Law. He practiced with several insurance defense law firms in the Los Angeles area until 1995, when he and his partner established their current firm. He is admitted to practice before all California state courts, all four California districts of the United States District Court, and the Ninth Circuit United States Court of Appeals.

Wallace served as president of the CPCU Society's San Gabriel Chapter, and is currently president of the Los Angeles Chapter. He was awarded the Rie R. Sharp Memorial Award (Insurance Person of the Year) by the Los Angeles-area chapters in 2000.

Wallace speaks and writes regularly on legal and insurance topics, and teaches CPCU 530 (The Legal Environment of Insurance) for the Insurance Educational Association. He maintains two online weblogs (blogs): the California law-oriented site Declarations & Exclusions (http://declarationsandexclusions.typepad.com/weblog/); and the more personal A Fool in the Forest (http://declarationsandexclusions.typepad.com/foolblog/), which received a 2005 Blawg Review Award.

Robes were donned, justice was done, knowledge was spread, and a good time was had by all as the CLEW Interest Group presented the latest in its continuing series of mock trials at the CPCU Society's 2007 Annual Meeting and Seminars in Honolulu. Appropriate to the venue, this year's mock trial convened under the title: Fun, Sun, and Umbrella Drinks. With numerous field reporters on the scene, *CLEWS* has compiled this exclusive summary of the proceedings.

Previously . . .
When last we encountered her, prominent entrepreneuse Foxy Contretemps **(Elise M. Farnham, CPCU)** was savoring her success and the sizable "bad-faith" judgment she had recovered against her insurer, Shifting Sands Mutual Insurance Company. That claim had arisen from the fire of questionable origin that consumed the production facilities of Contretemps' promising start-up company, Robophydeaux, a manufacturer of robot dogs. Contretemps had launched Robophydeaux with the "assistance" of the then-comatose investor, Remington Steele **(Donald S. Malecki, CPCU).** Flush with the proceeds of her suit against Shifting Sands, Contretemps revisited Steele, who was miraculously restored to health and lucidity when presented with his share. As this was clearly a match made in heaven, Steele and Contretemps promptly married and relocated to Honolulu to relaunch Robophydeaux.

Meanwhile . . .
The self-styled "richest man in Mocktrialdom," Seymour "Sy" Onara, **(Edward W.S. Neff, CPCU, ARM)** mogul, takeover specialist, and CEO of SOSUMI Corporation—also relocated his operations to Honolulu. In an unusual bit of synchronicity, Honolulu was also the site for the newest office of intrepid insurance agent Ara N. Omitian **(Norman F. Steinberg, CPCU)** and his DW/EIC ("Don't Worry, Everything Is Covered") Agency. Always there to help when his clients face challenging insurance placement problems, Omitian obtained a number of high limit liability policies, including directors and officers coverages, from Shifting Sands Mutual for the benefit of SOSUMI and Robophydeaux.

Our story continues . . .
With the assistance of his enthusiastic if unreliable new right-hand man, one-time SIU investigator Bull "the merciless" Goode, **(Tony Nix, CPCU)** Onara saw an opportunity of his own in Robophydeaux. Onara, through the medium of several shell companies, became a major investor in Robophydeaux. He then succeeded in persuading Foxy Contretemps-Steele of the mutual benefits to be gained by taking Robophydeaux public, helpfully offering the services one of his own attorneys, Huey D. Louie, **(George M. Wallace, J.D., CPCU)** to prepare the necessary SEC filings. The initial public offering went forward with great fanfare and seemed to be a resounding success.

But suddenly . . .
Unfortunately, Huey D. Louie's skills as an IPO attorney were not all that they might have been: a handful of innocent but critical misstatements in Robophydeaux's SEC filings left the company—and Contretemps and Steele personally—exposed to a potential liability of millions of dollars as defendants in a class-action lawsuit filed by disgruntled investors. Rather than risk an even worse outcome by litigating the action, the Contretemps-Steeles and Robophydeaux deposited their own assets in a $700 million fund toward settlement of the class action. Reassured by Ara N. Omitian's mantra that "everything is covered" under their D&O policy, Contretemps, Steele, and Robophydeaux turned to Shifting Sands Mutual, seeking recovery of the settlement funds.

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On the Beach with Shifting Sands Mutual

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Tension mounts as . . .
Shifting Sands' vice president of claims, W. E. Neverpeigh **(Kathleen J. Robison, CPCU, CPIW)** took personal responsibility for overseeing the Robophydeaux claim. To her dismay, if not to her surprise, Neverpeigh discovered that Shifting Sands' policy language incorporated a potentially devastating omission: notwithstanding public policy to the contrary, the D&O policy form's definition of a covered "loss" was potentially open to the interpretation that it included rather than excluded payments of a restitutionary nature—exactly the sort of payments that appeared to be involved in the Robophydeaux settlement fund. The risk of another huge "bad-faith" verdict was not enough to dissuade Neverpeigh from following her instincts that payment of the Robophydeaux claim would just not be right: after consultation with outside coverage counsel, K. Wit of Quit, Yellen & Settle, **(Nancy D. Adams, J.D., CPCU)** Shifting Sands Mutual took its fate in its hands and declined the claim. Already successful once against Shifting Sands, Foxy Contretemps-Steele promptly retained the high-powered services of Hyman "Hy" Perbole **(Robert L. Siems, J.D., CPCU)** to file suit to recover reimbursement of the class-action settlement funds and to pursue another large award of compensatory and punitive damages.

In a hushed courtroom in downtown Honolulu . . .
Legal titans Wit and Perbole squared off once again before the Honorable (and floral-robed) Judge Stan Nuewell **(Stanley L. Lipshultz, J.D., CPCU).** Judge Nuewell's courtroom runs with exemplary efficiency under the watchful eye of the bailiff **(Jean E. Lucey, CPCU).**

Weeks of testimony and argument flew by as if in minutes. In addition to the testimony of the parties themselves, the hard-working jury heard from a string of experts on both sides, including such notables as insurance claims handling and bad-faith experts I.O. Pine, of Crave, Pine & Long, LLP **(James A. Robertson, CPCU)** and John Henry "Doc" Holiday, D.D.S. **(Donn P. McVeigh, CPCU),** as well as coverage expert Max Elliott of The Ness and Company **(Vincent D. Boylan Jr., CPCU)** and underwriting maven I. Khan Cipher **(Richard V. Rupp, CPCU).**

The Mighty CLEW Players: (from left) Gregory G. Deimling, CPCU; Norman F. Steinberg, CPCU; Donn P. McVeigh, CPCU; George M. Wallace, J.D., CPCU; Kathleen J. Robison, CPCU, CPIW; Nancy Adams, J.D., CPCU; Jean E. Lucey, CPCU; Stanley L. Lipshultz, J.D., CPCU; Donald S. Malecki, CPCU; James A. Robertson, CPCU; Edward W.S. Neff, CPCU; Robert E. McHenry, CPCU, Vincent D. Boylan Jr., CPCU; Elise M. Farnham, CPCU; John G. DiLiberto, CPCU, CLU, ChFC; and Robert L. Siems, J.D., CPCU.

Many hours later . . .
Unfazed by the tsunami of evidence, expertise, argument, and legal legerdemain through which it was obliged to sift, a jury of six of Honolulu's most upright and outstanding citizens (identities withheld) returned to report their stunning verdict. The Shifting Sand litigation team was visibly shaken when the jury announced that it had concluded Shifting Sands had breached the insurance contract in denying the claim of Robophydeaux. The obvious glee of the plaintiffs was short-lived, however, as in a dramatic change of direction the jury also found that plaintiffs were entitled to recover . . . only nominal damages of one dollar (US $1).

Attempts by *CLEWS* reporters to obtain further comment from any of the participants went unanswered. By a curious coincidence, all of the principals in this legal drama seem to have left town almost immediately following the verdict, each leaving behind but a cryptic voicemail message: "Just wait until next year in Philadelphia." What can it mean? Only time will tell.

In conclusion . . .
As *CLEWS* also debarks from the sunny isles of Hawaii, we would be remiss if we failed to mention the invaluable contributions to this year's mock trial of the narrator, **John G. DiLiberto, CPCU, CLU, ChFC,** and of the tireless director of the Mighty CLEW Players, **Gregory G. Deimling, CPCU.**

The 2007 edition of the mock trial was presented in memory of friend, mentor, longtime cast member, and a cherished member of the Consulting, Litigation, & Expert Witness Interest Group, **George M. Gottheimer Jr., Ph.D., CPCU, CLU.** ■

Letter to the Editor

My thoughts after reading [articles in the most recent *CLEWS* newsletter] go back to a series of seminars that the New Jersey Chapter ran in the early '60s called "insuring the _____," one of which was "the contractor." Things really haven't changed much since then except to become fuzzier.

The success of third-party OCIPs is directly related to the cost of O&C protective cover in the CGL, which in turn relates to the strength of the "safe place to work" laws of the state involved. An OCIP eliminates or reduces the protective cost by combining the primary parties under one policy. In New York State, that can be a substantial saving; in New Jersey, it doesn't make much difference. The next determinant of success is whether the construction is controlled by the separate trades' sub-contractors and unions in the area, or by the general contractors or construction managers. Assuming everyone knows what they are doing, an OCIP can be very successful; if not, it can be a disaster. The Port Authority of New York and New Jersey has been running OCIPs almost since time began and done very well. Other projects involving separate owners on Pennsylvania, New York, and New Jersey sites have not always performed. There's nothing like having a contractor working under two OCIPs on the same site. That makes one wish that a joint loss agreement could be set up beforehand rather than experiencing litigation afterward.

The workers compensation loss experience under an OCIP will be transferred to the individual loss experience of each contractor for experience rating purposes. That usually results in a subcontractor screaming when his ERM goes up, his primary insurer smiling because the ERM is higher but he didn't have to pay the claim, and the OCIP insurer wondering why this is such a good deal. The other loss experience gets lost, but the individual contractor finds that his insurer will be looking for more money to cover the reduction in its premium income resulting from the OCIP.

The comment as to the completed operations tail is correct, and dangerous. The OCIP tail rarely goes beyond two years after theoretical completion, with the OCIP sometimes terminating before the punch lists are completed. So, we have a nebulous void with an exposure that theoretically ends after 10 years last touching. That touch may or may not coincide with the completion of the contract or toll from when the contractor last worked on the site for any reason. Regardless, the contractor's primary insurer finds that they have an increasingly large co-exposure as the contractor completes more and more jobs which are funded by the premiums for work completed during the policy year of the occurrence.

The comments as to the builders risk policy are correct. In effect, this is an OCIP—all owners, contractors, architects, and engineers are usually covered as insureds or additional insureds under the builder's risk. Frequently the architects and engineers are not covered under the liability OCIP or because of a professional liability exclusion. This may result in the builder's risk insurer with an insured design loss subrogating against the professionals only to find that they insured them under the builder's risk. It helps to have both covers written through the same insurer to stop article 2 from operating. A claim involving a liability OCIP, a builder's risk insurer, and a professional liability insurer usually brings tears of joy to the counsel involved, at least initially.

That brings in Don's comments on additional insureds. We frequently rely on the comment "there's a blanket additional insured endorsement on the policy." The only problem is that we don't know who's insured, particularly as respects professional liability.

Theoretically there should be administrative savings through the reduction in the need to review certificates of insurance. In practice, there is a greater need. Every contractor must still submit their certificates for their off-site operations. Sub-subcontractors whose certificates might be in the subcontractors file will have to provide theirs, plus all of the other paper work to join the OCIP. That results in some contractors employing an unusually diverse labor mix on the job site coming from the contractor's direct employment of the sub's labor force to cut the paper work, but also resulting in the contractors having little knowledge of who they have working on the job.

It's a bit harder now, but it used to be pretty easy for a contractor to make some money on the OCIP by structuring the payroll in his bid and his insurance costs to maximize his credit, including the final audits. That was popular when the state was building our stadiums and could still be done now with some additional effort.

I haven't really seen a need for OCIPs in 50 years. I've never seen any dramatic cost reductions in our area, usually increases. I've never seen a manual that really describes how the OCIP will work, and am usually lucky to get a certificate. I've reviewed policies, usually obtained by threat of brute force. I frankly prefer writing the coverage for our clients the way we think it should be, not as delivered. ■

—Richard C. Lofberg, CPCU
Teaneck, New Jersey

Why an M.B.A. Is Not Enough for Insurance Executives

by Mark C. Brockmeier, CPCU, ARe

■ **Mark C. Brockmeier, CPCU, ARe,** is chairman of the CPCU Society's Excess/Surplus/Specialty Lines Interest Group and is a senior principal for SAP's Value Engineering Group, assisting insurance companies worldwide in building business cases for strategic investments in process and technology tools. He has more than 20 years in the insurance industry and has worked for insurers, reinsurers, TPAs, and self-insurers prior to his current position. Brockmeier received his CPCU designation in 1993 and is a graduate of Boston University's masters of insurance management program.

For many years now, the M.B.A. has been considered the ultimate business tool for managers. It teaches a method of thinking about a broad range of topics, including finance, operations, marketing, and managerial accounting. Most business schools would have you believe that there is little tangible difference between businesses, and that once trained in their managerial method of thinking, almost anyone can apply almost any tool at almost any time to almost any situation. Is that actually the case? Are insurance companies businesses that have such little differentiation as to warrant no other training than advanced business thinking? Where does specialized industry training belong, and specifically, what is the role of the CPCU in today's insurance environment?

Insurance occupies a unique position in American consumer society. It is the only private market product that is mandated by law for consumers. In Massachusetts, as a condition of being a full-time resident of that state, people are required by law to be covered by health insurance. In most states, in order to drive a car, people are required by law to carry insurance against accidents caused by the driver. There are other kinds of insurance that have

compelling ownership requirements as well. Most persons who own homes do so through a mortgage, and that mortgage company requires homeowners insurance as protection of their lien on that asset. Homeowners who buy with very little money down are required to carry private mortgage insurance as protection against default. As a product that is "required" to participate in many of the tenets of American society, insurance's unique place should give it a unique position in education and training as well.

The M.B.A.'s tools of financial engineering are limited by accounting and other regulatory oversights as well. Rates and pricing, unrestricted in most other product markets, are regulated in many areas by insurance commissioners. Companies must hold reserves, much like banks, and not outstrip their ability to pay pending obligations. Policyholder surplus is closely regulated as well. So the tools of financial engineering and capital allocation, as taught in the business schools, do not apply in insurance. Government has insured that there is great public purpose in a private market, which allows access for most consumers. And outsourcing some key functions is out of the question, since policies must be underwritten by licensed agents, and claims must be managed by licensed adjusters.

Companies cannot afford, from a regulatory or market reputation risk, to operate in an unrestricted manner. Business schools don't teach the economic value of good public policy behavior and what it means to operate in highly regulated environments. They stress the reliability and time-tested ability of self-correcting product and capital markets. Insurers have learned the hard way that this is simply not enough. There should be, and must be, purpose to the consumer of insurance, whether that is in personal, commercial, or life and health lines. Examples in my working lifetime include the recent scandals around contingent commissions, catastrophe claims services, premium fraud schemes driven by the PEO craze, and others. In my view and the view of many others in the industry, it's time for a "back to basics" focus to succeed in this highly structured and regulated marketplace.

Working with technology for insurers, there has been pressure to come up with ever-more sophisticated tools that help make ever-more sophisticated decisions. Actuaries have catastrophe models. Claims professionals have reserve models. Underwriters have rating models. These tools are no longer decision support systems, but have become decisioning tools in and of themselves . . . with the insurance professional having to explain "why not the model" rather than having education, reason, and experience as the decisioning tool. It's an M.B.A.-like mentality that pressures this kind of operating environment, seeking to push automation and aggregate results down to the individual file level. Are we becoming victims of our own training, forgetting what we have been taught by society and our designation?

The Chartered Property Casualty Underwriter designation alone takes on this education/ethics continuum. The training received in the business of insurance—its historical context, contemporary importance, and duty to act in the best interests of every party with whom the CPCU acts—is the necessary perspective needed in today's business

world. It is simply not enough to operate without context. Companies require identities and have histories of who they are and what they represent beyond just good financial results. We are surrounded by statements of that public purpose in the logos of the many companies of our industry: "the good hands people," "like a good neighbor," "on your side," and many others that suggest high reliability, high ethics, and purpose to our business. We cannot as an industry, and should not, as CPCUs, allow financial engineering and investor pressure to supplant those identities and histories. Insurers have deservedly poor reputations among consumers for the reason that we don't remember why we got into this business in the first place.

Most of us are not in it for the money. There are better paying business careers, but more than 3.2 million people work in insurance to make a difference in the lives of others. There is a social reward and context that while we all generate revenue and income for the corporation, we also provide service and an ethical construct for other businesses to admire. But only if we take the lead ourselves. How many of our CEOs are educated this way, in the basic tenets of insurance, and why we are who we are? How insurance has made a difference in people's lives every day, and particularly at the major catastrophic events in American history, from the Chicago fire of 1871 to September 11, and Hurricane Katrina? Why do we not, as an industry, take the European view that business requires a 360-degree commitment to its customers and employees as well as investors? What is the ultimate value of an insurance company's brand equity, and how can managers be trained to keep it alive?

For my money, the CPCU designation trains managers to think in terms of broader public purpose while protecting the balance sheet. For our industry to survive, we need CPCUs to change how

we're perceived, how we do business, how we think, and how we behave. And no spreadsheet or model, no matter how sophisticated, can do that. As important as the philosophy of business in the M.B.A. program, so shouldn't the CPCU be required reading for the senior manager. History has shown the greatest leaders in business and public life to be those who best know themselves, and it tempers their decision-making toward making great things even better. I challenge those of you who know an executive who is not a CPCU to pursue the designation. In training managers and executives in a world of continuous learning, and 100 new business books a month on managerial decision-making, the CPCU course books are still some of the best books around. ■

The Deep End of the (Risk) Pool: A Lifeguard's View

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

I recently had occasion to scan several insurance trade publications, looking for one that made no mention of the current "softening" of the market for property and casualty insurance. It took a while. This search was prompted by a couple of calls from people who were asking about a new risk-sharing pool that was being aggressively marketed to their organizations.

Insurance company competition for the group targeted by the pool was described as "bloody" and "tooth and nail" by a knowledgeable and prominent local broker. With insurance readily available at the lowest pricing in years, I pondered whether the caller's interest in joining a new pool with minimal capitalization and no track record was based upon a lack of understanding, a leap of faith, or both. Sensing I knew the answer to my question, I asked: What's in it for you?" "Well," he said, "they say we're going to save a whole bunch of money on our insurance." A few more questions revealed that he knew little more, which was scary. This leads me to my next point and the purpose of this article.

As everyone knows, directors and officers have a legal duty to act in the best interests of the organizations they serve. Decisions must be based on thorough and timely information, with due diligence given to the implications, both positive and negative, of the decision to be made. Failure to do so may be seen as negligence and can give rise to legal liability, in addition to whatever financial, reputational, or political consequences result. This is as true with respect to purchasing decisions about property and casualty insurance and risk financing products as it is with anything else.

So it is at once both puzzling and with some trepidation that we learn of risk financing decisions made solely on the basis of price, without due consideration being given to the terms of coverage being offered or the financial solvency and claims-paying ability of the entity providing it. Thorough analysis is necessary regardless of whether the "insurance" is being offered by a commercial carrier or an alternative risk financing entity, such as a self-insurance trust (trust) or a risk-sharing pool (pool). However, trusts and pools deserve greater scrutiny.

This is not an effort at "bashing" trusts and pools. Our firm has a wide variety of clients that employ nearly every type of alternative risk financing vehicle, including trusts, pools, single and multi-owner captives, risk retention groups, and purchasing groups. However, the decision to participate in such an enterprise should never be made solely because the premium is less than the cost of commercial insurance.

Trusts and pools have been around for years and exist in nearly every state in the Union. A good number of them are well established. Trusts and pools found their niche during the hard market cycles of the '70s and '80s. The highly publicized "lawsuit crisis," together with market-driven premium increases in double and triple digits made commercial insurance either unavailable or prohibitively costly. Pools and trusts were formed by many organizations, particularly public entities, to provide some protection against adverse losses from workers compensation and liability claims. In some instances, insurance companies withdrew from the marketplace, leaving vehicles like trusts and pools as "the only game in town."

Today, the situation is different. While we would like to see even stronger competition among insurers, for most entities, commercial insurance is readily available from insurers regarded as financially sound by one or more of the well-recognized rating services. That said, we are seeing the emergence of some new trusts and pools, as well as more aggressive marketing efforts by those already in existence.

Unfortunately, some of the pitfalls that may be associated with pools and trusts are not properly disclosed or emphasized. Most trusts or pools are promoted and managed by insurance sales organizations that generate fees from the pool for management, sales, accounting, and actuarial work, as well as commissions on the placement of excess insurance or reinsurance. The larger the pool, the greater the revenue stream. Thus, there is little incentive to focus on some of the downside risks. A few of these are listed below.

- **Assessibility.** If premiums from members are not enough to pay claims, members may be assessed. This has recently happened in Illinois. Pool members can be assessed for each year of participation in the pool, even if they are no longer a member at the time of the assessment. Members may also be assessed multiple times for the same policy year, until all claims from that year, from all members, are closed. This can quickly erase any "front-end" premium savings.
- **Mandatory Participation.** Participants in pools are usually required to make a three- to five-year commitment, regardless of increases in the cost of participation, or the comparative cost of insurance in the traditional marketplace. Promoters cite the potential for participants to share in future dividends if the pool has good loss experience. However, leaving the pool early usually means forfeiture of dividends. Return of any capital contribution can be delayed for years. By contrast, a commercial policyholder can cancel at any time for a standard short-rate penalty, or simply not renew.
- **Minimal Government Oversight.** Unlike commercial insurance companies, most alternative risk

financing vehicles, such as captives, risk retention groups, trusts, and pools are not subject to the same regulation or oversight by the departments of insurance of the states in which they operate as are commercial insurers. Some states do not require the use of conventional accounting methods and only require the filing of audited financial statements. Filings may not be open to public review.

- **No State Guaranty Fund Protection.** By state law, insurers pay a portion of the premiums written in each state into a guaranty fund, run by the state, which is used to pay claims presented by and against policyholders whose insurance companies have become insolvent. These guaranty funds do not provide protection to members of insolvent captives, risk retention groups, trusts, pools, or surplus lines insurers. When combined with minimal government oversight or accounting requirements, this becomes even more important.
- **Timely Distribution of Financial Statements.** This varies widely, but some trusts and pools do not provide their members with timely, accurate statements of financial condition. We have actually seen a couple of pools that refuse to provide financial information. This means that a pool member might not learn of serious financial difficulties until it is too late.
- **Long-Term Stability.** One universally cited advantage of pools and trusts is that they insulate participants from the "volatility" of the insurance marketplace. This may be true, to the extent that the pool bears some of its own risk, with excess or reinsurance attaching at some point. However, they are subject to price fluctuation in the excess or reinsurance markets, just the same as commercial insurers. Moreover, when commercial insurance is in a "soft" market cycle and pricing is comparatively low, participants may opt for commercial insurance at lower cost, particularly those with excellent loss histories. When they leave, adverse selection occurs, leading to higher loss costs and premiums for those who remain.
- **Lack of "Critical Mass."** Since insurance is based upon the law of large numbers, the greater the number of participants sharing the risk, the greater the likelihood the group will survive bad loss years. Pools and trusts tend to have very limited numbers of subscribers or members, especially "start ups." A small number of members means a reduced spread of the risk and a greater likelihood that bad loss experience will have a negative financial impact on the group as a whole. Pro-forma financial statements usually assume optimistic initial participation to make the numbers look stronger. Promoters know this, which is why pressure for an immediate multi-year commitment can seem relentless.
- **Loss Sharing.** This is related to the point made immediately above. Losses within the layer retained by the pool or trust are shared—members contribute funds to pay for losses within the retention. If some members' histories are good, but others have bad loss experience, the contribution to the loss fund by those with good loss experience will amount to a payment for other members' losses. This is not so true with respect to commercial insurance, because of the large number of insureds that provide "critical mass."
- **Unusual Coverage Documents.** Pools and trusts do not use "standard" forms the same way that the insurance industry does. Coverage terms and conditions vary widely from one entity to the next, which makes it difficult to ascertain what coverage is being provided. Moreover, some pools and trusts only provide a membership certificate, with little other evidence of coverage. This can create a serious problem following a loss.
- **Disruption of Agent/Broker Relationships.** Some pools and trusts are not accessible to general lines agents. This means severing a relationship with the current agent or broker, which may not be desirable. Service quality is an unknown with a new provider. A new working relationship takes time and effort to develop.
- **Failure to Effect and Maintain Insurance.** Many management liability policies, such as directors and officers, educators' legal, and public officials liability, exclude coverage for claims arising from the failure to effect and maintain insurance. The exclusion is not limited to commercial insurers. If an organization suffers a financial loss because of the insolvency of a pool, trust, or insurer, the resulting lawsuit against the directors, officers, or trustees would not be covered.

In fairness to pools and trusts, commercial insurance companies also can and do become insolvent. However, they are subject to greater regulatory oversight, as well as financial analysis by firms like A.M. Best, Standard & Poor's, Moody's, and Weiss Rating Service. The upshot is that an insurance company's financial problems are likely to be discovered sooner, giving its policyholders enough time to consider their options.

Thus, while pools and trusts may appear very attractive, there are risk factors associated with membership in them that do not exist to the same degree with the use of commercial insurance. These should be clearly disclosed by promoters and understood by management.

Finally, it is simply not sensible to be pressured into a hasty decision. One can always wait. If the pool or trust is viable a few years down the road, its promoters will still accept new members and their money. Throwing caution to the winds could be financially disastrous if insolvency makes the venture, in the words of poet E.E. Cummings, "a recent footprint in the sand of was." ■

A Scientific Revolution in Toxic Tort Litigation and Workers Compensation: DNA Evidence

by Michael P. Roche, Esq., CPCU

Michael P. Roche, Esq., CPCU, is a managing director of The Cytokine Institute, LLC. The Cytokine Institute is a DNA-based litigation and environmental consulting firm that has offices throughout the United States and provides cutting-edge scientific technologies and research regarding critical toxic tort causation and occupational health issues. He can be reached at mroche@cytoinst.com.

The future of DNA evidence in civil litigation cases is now. DNA evidence is the most powerful forensic tool available to litigants today. During this decade and beyond, gene expression data developed in connection with the mapping of the human genome will provide causation proof in toxic tort cases and workers compensation claims that epidemiology studies cannot match. Corporations and their insurance carriers are beginning to reap the financial benefits of toxicogenomic science, which tells them, at an early stage, whether a toxic exposure has caused an injury to a claimant.

Most, if not all, potential jurors are aware of the use of DNA evidence in criminal cases. The television series *CSI* and the mass media "CSI Effect" have created a desire, in fact a need, among jurors to see DNA proof of certain crimes such as rape or murder. Jurors want to hear about the crime scene investigators with high-tech equipment, cameras, rubber gloves, and DNA swabs gathering DNA evidence such as blood, semen, and saliva samples. The jurors' search for truth typically includes a need to see and hear DNA proof, which is the smoking gun for a prosecutor to obtain a conviction. On the other hand, the lack of DNA evidence can be used by criminal defendants to raise reasonable doubt for acquittal. For instance, the lack of a DNA match was a key factor in showing the exoneration of the three accused Duke University lacrosse players, and DNA evidence has been used for several years to prove the innocence of death row inmates.

The increased use of DNA evidence in litigation is possible because of constant scientific advances, and now DNA technology is recognized by the courts as reliable evidence. Until now, the use of DNA as forensic evidence has been limited to criminal cases. Today, just four years after scientists finished mapping the human genome (the complete sequence of approximately three billion letters of DNA within each cell), gene expression technology can provide scientific data for civil litigants to prove or disprove causation in toxic tort cases and workers compensation claims. Crime scene analysis and crime scene investigation involves more than simply processing and documenting tagged evidence. Crime scene analysis is a methodical, systematic, and orderly process utilizing laboratory protocols and a processing methodology. As a result, prosecutors and defense attorneys are left with the best form of proof.

Toxicogenomics is the study of genomics and the impact of certain toxic substances at the gene level. Scientists use toxicogenomics to identify the specific DNA signature, or cytokine expression, generated by human cells in response to exposure to a toxic contaminant or chemical such as pesticides, benzene, hexavalent chromium, mold, formaldehyde, welding rod fumes, lead, or asbestos fibers. Scientists in the lab can analyze genomic sequences to understand the gene transcript, cytokine and metabolite profile for toxin. Any company can identify its toxic exposures and introduce its products and chemicals or other toxic contaminants onto a computer chip, which analyzes tens of thousands of genomic responses. The study isolates cytokine responses emitted by the genes and provides a DNA signature expression for the particular toxin and its metabolites. The resulting DNA signature expression, in turn, provides the company and its attorneys with an invaluable matching tool to determine causation in toxic tort and workers compensation claims.

Everyone has unique DNA, which is the basis for the approximately 30,000 genes each of us carries. The genes function in three ways when exposed to a toxin: (1) they are turned on (upregulated), (2) they are turned off (downregulated), or (3) they do nothing. The manner of expected response is unique to the chemical or toxin. Accordingly, any claimant's DNA can be studied to determine if the alleged toxic exposure caused a particular illness or injury. If the claimant's DNA has changed at the molecular level in response to introduction of the particular toxin, then there has been a harmful or injurious exposure. If the cell's DNA has not changed, then the exposure to the toxin did not cause any harm to the claimant and the claim can be defended with a smoking gun evidentiary tool to defeat causation. This medical causation tool is a breakthrough for civil litigants

and companies seeking ways to reduce litigation costs and weed out frivolous bodily injury lawsuits.

To illustrate the benefits of the causation tool, one can compare the toxicogenomic investigation and proof with the traditional cumbersome and ambiguous proof used in benzene litigation. In this hypothetical, imagine a former worker or neighbor of a petroleum refinery has brought suit alleging leukemia due to benzene exposure. Benzene, a known carcinogen, is a component of gasoline. Refinery workers and neighbors can be exposed, despite heavy safety regulation and compliance standards, to varying levels of benzene via skin absorption and inhalation. We know that benzene can cause leukemia and other cancers in humans.

We also know that there are trace levels of benzene in most aspects of everyday life, and that people develop cancer in many ways. We are exposed to benzene when we breathe second-hand smoke, when we fill up our vehicles at self-service gasoline stations, when we sit in rush-hour traffic, and even when we drink soda. Many industrial settings, including plastics manufacturers, petroleum refiners, and chemical manufacturers, expose workers to benzene and its metabolites on a daily basis as well.

Current methods of proof in most toxic tort cases can be viewed as circumstantial. The evidence is often some combination of medical records, testimony of industrial hygienists, reports of epidemiological studies, toxicology reports, and other statistical data. These empirical studies are often unreliable as they study subsets of populations, anecdotal dose reports, and exposure data that may be different than the case at hand. Benzene exposures are especially difficult to quantify due to lack of documentation (the refinery may have closed years ago), poor memory recall, and other factors that must be considered when reconstructing the alleged exposure at trial. Past methods of proof including dose-response relationship tests and reliance on epidemiological reports are outdated, ambiguous, and largely circumstantial. We know that the varying degrees of exposure, whether industrial or in everyday life, do not cause each of us to develop leukemia or other illness. We also know the complex etiology of most types of cancer provides a multitude of potential causes of the alleged injury in most toxic tort claims.

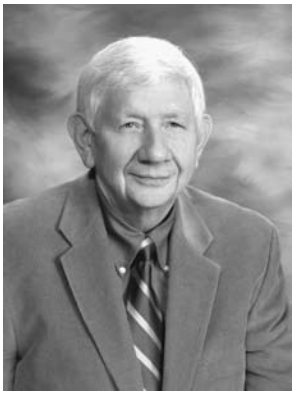
Toxicogenomic analysis can be used like the criminal investigator seeking a DNA match: if the chemical or toxic contaminant has not caused the matching gene expression in the claimant's blood test, then there has been no injury to the claimant caused by the toxin. In the benzene exposure hypothetical, a toxicogenomic analysis of the claimant's DNA compared with the DNA signature cytokine expression for benzene would provide the litigants with the causation tool to determine if the claimant's leukemia was caused by benzene exposure. Toxicogenomics will not provide the real cause of the claimant's leukemia, but it can provide the claimant or the defendant with the smoking gun evidence on benzene causation. Remarkably, the evidence is no longer based on circumstantial dose questions, epidemiological studies, or a physician's differential diagnosis and medical guess on causation. Instead, the evidence is based on widely accepted gene expression technology and DNA proof, much like the criminal proof discussed earlier. As a result, the standard of proof in a civil case requiring a showing based on a "preponderance of the evidence" is surpassed and actually falls closer to the criminal "beyond a reasonable doubt" standard.

Human resource departments and corporate safety/risk managers may also utilize toxicogenomics for medical monitoring when determining whether a person has suffered a job-related traumatic toxic exposure and whether there are any residual consequences. Toxicogenomic labs typically measure specific proteins in the claimant or employee blood, therefore the tests can be performed in a blind setting with absolute patient anonymity, and confidentiality is appropriately protected.

We now have the ability to understand how a toxic contaminant or chemical impacts the health of an individual at the molecular level rather than relying epidemiology studies of subsets populations. Improved hazard communication plans, worker safety protocols, and increased consumer protection will stem from litigation using toxicogenomic proof. Finally, corporations can see improvements in litigation, which will force outcomes to be fair, objective, and based on specific scientific proof. ■

Q&A with Donald S. 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.

We are an insurance agency in the state of Tennessee and a great deal of our business clientele are construction contractors. A number of project owners and general contractors are still requiring subcontractors to obtain the additional insured endorsement entitled "Additional Insured—Owners, Lessees, or Contractors—Scheduled Persons or Organizations" CG 20 10 11-85. Possibly recognizing that this endorsement may no longer be available, the specifications give the option of the 2001 edition of that endorsement, coupled with the 2001 edition of CG 20 37, which provides the additional insured with Completed Operations insurance.

We are telling these project owners and general contractors that our insurers will not issue those endorsements and that the only ones available are the 2004 editions of both endorsements. Is there anything else we can do to explain the unavailability of the earlier endorsements? If we cannot convince these project owners and general contractors, we are afraid our insureds are going to lose out on valuable work.

What these project owners and general contractors do not understand is that both editions of CG 20 10 for 1985 and 2001 were broad enough to provide sole fault coverage to additional insureds. If, however, you look at the Tennessee anti-indemnification statute, Section 62-6-123, you will note that sole fault coverage under hold-harmless agreements is void and unenforceable. Since this statute does not permit insurance for sole fault, this also means that sole fault coverage cannot be provided with an additional insured endorsement.

This may come as news to you and others because insurers probably have long issued broad additional insured endorsements in your state, despite this anti-indemnification statute. Your state, however, would not be alone here, since these statutes were largely ignored when additional insured endorsements were issued.

What you need to explain to project owners and general contractors is that your insured's insurance companies could not issue those broader endorsements even if they had wanted to do so. Tell them, it is the law!!

As a compromise, inform the project owners and general contractors that you can obtain the 2004 editions of both endorsements, but they will not be as broad. In other words, these endorsements will not provide sole fault coverage, which isn't permitted anyway. What they will provide is coverage so long as the named insured is at least partially at fault. While they may be reluctant to accept these more limited endorsements, remind them that all it takes is for the named insured to be 1 percent at fault and the additional insured obtains full coverage. The reason is that the commercial general liability policies do not contain any provisions for allocating liability.

While we are at it here, it may be a good idea to explain what other states likewise view additional insured endorsements providing sole fault coverage to also be void and unenforceable. Within this category are Georgia, Idaho, Indiana, South Dakota, and Utah.

Those states where both sole and partial fault coverages under contractual liability and additional insured endorsements are not permitted are: Arizona, Colorado, Florida, Montana, New Mexico, North Dakota, Oklahoma, Oregon, and Washington. A caveat with these states is that there are certain exceptions that need to be considered. As a whole, however, not even the latest (2004) endorsements would be permitted in these states.

What would be permitted is a limited form of contractual liability coverage, similar to a CGL policy endorsed subject to Contractual Liability Limitation CG 21 39, and an additional insured endorsement that covers the additional insured for acts or omissions solely committed by the named insured. In other words, coverage is purely vicarious in nature. An alternative to the additional insured endorsement would be the Owners and Contractors Protective Liability policy.

What may beg the question here is suppose an insurer, in these latter states, were to issue the 2004 edition of additional insured endorsements, or some earlier edition. Would they have to honor the coverage, despite what the prevailing statute says? That is a legal question best left up to competent attorneys to answer. Having said that, however, insurers may be hard pressed in denying coverage, considering that they should be cognizant of the law when issuing policies and endorsements. ■

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CLEW Member Profile

Andrew J. Barile, CPCU

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Position

Founder and chief executive officer of Andrew Barile Consulting Corporation, Inc., which provides a wide range of consulting services including:

For Owners of Agencies:
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- program design and implementation
- agency-company relations (negotiating MGA agreements)

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- fronts and reinsurance for captives
- capital raising for captives

For Law Firms:
- errors and omissions litigation services
- litigation support to law firms
- insurance/reinsurance expert witness/arbitrator

For Insurance Companies:
- reinsurance negotiating
- marketing negotiating
- insurance industry mergers and acquisitions
- director/insurers and offshore insurers

Education

- Graduate of The College of Insurance, B.B.A. Degree, June 1970
- Graduate of NYU Business School, M.B.A. Degree, June 1972
- CPCU June 1970

Career Background

Barile's 40-year extensive background includes positions with primary insurers including Commercial Union, Home, Phoenix of London, and Great American; and work for reinsurers Swiss Re and American Re. He co-founded a reinsurance brokerage firm and served on the Board of Directors of the first publicly held Bermuda reinsurer. Barile lead the commercial division of a managing general agency and served as president/CEO of an insurance and reinsurance consulting company before founding his current firm. In addition to his consulting practice, Barile is currently on the Board of Directors of a property and casualty insurance company.

Professional Activities

- member of the International Insurance Society of New York, Inc.
- member of the AIDA Reinsurance and Insurance Arbitration Society, ARIAS-U.S.
- former adjunct professor at the College of Insurance in New York
- author of several books and numerous articles that have appeared in the *National Underwriter, Insurance Advocate, Florida Insurance News, Business Insurance, Forbes Magazine,* and the *Insurance Journal*

CPCU Society Involvement

- member of the San Diego Chapter
- member of several interest groups in addition to CLEW
- contributing author to interest group newsletters including those published by the Agent & Broker, Excess/Surplus/Specialty Lines, Regulatory & Legislative, Reinsurance, and Underwriting Interest Groups

Family

- native of Bronx, New York near Yankee Stadium
- spouse Mary Lou (an avid tennis player); and children—Cristina and Andrew (both college graduates)

Hobbies

Reading insurance publications and walking on the beaches of southern California.

How would you describe your current work?
Clients hire me for my in-depth knowledge of the insurance and reinsurance industries. I have no typical client. One day it may be a litigation lawyer in Los Angeles, the next an owner of an insurance company in New York or an agency owner in Tennessee. In a sense, I am a "reactionary consultant" in that I am reacting to and assisting my clients with the problems they are facing.

What is the most interesting aspect of your job?
The challenge presented when the phone rings or the e-mail comes in and I hear or read: "I am starting an insurance agency and/or an insurance company and you have come highly recommended as an insurance consultant." I immediately begin to use everything I have done in the past 40 years and apply or relate it to this client's problem or issue. I never know what the next telephone call will bring.

How about the most frustrating?
When the clients ignore my advice for which they are paying me! Also I frequently find that the confidentiality agreements I enter into on a case prevent me from using the mistakes made in one situation as a learning tool for other clients with a similar problem.

What were the most fascinating or challenging problems or cases you have been involved with?
The World Trade Center case, Hurricane Katrina, and a finite risk reinsurance case come to mind. Unfortunately, I can't share the details with you because of the confidentiality agreements I signed on each of these matters.

What person had the most influence on your career and why?
Bernard J. Daenzer, J.D., CPCU, one of the first CPCUs and a great family man, gave me the opportunity to start a reinsurance company, and a reinsurance broker firm.

What is good about the insurance industry? What is bad?
The insurance industry makes the economy run. It is bad when it is accused of taking advantage of policyholders.

What is good and bad about the legal industry?
The legal industry is a necessary evil that will always be present. It is one of the few ways to vent a complaint assuming you have the resources to utilize it.

Where are you headed in your career? What are you going to do next?
I am headed in the direction of becoming a strategic advisory director to agency owners and insurance company owners. In other words, I intend to help these clients with a variety of strategic and operational issues. Also, I will continue to be retained by and work with insurance and reinsurance litigation attorneys located throughout the United States and Bermuda. The focus of much of this work is on reinsurance recoveries and disputes involving them.

The key to business today for all of us is the ability to deal with communication methods that are far superior to those of the past, i.e. the Internet. I recently received a call from a new client from another region of the country who learned about me by simply "googling" my name.

I'm also looking toward the development of Dubai and China as the next insurance frontiers. China will be a force because of its size, population, products, and people who will have money to buy insurance. Dubai will have an impact because of its great financial resources. ■

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