CPCU SOCIETY INSURING YOUR SUCCESS

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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.

The CPCU Society's 2007 Annual Meeting and Seminars in Honolulu are now behind us and I am pleased to report that the CLEW Interest Group once again made a significant contribution to the event. Our mock trial, "Fun, Sun, and Umbrella Drinks" went extremely well, due in large part to the level of planning and effort that you have come to expect from CLEW. I would like to recognize the efforts of **Stanley L. Lipshultz, J.D., CPCU,** who wrote the script and served as the judge, along with **Nancy D. Adams, J.D., CPCU,** and **Robert L. Siems, J.D., CPCU,** as the attorneys, and **Gregory G. Deimling, CPCU,** our producer. Our thanks also go to the "CPCU Players," many of whom have been in the previous mock trials, and the staff at Malvern who helped us with logistics and scheduling.

We also sponsored a seminar: "D&O Liability Insurance 101: What You Need to Know and Why" produced by **Nancy Adams,** who, like many of our members, shouldered multiple responsibilities at this year's Annual Meeting and Seminars.

We are pleased to announce that the CLEW Interest Group has created and awarded its first George M. Gottheimer Memorial Award. This award will be

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presented annually to a CLEW Interest Group member who has made an outstanding contribution to the fields of insurance, insurance litigation, risk management consulting, or service as an expert witness. This year's inaugural award was bestowed upon **Donald S. Malecki, CPCU,** whose contributions in all areas of consideration are too numerous to list in the space we have here. I thank my fellow members of the selection committee, **Donn P. McVeigh, CPCU,** and **James A. Robertson, CPCU, ARM.** One might think the selection committee's task an arduous one, given the quality of our membership. But in this case it wasn't, because we all felt Don was the obvious choice.

Each year we will make a call for nominations, so keep in mind those of our colleagues whom you feel are deserving of the award for 2008.

Finally, I would like to offer my thanks to Vincent "Chip" Boylan, CPCU, for handling the chairman's duties in my absence. ■

Editor's Notes

by Jean E. Lucey, CPCU

I don't know if I'm a typical newspaper reader, but one section of the paper I try to read every day (even if the Red Sox and Yankees are competing with each other and for my attention) is the letter to the editor section. I often have had strong feelings about a story or news item and feel either vindicated or chagrined by the well-expressed opinions of writers who agree or disagree with my views. Occasionally, yelling seems appropriate.

The best kinds of letters to the editor are those that express a reasoned view of the subject at hand and even expand the purview of the original item. Such, I believe, is Craig Stanovich's letter concerning J. Carlton Sims's article on pre-judgment interest, which appeared in the July issue of this newsletter. I thank both Mr. Sims for his original treatment of this subject, and Mr. Stanovich for making the effort to add his comments.

I encourage all who read these newsletters to put fingers to keyboards and express themselves, either in agreement or disagreement with something that has been published in one of our newsletters, or to expand upon a topic. I can be e-mailed at jlucey@insurancelibrary.org.

Another thing I like in newspapers is serial stories. The additional item in this issue regarding pets and their valuation, and a lawyer who specializes in this kind of law, cannot really be considered to join with George Wallace's article in the July issue to make a series. It was interesting to me, though, and I hope to you, to get a little personal insight into an attorney who is in the forefront of this field.

CLEW Interest Group Committee member **Joseph G. Burkle, J.D., CPCU,** elicited the article on "Owner-Controlled Insurance Programs (OCIP): The Good, The Bad and the Ugly" from the attorney contributors. Although the title has caused the theme song from the good old spaghetti western to repeat in my head (it could be worse!), it is clear that contractors in California and elsewhere, along with their insurance professionals, can be alerted to pitfalls in the burgeoning world of wrap-up and OCIP insurance programs through its pages.

The law firm of Anderson Kill & Olick, P.C. is proud of its inclinations and abilities to assist policyholders in obtaining the full benefit of their insurance policies. Certainly attorneys John B. Berringer and Natasha Z. Millman reflect this pride in their exposition of policyholders' rights when insurers obdurately refuse to effect settlements. And they don't advise just getting mad—they explain how getting even may be possible.

I have included a short review of a new report from TowerGroup, "Technology Direction in U.S. Property and Casualty Insurance Claims Operations: Transforming a People Business." It may be that some readers will want to investigate the entire (if short) report.

Donald S. Malecki, CPCU, has, as usual, given a cogent answer to a question. This time, the question is in the context of owners' requests for particular additional insured requirements on contractors' policies. I know of no one better to address an additional insured issue than Don, and his "pay me now or pay me later" warning should be heeded by contractors and those effecting their insurance coverage.

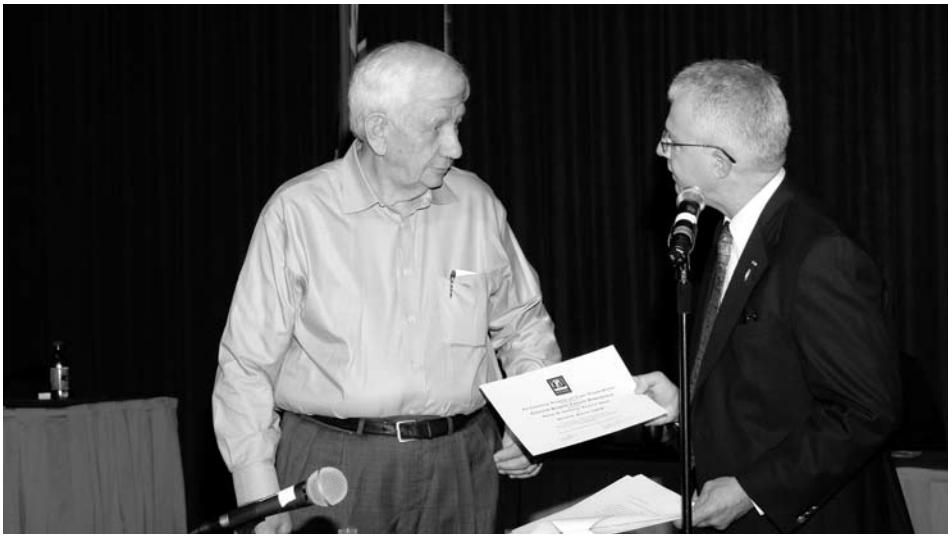
And finally, in addition to hearing from you in the form of letters, I welcome contributions for publication—again, just e-mail me at jlucey@insurancelibrary.org. ■

Donald S. Malecki, CPCU, First Recipient of the George M. Gottheimer Memorial Award

You may recall that in the previous issue of the *CLEWS* newsletter we expressed our sadness concerning the death of our well-loved and respected colleague **George M. Gottheimer Jr. Ph.D., CPCU, CLU,** who died earlier this year. In his memory and honor, the CLEW Interest Group Committee voted to create the George M. Gottheimer Memorial Award. The award will be presented annually to a CLEW Interest Group member who has made an outstanding contribution to the fields of insurance, insurance litigation, risk management consulting, or service as an expert witness. A selection committee comprised of the current and two former chairmen of the CLEW Interest Group Committee was appointed to receive and review nominations for the 2007 award.

We are pleased to announce that the first recipient of the George M. Gottheimer Memorial Award, presented prior to the CLEW Interest Group mock trial at the CPCU Society's 2007 Annual Meeting in Honolulu, is **Donald S. Malecki, CPCU.**

Any insurance professional who has not heard of Don Malecki must not read trade journals, attend seminars, or have ever studied using CPCU textbooks. Don has spent more than 47 years in the insurance industry, and for the last 40 of those years, people in the property and casualty insurance business have been relying upon his research and published commentaries for elucidation of matters both practical and arcane (but who knows when the latter will become the former?). His 1966–1984 tenure with the National Underwriter Company, where he served among other things as associate editor of the *FC&S Bulletins*, proved most productive of well-used publications in the field. Don currently writes the monthly *Malecki on Insurance*, an excellent source of information and informed opinion on a wide variety of property and casualty insurance-related matters. We are lucky enough to publish relevant questions and answers from Don in issues of the *CLEWS* newsletter—this issue is no exception.



■ *Immediately preceding the CLEW Interest Group Mock Trial at the Annual Meeting and Seminars in Honolulu, James A. Robertson, CPCU, ARM, (right) presented the first annual George M. Gottheimer Award to Donald S. Malecki, CPCU.*

Like award namesake George Gottheimer, Don was a teacher for many years. He taught CPCU courses through his local CPCU Society chapter in Cincinnati, Ohio, as well as at Miami University of Ohio and the College of Business Administration of the University of Cincinnati.

Since receiving his CPCU designation in 1970, Don has been serving the Society in a variety of capacities, including his current position on the CLEW Interest Group Committee. There is probably no other individual who has presented more programs for CPCU Society members. His curriculum vitae lists more than 120 presentations made in the form of seminars, symposia, and workshops just in the last 10 years. Many of them require travel from one coast to the other, and some have been delivered in foreign countries. His seminars at the Society's Annual Meetings and Seminars are always among the best-attended events of the week.

It was with great pleasure that colleague **James A. Robertson, CPCU, ARM,** presented Don with the 2007 George M. Gottheimer Award, on which the citation reads:

> The Consulting, Litigation, and Expert Witness Section of the Society of Chartered Property Casualty Underwriters presents the George M. Gottheimer Award to Donald S. Malecki, CPCU, in recognition of his exemplary contributions in the fields of insurance and risk management consulting, service as an expert witness, and generous contributions of time and knowledge to the CLEW Section and the CPCU Society. Presented at Honolulu, Hawaii this ninth day of September 2007.

The award is signed by **Daniel C. Free, J.D., CPCU,** chairman of the CLEW Interest Group, and **Betsey Brewer, CPCU,** 2006–2007 president of the CPCU Society.

We all join in congratulating Don for his well-earned honor. And it's never too early to start thinking about which worthy individual should be the recipient of the 2008 George M. Gottheimer Award—nominations are welcome! ■

Letter to the Editor

I did want to comment on J. Carlton Sims' article on pre-judgment interest. While the point that the amounts of such interest can be significant and should not be overlooked when considering an SIR or other portions of an insurance policy is well made, the reason for pre-judgment interest is really not to "level the playing field" and pressure the insurer into settling a liability claim, although it might have that effect. The various state statutes are to recognize the time value of money for the injured party and that their day in court (and thus their judgment) may take months if not years and that they should, if a judgment is entered in their favor for damages, receive an award in today's dollars.

In most states, legal action has to be initiated for such interest to apply; as you know, many claims are settled without the claimant actually filing a complaint with a court of competent jurisdiction. In those cases, the pre-judgment interest usually does not apply (although a settlement amount may well take into account such interest costs).

For context, the standard ISO CGL policy (12/2004 edition and prior editions) pay pre-judgment interests as a Supplementary Payment and thus in addition to the limit. In contrast, the ISO Business Auto Policy (03/2006 edition and prior editions) will pay pre-judgment interest, but will consider such interest costs as damages and thus payments will be included within the limit. Commercial Umbrella policies vary on this issue, but some (for instance AIG's Prime Form—2007) will pay pre-judgment interest on the umbrella insurer's portion of the damages (but will not pay any interest after the insurer makes a settlement offer) to the extent that the underlying insurer does not cover pre-judgment interest.

Craig F. Stanovich, CPCU, CIC, AU
Principal and Consultant
Austin & Stanovich Risk Managers LLC
Douglas, MA

Up-and-Coming Lawyers—Robert H. Fennessy

Animal-Rights Lawyer Earns National Rep

by Alyssa Cutler

Editor's note: This article originally appeared in *Massachusetts Lawyers Weekly* on August 20, 2007, and is reproduced here with permission from *Lawyers Weekly*.

As deputy director of law enforcement at the Massachusetts Society for the Prevention of Cruelty to Animals from 1978 to 2001, Robert H. Fennessy seemed destined to one day practice animal law.

And, indeed, since becoming an attorney in 2002, the 51-year-old sole practitioner has made it his life's work to advocate for victims who don't have a voice—or specific laws to protect them—in society.

With few other attorneys in Massachusetts practicing in a field that offers only modest financial incentives, Fennessy continues to make a name for himself as the state's go-to animal lawyer.

But Fennessy has faced major barriers in his efforts to protect and seek justice for his clients' four-legged companions.

That's because the laws in Massachusetts are not pet-friendly, according to Fennessy.

"Animals are looked at as property—[they] depreciate in value like a car. My argument is that [they are] appreciating like a fine wine," says Fennessy. "[There is a] lack of acknowledgement by the courts that animals are more than just property, hence the reason why most attorneys won't take an animal case. Who's going to pay the legal bills?"

Since the laws in Massachusetts typically are not conducive to multi-million-dollar awards in animal cases, Fennessy himself supplements his practice by taking on family and employment law cases.

But Fennessy says that the demand for animal-law attorneys is rising, as is evidenced by the numerous animal-law programs he has taught at law schools in the area and across the country.

"An animal is not just a piece of equipment; it is a living being," says Fennessy. "The person who loses an animal at the hands of a vet or kennel should be compensated as if they lost an heirloom, child, or spouse."

Most recently, Fennessy represented several clients in a class-action lawsuit in California involving the tainted pet-food scandal. His caseload also includes brokering a horse deal, dog-bite incidents, and matters involving town ordinances and veterinary malpractice.

"Vet-malpractice cases are a consistent theme," adds Fennessy. "They are much like medical malpractice, but [it is] harder to get a positive outcome because your client can't speak."

Although obtaining a monetary award or working out a conflict for his clients is his main objective, there is also an emotional side to Fennessy's work.

"Like most cases, a figure is offered and a client has to decide to go forward or end it all," he says, noting that the loss of a pet for most clients is like the loss of a family member. "Sometimes I'd like to pursue [a case] to change the law, but it is up to the client."

Despite the setbacks in Massachusetts with regard to animal law, Fennessy has no plans to slow down.

"People know me by what I do and seek me out," says the Walpole solo who once had a woman in California contact him on a case.

"I'm a very sensitive person; when clients get emotional, I do, too," says Fennessy. "A case like that is more than someone suing someone for damage to a car."

To that end, Fennessy is trying to get recognition for the field so that "the courts and judges recognize there is more value in an animal than just a piece of property. [I'm] very optimistic that we're moving in the right direction to bring these things forward. It's a burgeoning field of law, a very important field of law, and hopefully someday a self-sustaining [field of law]." ■

At a Glance: Robert H. Fennessy

Age: 51

Graduated: Southern New England School of Law, 2001

Position: Sole practitioner, Walpole

One thing about him that might surprise people: "In 2005, I was honored by my hometown as one of the 'One Hundred Historical Stars of Plainville' for the Plainville Centennial Celebration."

Owner-Controlled Insurance Programs (OCIPs):

The Good, the Bad, and the Ugly

by Keith G. Bremer, J.D., and Raymond Meyer Jr., J.D.

- **Keith G. Bremer, J.D.,** is a founding principal of Bremer Whyte Brown & O'Meara LLP, and concentrates his practice in complex civil litigation, construction litigation, business litigation, and corporate law. He earned a bachelor of science degree in criminal justice from San Diego State University; and a juris doctorate degree from Western State University School of Law in San Diego, California.

- **Raymond Meyer Jr., J.D.,** is a founding member of Bremer Whyte Brown & O'Meara LLP, where he focuses his practice in the area of complex construction defect, general liability, personal injury insurance, and business litigation. He earned a bachelor of science degree in international business from New York State University; a master's in business administration from Golden Gate University; and a juris doctorate from Western State University in San Diego.

Owner-controlled insurance programs (OCIPs) have become commonplace in the residential tract construction industry in California. There are a variety of advantages to these insuring programs, and a variety of downsides too, depending where a given participant is coming from.

OCIPs are, under limited scrutiny, an easy means of getting a project or series of projects built by a given builder insured. Initially, it is the builder that negotiates for and secures the coverage for itself and any other (usually subcontractors) OCIP program participants the builder and its OCIP insurer will allow to be participants. The builder then requires the participants identify their own insurance costs and reduce their prices for the job accordingly as a means of funding the premium for the OCIP policy. The idea being that the builder intends to reduce overall project costs, including insurance costs by buying reduced cost OCIP coverage (compared to normal insurance costs) and by avoiding contractor markups on insurance costs. A single insurance carrier on the risk for claims can also result in more efficient and less expensive claim resolution. This promise is what sells OCIPs.

Contractors and subcontractors need to be cautious when participating in an OCIP project. They must ensure that the coverage offered by the OCIP is sufficient to replace their collective existing insurance coverage, and that the total cost for having and using (in the event of a claim) this insurance coverage makes financial sense to them.

The OCIP documents must be carefully reviewed and considered for each project, both by the builder and by other participants. Usually, the participation in an OCIP program is delineated in some form of project contract document. This often outlines in general reference terms the nature and extent of coverage and how it will be administered in the event of a claim. It is critical to note the contract may have binding effect between the contracting parties (usually builders and their subcontractors), but invariably these documents state that the actual coverage terms can only be determined from the policy itself. Thus, it seems that a review and understanding of the policy should be completed before agreeing to be a participant in an OCIP program.

Each OCIP is designed for a specific owner's needs for a specific project. The following overview of OCIPs is a broad summary of applicable considerations and factors that should be taken into account when evaluating OCIP coverage.

OCIP Coverage in General

In an OCIP, the builder (or maybe the owner) purchases insurance for other participants in a construction project. OCIPs also are sometimes called "wrap-ups." An OCIP will frequently cover the owner, general contractor, and subcontractors. An OCIP also *may* include design professionals and certain product suppliers. The coverage can include general liability (CGL), builder's risk, workers compensation, and professional design errors and omissions coverage. It may also include excess, umbrella, and other special coverages.

The coverage provided by an OCIP is based on an OCIP policy document. It may also be summarized in a document identified something like "OCIP Addendum," "OCIP Exhibit," or "OCIP Manual." This kind of document may describe the project bidding and insurance rate identification and "deduct" process, claims management, and safety requirements. This important document is normally made a part of any bid solicitation and of ultimate contract documents. The "OCIP Administrator" administers the OCIP program. The "OCIP Administrator" is either someone from the builder's company or an independent insurance professional who acts as an agent of the owner and usually

is supplied by the broker that set up the OCIP Program.

The OCIP participants (subcontractors usually) who obtain the coverage benefits from the OCIP must give the owner credit for this insurance coverage. This is the "bid deduct" process. There are two basic methods for the bid deduct process. In one, the owner can ask that all interested contractors and subcontractors provide a price for the work, which excludes insurance. Each proposal must be reviewed by the OCIP administrator to determine whether the price accurately reflects the elimination of contractor insurance costs. This can be a time-consuming process. In the second approach, all interested contractors and subcontractors are asked to submit proposals that include insurance costs. When the contract is awarded, the OCIP administrator will calculate a deductive change order for the successful contractor's and subcontractors' insurance costs. This second method requires that only those subcontractors whose bids for the project are accepted be reviewed for a deduction of insurance costs.

Other general aspects of common OCIP policies include coverage for claims under all applicable statutes of limitations, broad coverage inclusions, including completed operations coverage, and some kind of self-insured retention or deductible that comes into play if a claim triggers the policy.

What Are the Benefits to an Owner or Builder of an OCIP Policy?

Traditionally, an owner/builder accepts the economic risk of a project, but seeks to avoid the construction risk. An owner/builder typically would retain a design team to provide the designs for the project. Alternatively, an owner may hire a design-build contractor to be responsible for constructing the project for a fixed price or a guaranteed maximum price. Under either scenario, there are contractual provisions that transfer the risk of loss and the responsibility of purchasing the necessary insurance downward from an owner to builder and builder to subcontractors and designers.

An OCIP somewhat changes this approach. The owner/builder becomes responsible for insuring the project and for administering loss prevention programs and becomes exposed to the risk of increased premiums for unexpected losses. Although this is true in almost every case, from a practical standpoint the total costs for these programs is often defrayed by contractual provisions in the operative project documents requiring OCIP participants to fund a large share of the premium and deductible/SIR in the event of a claim. In exchange for assuming these risks, the owner/builder hopes to obtain insurance cost savings overall.

The Benefits of an OCIP

Cost savings are the primary advantage of an OCIP. The owner/builder always indirectly bears the cost of insurance on a construction project. The design consultants, contractor, subcontractors, and other parties involved in the project include the cost of project insurance in their bid pricing. It has been said by the insurance industry that savings can be obtained by using an OCIP. The savings come from: (1) the elimination of contractor mark-up of insurance costs; and (2) the ability to obtain insurance at a lower cost than contractors, subcontractors, and others can obtain it for.

An OCIP also can provide increased coverage limits. The typical contractor or subcontractor has liability coverage in the $1 million to $2 million range. OCIP liability limits may be $5 million or more for primary coverage, with additional excess coverage. OCIP coverage may be broader than that available to contractors. In some cases such as condominium projects, contractors and subcontractors, often are not able to obtain coverage at all.

> ***It has been said by the insurance industry that savings can be obtained by using an OCIP.***

OCIP coverage also is consistent across the board for all participants, rather than varying from one company to another, which is usually what the situation is when each company involved in a project has its own insurance. Even though contractors and subcontractors usually provide certificates of insurance evidencing coverage limits, the specific endorsements and limitations of their particular policies may not be fully disclosed. It also is possible that a contractor's or subcontractor's policy limits have been depleted by payments on claims on other projects, which may not be evident to the owner or builder from the evidence of insurance he or she gets for a given project.

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Owner-Controlled Insurance Programs (OCIPs)

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A key part of OCIPs is a uniform risk management program. The OCIP administrator has overall responsibility for safety and loss control on the project. The OCIP administrator also will handle claims. This centralized management, in theory, can result in cost savings from improved safety, increased loss control, and more efficient claims handling.

The Disadvantages of an OCIP

The promise of cost savings may be illusory, both to the owner or builder and to the lower-tier participants such as the subcontractors. Administration of an OCIP will impose new, additional costs on the owner. The owner, through its OCIP administrator (in house or out-sourced), becomes responsible for safety and claims management on the project. The OCIP administrator will need to administer the bid-deduct process. The actual experience of owners suggests that the promised cost savings of an OCIP may not always be fully realized.

> ***Under an OCIP, it may be more difficult to manage the performance of contractors and subcontractors that have insurance-related claims.***

The insurance premium/loss risk is shifted from the contractor and subcontractors to the owner. The owner may be exposed to the risk of premium increases if labor costs and loss experiences exceed estimates. But, it also is possible that an owner will benefit from premium rebates if claims are less than anticipated. Premium rebate benefits have historically been very rare for these programs, however.

Under an OCIP, it may be more difficult to manage the performance of contractors and subcontractors that have insurance-related claims. For example, a subcontractor with an insurance claim for damaged work may wait for the owner's OCIP administrator to settle the claim before repairing the work. It may be more difficult for the owner to enforce contractual obligations to repair the work and proceed before disputes are resolved when the subcontractor asserts that the owner's OCIP administrator is delaying adjustment of the claim.

An OCIP also may discourage bidders. Contractors and subcontractors may be hesitant to bid on the project because they are unfamiliar with OCIPs. Potential bidders may have concerns about unfair calculations of credits for insurance costs during the bid deduct process, about uncompensated overhead resulting from new administrative responsibilities for the OCIP, and about loss of mark-up on insurance costs. Further, these potential participants may shy away when they learn of the often large or unilaterally imposed deductible or SIR obligations that will be imposed on them in the event of a claim under the OCIP. The owner or builder generally retains absolute right to trigger the OCIP, and if he or she does so and unilaterally involves a given OCIP participant in an OCIP claim, these financial obligations may be a deterrent.

What Coverage Does an OCIP Provide?

Who Is Covered?

OCIP coverage will include the owner and the general contractor. Coverage also will include subcontractors but may limit coverage to subcontractors with contract values over a certain amount, such as $25,000. In that case, subcontractors with contracts for less than $25,000 should be required to provide certificates of insurance. Coverage also may be limited to those providing direct labor to the construction site. Therefore, material suppliers typically are not covered. There are some OCIPs that do not cover design professionals, such as architects and engineers, though some do.

What Is Covered?

OCIP coverage will be tailored specifically to the project. In general, coverage will include workers compensation/employer's liability, general liability (CGL), and builder's risk property insurance. Coverage generally is limited to operations at the project site during construction. The OCIP typically will not provide coverage for off-site operations, including work and transportation, and for post-completion on-site work, such as warranty work. Accordingly, contractors and subcontractors must be required to provide proof of insurance by their own carriers for non-covered activities. Commonly, there is "tail" coverage, which extends coverage for all project-related statutes of limitation.

OCIP programs also usually offer excess or umbrella coverage. Less commonly, an OCIP will provide for design errors and omissions coverage. Such coverage is included when the design professionals are included in OCIP coverage. Such coverage, however, also will be necessary for contractors to the extent that any portion of their scope is design-build.

OCIP coverage generally does not include surety bonds. An OCIP may include subcontractor default insurance, however.

Contractual Indemnity Issues

The existence of an OCIP does not eliminate the need to include provisions in applicable contracts that address contractual indemnity. Usually, owner and builders include a broad indemnity clause in the construction contract as a second basis of protection from loss. It is becoming more and more common to see a limitation clause indicating the contractual indemnity provisions only apply to the extent the project OCIP does not fully cover a claim. Such provisions tend to balance out the risk/benefit to all OCIP participants.

What an OCIP Means to the Contractor and Subcontractors

When an owner implements an OCIP, participation is often mandatory for the contractor and subcontractors. While OCIPs often are touted as having benefits, these benefits usually mostly accrue to the owner. An OCIP imposes real risks to and expenses on contractors and subcontractors, and they must be carefully managed.

The contractor must carefully review the OCIP manual before submitting pricing. OCIPs commonly require the contractor to submit pricing with the cost of insurance included. The contractor then must complete an OCIP Enrollment Form to become eligible for the OCIP. Once the OCIP insurance is issued, the cost of the contractor's insurance is deducted from the contractor's pricing.

Subcontractors must carefully read and understand the provisions that inform them what their financial exposure is should a claim be tendered to the OCIP and they are involved. There may be immediate and up-front obligations to pay large SIRs, even though a subcontractor may seriously question the legitimacy of a builder or owner involving it in a claim.

The Benefits of an OCIP to a Contractor or Subcontractor

An OCIP may provide greater limits for primary and excess or umbrella coverage than the contractor's or the subcontractor's regular policy. This may prove beneficial in resolving defect claims. In addition, because a single carrier insures all of the participants in a project, claims resolution may be easier.

An OCIP also may allow a contractor to engage in work that it may not otherwise be able to obtain. Many contractors and subcontractors cannot take work involving multi-family residential structures. Such projects have been plagued by claims and lawsuits for years, and as a result, such work usually is excluded from insurance coverage. An OCIP provided by the owner-developer may be the only way a condominium project can be constructed with insurance.

Another great benefit is when a claim does come up under an OCIP, the loss history for such claims is not reflected on the participant's own insurance picture. This fact historically tends to help keep renewal costs down on the insurance the subcontractors have to otherwise maintain.

The Disadvantages of an OCIP to a Contractor or Subcontractor

The three major disadvantages of an OCIP are: (1) possible gaps in coverage; (2) OCIP deductions that exceed actual insurance cost savings, and (3) uncompensated administrative costs.

The prudent contractor must do more than review the OCIP manual for a summary of the coverage provided. The contractor should request copies of the OCIP policies and have the policies reviewed by the contractor's broker or attorney for the coverage it offers. This is especially true for general liability and builder's risk policies, which can vary significantly between policies. Critical liability insurance issues include whether the policy provides "broad form" coverage, how long the "completed operations" coverage continues, and what exclusions are included. It is also critical to determine whether total coverage limits seem adequate for the total amount of units to be built under the term of coverage.

The contractor must carefully review and complete the OCIP Enrollment Form. The format of OCIP Enrollment Forms varies. The form must be carefully scrutinized to ensure that it allows the contractor to show its true cost of insurance. If all discounts and credits are not reflected, the OCIP deduct will exceed the true cost of the insurance.

If the contractor has any flat-rate premiums, this should be carefully noted. The OCIP deduct should not include any flat-rate premiums because the contractor is unlikely to receive credit from its insurer for the OCIP-provided coverage.

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The contractor also should ask the OCIP administrator for a complete breakdown of the eventual OCIP deduct, and should be prepared to challenge an excessive deduction.

The OCIP enrollment process, the submission of monthly insurance-related information such as payrolls, and the OCIP deduct review process can impose a significant administrative cost on the contractor. It is unlikely that the owner will agree to compensate the contractor for these additional costs.

The timing of the OCIP deduct process also may cause problems. The OCIP deduct is usually taken through owner-issued deductive change orders. The initial OCIP deduct may be applied to a single progress payment, which may significantly reduce a month's cash flow. The OCIP deduct process also affects change orders. The owner generally will request that the contractor provide additive change orders with insurance costs included. When the additive change orders are numerous or constitute a large dollar volume, the OCIP deduct process for change orders may be slow. The owner will hold final payment until the OCIP administrator can calculate the total amount of the deduct for change orders.

What Is Covered?

OCIPs usually provide workers compensation/employer's liability, general liability (CGL) and builder's risk coverage. The coverage has two basic limitations: (1) coverage is restricted to activities at the project site; and (2) coverage, with certain limitations, ends upon completion of the project. In an effort to maximize cost savings, the owner may select a less expensive policy, which leaves the contractor at risk after project completion.

The contractor should be wary of "modified occurrence"-type policies, which provide coverage only for claims made during the policy year. Also, it is important to confirm that there is

"completed operations" CGL coverage. Further, certain policies may only provide "completed operations" coverage for a limited time period such as for three or five years after project completion. If this period is less than 10 years, there may be uninsured exposure to liability for construction defects because such actions may be brought for up to 10 years after completion of the project, particularly for latent defects.

What Is Not Covered?

OCIP coverage should be reviewed to determine whether it is as broad as needed to replace the contractor's existing policies. The existing policies must be maintained because off-site work incidental to the project is generally not covered by most OCIP programs. Warranty work and call-backs also generally are not covered after completion of the project. There are major concerns about whether OCIPs will cover state statutory claim processes, such as California's "SB800" process.

Conclusion

OCIPs are the wave of the future, and clearly have both benefits and disadvantages that need to be carefully weighed when considering an OCIP program. For owners and developers, OCIPs may bring real benefits in the form of cost savings. These cost savings, to some extent, are counterbalanced by increased administrative costs and exposure to risk. For contractors and subcontractors, OCIPs can be survived. It is important to carefully review the coverage provided by the OCIP and to manage the method by which insurance costs are deducted to ensure that the process accurately reflects the true cost of insurance. ■

Are Policyholders Left in the Lurch When Insurance Companies Refuse to Settle?

by John B. Berringer and Natasha Z. Millman

Editor's note: This article originally appeared in Volume 16 Number 3 (May/June 2007) of the Anderson Kill & Olick, P.C., *Policyholder Advisor* and is reprinted here with permission. The firm may be contacted through its web site at www.andersonkill.com.

Policyholders facing substantial liability from products liability or "mass tort" claims are often presented with an additional dilemma: what to do when their insurance company either refuses to get involved in settlement negotiations or, even worse, affirmatively refuses to authorize the policyholder to settle the claims. In the first scenario, an insurance company may, in effect, leave the policyholder to its own devices, while continuing to reserve its purported right to deny coverage. In the second scenario, an insurance company may decide to "roll the dice" on the first of a host of similar claims, even though a loss may expose the policyholder to judgments in subsequent cases far in excess of the insurer's policy limits. The good news for policyholders is that such conduct by an insurance company may free the policyholder to settle the case on its own and then recover the cost of the settlement as damages from its insurers. Moreover, the policyholder may even be entitled to punitive damages and attorneys' fees, at least in some states.

Background

There is a fundamental principle of insurance law that has been validated by courts around the country: once a liability claim has been settled by a policyholder, the relevant inquiry is whether the claim was covered under the policyholder's liability insurance, and not whether the claim, if brought to trial, would have resulted in a judgment triggering the insurance policy's coverage.

Courts around the country have uniformly held that once an underlying action is settled, an insurance company must provide coverage to the extent the settlement compromised claims that are covered by its policy. Thus, the only relevant inquiry in a post-settlement coverage dispute, aside from whether the amount paid was reasonable, is whether the claim as settled is covered by the policy at issue.

Because only claims as settled are relevant, numerous other courts have similarly held that no party is ever entitled to retry an underlying claim in a coverage action. The actual merit of the underlying claim is simply irrelevant in a post-settlement coverage dispute. As one court explained, a party "need only prove the underlying claims were covered by the policies . . . [T]o require claims to be actually proved in an action to enforce a settlement would defeat the purpose of settlement agreements."

When Insurance Companies Refuse to Settle

Courts around the country also have held that a liability insurance company's unreasonable refusal to settle a claim will free a policyholder of any obligation to seek the insurance company's consent before settling an action. In fact, an insurance company may be liable to its policyholder for damages sustained by the policyholder due to the insurance company's bad faith or negligent refusal to settle a claim within policy limits. Under Georgia law, for example, an insurer "is negligent in failing to settle if the ordinarily prudent insurer would consider choosing to try the case as creating an unreasonable risk." Moreover, although the law is uncertain on this point, there is case law indicating that an insurance company may be held liable for tortious refusal to settle for failing to initiate settlement negotiations.

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Are Policyholders Left in the Lurch When Insurance Companies Refuse to Settle?

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Alabama law similarly holds that if an insurance company fails to settle a case against its policyholder—either negligently or in bad faith—the insurance company may be liable for the full amount of any judgment, including any excess over the policy limits. The insurance company will be liable in negligence for any excess judgment if it fails to exercise "ordinary care" to "ascertain the facts" necessary to make a settlement decision, and if it fails to make a settlement "when such knowledge would have caused a reasonably prudent person" to settle the action. However, if it is shown that the insurance company made an investigation and ascertained the necessary facts, and refuses to settle based upon an "honest judgment" that settlement is "not warranted," then the insurance company will not be liable for negligence.

Although most of the reported decisions on this issue have dealt with the far more common scenario of contentions that an insurer should have settled a case that ultimately was tried and resulted in a greater-than-limits verdict, the principles developed in these "failure-to-settle" cases should apply equally to cases where a policyholder has settled the action without the insurance company's consent, rather than risking an excess verdict by going to trial. In fact, a number of courts have applied identical reasoning in cases where a settlement was achieved by the policyholder after an insurance company's wrongful refusal to settle.

As far back as 1942, a court held that the duty of good faith "applies with equal force to a prudent settlement made by the assured in the face of a potential judgment far in excess of the limits of the policy." *Traders & General Insurance Co. v Rudco Oil & Gas Co.*, 129F. 2d 621 (10th Cir. 1942). That court concluded that before an insurer may interpose the policyholder's settlement of the underlying action without consent as a defense, the insurer must show that it acted in good faith in rejecting the settlement offer. In *Rudco*, because Traders had acted in bad faith in rejecting a settlement offer, Rudco was relieved of its contractual duty to refrain from settling the underlying action, and Traders was held liable for the settlement.

The *Rudco* court noted that a policyholder should not "be required to wait until after the storm before seeking refuge" when faced with "a potential judgment far in excess of the limits of the policy." Significantly, absent evidence of collusion between the policyholder and the underlying plaintiff, courts around the country have cited *Rudco* with approval.

In yet another case, the Fifth Circuit commented that:

> It is well established that the law imposes upon the insurer the duty to exercise diligence, intelligence, good faith, and honest and conscientious fidelity to the common interest of the insured as well as itself in determining whether to accept or reject an offer of settlement. While the insurer may properly give consideration to its own interest, it must in good faith give at least equal consideration to the interest of the insured, and if it fails to do so, it acts in bad faith. *State Farm Mutual Auto Insurance Co. v Smoot,* 381 F 2d 331 (5thCir. 1967).

Significantly, the *Smoot* court also held that punitive damages were available under Georgia law to the extent that the insurance company's refusal was willful and in reckless disregard of the policyholder's rights, and that an award of attorneys' fees was available under Georgia law if the insurer acted in bad faith. *Id.* at 338-39. While punitive damages generally are not available under Georgia law for breach of contract, where an insurer acts with "such entire want of care amounting to a conscious indifference to the consequences," this may constitute tortious conduct making punitive damages authorized in any action for negligence or the intentional tort of bad faith.

Conclusion

A policyholder facing "bet the company" liability from product liability, "mass tort," or other forms of liability need not "roll the dice" when its insurance company unreasonably refuses to participate in settlement negotiations or even when its insurer affirmatively presses to try the underlying claims. Under well-recognized law in many states, a policyholder in such circumstances should be entitled to settle the underlying claims and then look to its insurance company for reimbursement of the settlement costs, along with punitive damages and attorneys' fees in some states. ■

2007–2008 CLEW Interest Group Committee

Chairman
Daniel C. Free, J.D., CPCU, ARM
Insurance Audit and Inspection Company
Indianapolis, IN
Phone: (317) 259-1013
E-mail: dfree@insuranceaudit.com

Webmaster
Vincent D. Boylan Jr., CPCU
Hilb Rogal and Hobbs Company (HRH)
Rockville, MD
Phone: (301) 692-3068
E-mail: vincent.boylan@hrh.com

Newsletter Editor
Jean E. Lucey, CPCU
Insurance Library Association of Boston
Boston, MA
Phone: (617) 227-2087
E-mail: jlucey@insurancelibrary.org

Nancy D. Adams, J.D., CPCU
Mintz Levin
Boston, MA
Phone: (617) 348-1865
E-mail: nadams@mintz.com

Joseph Gerald Burkle, J.D., CPCU
EMC Insurance Companies
717 Mulberry
Des Moines, IA 50306-0712
Phone: (515) 345-7881
E-mail: joe.g.burkle@emcins.com

Gregory George Deimling, CPCU
Malecki Deimling Nielander and Associates LLC
Erlanger, KY
Phone: (859) 342-2266
E-mail: greg.deimling@mdnconsults.com

John G. DiLiberto, CPCU, CLU, ChFC
John G. DiLiberto Insurance Consultant
Plainedge, NY
Phone: (516) 840-3789

Donald S. Malecki, CPCU
Malecki Deimling Nielander & Associates LLC
Fort Thomas, KY
Phone: (859) 441-4545
E-mail: dsmmcc@insightbb.com

Donn P. McVeigh, CPCU
Creative Risk Concepts International
Oakland, CA
Phone: (510) 531-9150
E-mail: dmcveigh@CRCinternational.net

James A. Misselwitz, CPCU
ECBM
Phone: (610) 668-7100
E-mail: jmisselwitz@ecbm.com

Norman F. Steinberg, CPCU
Mayer and Steinberg
Baltimore, MD
Phone: (410) 627-4040
E-mail: norman@mayersteinberg.com

Steven Arthur Stinson, J.D., CPCU
Stinson Forensic Insurance Consulting LLC
Palm Beach Gardens, FL
Phone: ((56)) 707-8707
E-mail: steve@stinsonforensic.com

Lawton Swan III, CPCU, CLU
Interisk Corporation
Tampa, FL
Phone: (813) 287-1040
E-mail: lawton.swan@interisk.net

Michael B. Vehec, CPCU
Erie, PA
E-mail: pattinwpa@ma.rr.com

George M. Wallace, J.D., CPCU
Wallace & Schwartz
Pasadena, CA
Phone: (626) 844-6777
E-mail: gwallace@wallace-schwartz.com

Douglas J. Zogby, CPCU
Got Game Consulting
Phoenix, AZ
Phone: (480) 272-7640
E-mail: dzogby@gotgameconsulting.com

Liaison
John J. Kelly, CPCU
CPCU Society
720 Providence Road
Malvern, PA 19355-3446
Phone: (610) 251-2773
E-mail: jkelly@cpcusociety.org

A Review of a TowerGroup Report

"Technology Direction in U.S. Property and Casualty Insurance Claims Operations: Transforming a People Business"

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.

Editor's note: This article is a review of the July 2007 TowerGroup Report from Karen Pauli, senior analyst, insurance.

It is clear that placing a value on some sorts of things is a pretty easy, or at least data-driven, process:

- A house: "comps" can be rather readily found.
- A thoroughbred stallion: data is available to gauge the potential future earnings as a sire.
- A car: there are books, blue and otherwise, albeit some may differ from others.

But the less things resemble "commodities," the harder they are to value in monetary terms. The example of pets, as contrasted with thoroughbred stallions, is discussed in the pages of this issue of the *CLEWS* newsletter and by George M. Wallace, J.D., CPCU, in the previous issue. Difficulties also arise in the realm of intellectual property. What is an idea worth? The future efficacy and value of patented devices may well be discernable to a venture capitalist, at least to a level facilitating an investment decision. When it comes to copy-written publications, things veer into the more subjective realm again.

All of this is by way of explanation why a 12-page report is on sale for $1,750 and why, depending on your particular circumstances, it may be worth the price.

TowerGroup analyst Karen Pauli has synthesized why and how insurance carriers must plan now to leverage technology tools in their claims operations. Relying on some data that is readily available from other sources, combined with primary research in the "claims space" that included interviews of insurance claims personnel, she has posited several cogent conclusions. It seems to me that, while some of them are intuitive, it is a good thing to have these conclusions and insights formalized in a document.

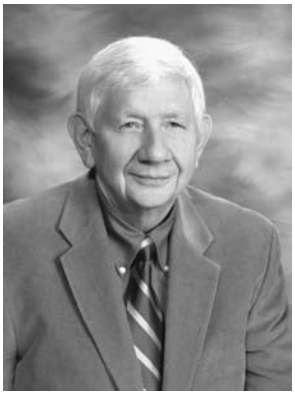
Perhaps the best way to impart the gist of the report is to reproduce the "TowerGroup Take-Aways" listed on the first page. They are:

- Historically, the claims departments of property and casualty (P&C) carriers have rejected technology because they considered claims adjusting an art laden with nuance and subtleties.
- Time-intensive, process-driven, and impersonal claims settlement practices drive profitable producers and customers straight to carriers that can provide exemplary service.
- Loss of claims experience due to the retirement of claims adjusters of the baby boom generation will increasingly threaten the capabilities of many carriers over the next 10 years.
- Carriers must aggressively manage all components of the claims settlement process to control expenses, stabilize results, and achieve competitive advantage.
- Unlike other carrier segments, in which leading-edge technology resulted in completely automated processes, the greatest benefit to claims operations will be decision support.
- Developing a business and technology plan for claims that fills requirements for the next three to five years is an imperative.

It seems to me that property and casualty insurance company management must be aware of the issues posed in this report, and must have plans to address them. Certainly, though, they cannot expect that a $1,750 investment will get them too far along in the process. It may be that Pauli's work only restates what they already knew. Then again, maybe some observation or suggestion contained in the 12 pages will be invaluable—possibly otherwise overlooked. As TowerGroup indicates on its web site, a goal of its research program is to provide "actionable insights:" it, as well as its peers in the consulting business, certainly offers customized services to determine just what those appropriate actions might be. ■

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 have noticed for a long time now that some construction contracts written by owners of projects require contractors to not only name the owners as additional insureds but also to cover the owner's officers, directors, and employees. When the owner is a partner or joint venture, the contract requires not only the partnership to be covered but also its partners and employees.

While some insurers may accommodate their contractor insureds and fulfill those requirements, we think it would be the exception rather than the rule. What we are wondering is whether you are aware of any cases that have been litigated over a contractor's failure to obtain additional insured status covering all the persons specified in the contract, and your opinion over the practice of promising coverage that is not delivered.

For as often as these contractual requirements have been made, and as frequent as additional insured court cases are, one would expect to see arguments over a contractor's breach of contract for failing to obtain the additional insured coverage for an entity (corporation or partnership) and its officers, directors, and employees. (Some contracts may even require coverage for an entity's agents.) Yet, there are no cases on this point, or if there are, they are very few in number.

Probably the reason for a dearth of these cases is that when a suit is filed, the plaintiff generally looks for the "deep pocket," which, in most cases, is the entity, rather than its executives, employees, and agents. An executive or employee could conceivably be singled-out when his or her conduct was egregious enough to prompt being named, but these cases are not known to exist.

Why a contractor or anyone for that matter would agree to add all of those persons as additional insureds is difficult to answer. Contractors may be under the assumption that additional insured status encompasses everyone. They may not care what the contract states so long as they are awarded the job. They can worry about problems later, if they should arise. There is also the possibility that contractors, and others who must agree to add others as additional insureds, are confused. After all executive officers and employees are commonly considered insureds under an entity's liability policy, why not also under an additional insured endorsement?

It does not take a rocket scientist to figure out that question; an additional insured endorsement does not commonly cover an entity's executives (partnership or corporation) and employees. Most additional insured endorsements describe the entity considered to be an additional insured and nothing more.

Today, more so than ever before, additional insured requirements must be in writing and with a copy of the endorsement accompanying a certificate of insurance. If the entity requiring additional insured status for itself and its executives and employees does not check the endorsement and reject it where coverage falls short of the requirements, there is a chance that if a dispute arises, at the time of claim or suit, a court could consider that requirement waived.

The basis for this statement—which by no means is this writer's opinion—is that some courts have ruled that when a noncomplying insurance certificate is not questioned until after a claim is made, the requirements that were to be reflected in the certificate are considered waived. One such case is *Geier v Hamer Enterprises, Inc.*, 226 Ill App 3d 372, 589 N.E.3d 711 (1st Dist. 5th Div. 1992).

This is a minority opinion, but since many court cases are like playing roulette, there is no telling what the outcome may be.

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Q&A with Donald S. Malecki, CPCU

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It is important to understand that whenever a contractor agrees to add an owner and its executives, employees, and others as additional insureds and the endorsement issued does not reflect that requirement, the contractor may be confronted with a situation of having to pay for defense costs out of its own pocket. The reason is that the failure to procure a required coverage is not the subject of insurance, and certainly not considered as contractual liability—contrary to what some people may think.

So far, contractors and others who have not fulfilled their additional insured requirements are fortunate, in light of the absence of any cases holding them to their promises and adding executives and employees as insureds. But they are playing with fire. Contractors fear they will not get the job if they do not meet the contract requirements. However, it is so much easier to ask for that added coverage and to inform the owner when that requirement cannot be fulfilled than to act as if these requirements are automatically fulfilled. Sometimes owners will back off from such unrealistic requests.

In the final analysis, it is wise not to agree to additional insured status covering every one of the entity's personnel when it is not possible to do so. It could end up where the contractor's payout in defense costs and indemnification may be more than the contract was worth. It also behooves owners and others who request additional insured status for the entity and its personnel to check the endorsement at the time of issuance and deal with it then. It may be a lot cheaper in the long run for them, too. ■

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CLEW Interest Group Chairman
Daniel C. Free, J.D., CPCU, ARM
Insurance Audit & Inspection Company
E-mail: dfree@insuranceaudit.com

***CLEWS* Editor**
Jean E. Lucey, CPCU
Insurance Library Association of Boston
E-mail: jlucey@insurancelibrary.org

Interest Group Manager
John Kelly, CPCU
CPCU Society

Managing Editor
Michele A. Ianetti, AIT
CPCU Society

Production Editor/Design
Joan Satchell
CPCU Society

CPCU Society
720 Providence Road
Malvern, PA 19355
(800) 932-CPCU
www.cpcusociety.org

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