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From the Chairman

by Patricia A. Hannemann, CPCU

Patricia A. Hannemann, CPCU, is the chairman for the CPCU Society's Risk Management Section. Her insurance career consists of more than 20 years' experience working in agencies and companies. Currently, she is working with The Insurance Society of Baltimore in promoting and teaching various insurance classes. Hannemann served as the CPCU Society's Maryland Chapter president and chaired both the Public Relations and Good Works Committees. The Maryland Chapter's CPCU Excellence Award was presented to her for spearheading the Good Works Committee and establishing the chapter's scholarship fund in connection with the SADD organization. Serving on the CPCU Society's Chapter Awards Task Force, she helped create and judge the current Circle of Excellence Award. Hannemann received her CPCU designation in 1987 and holds bachelor's and master's degrees in music from the Manhattan School of Music and a master's degree in business from Johns Hopkins University.

Our issues of the *RMQ* are beginning to flourish just like all opportunities a new year brings. Everyone is getting settled into a routine and I hope for our CPCU Society section members it includes actively participating—be it in your section, your local chapter, helping someone start, continue, or complete the CPCU designation, attendance at the CPCU Society's Annual Meeting and Seminars, etc. Here's something to ponder:

> Xvxry pxrson is important, rxgardlxss of the amount of timx you spxnd, you arx a kxy pxrson. You may say to yoursxlf—wxll, I'm only onx pxrson who is unablx to attxnd or contributx. BUT, it doxs makx a diffxrxncx bxcausx an xffxctivx organization nxxds activx participation by xvxry mxmbxr, rxgardlxss of how small thx xffort sxxms. So thx nxxt timx you think you arx not important just rxmxmbxr—you arx a kxy pxrson.

Now for those of you who thought to yourself—she's lost it—I apologize for changing all of the "e"s in the above paragraph. As on a keyboard (computer or a piano—remember my musical background), every "kxy" or "notx" is important, so don't miss an opportunity.

Our editors have assembled another interesting and diversified *RMQ* with articles written by **Donald S. Malecki, CPCU, Demmie Hicks,** and **George L. Head, Ph.D., CPCU, CLU.** We've presented you with a lot of reading on several topics but the articles are well worth the effort.

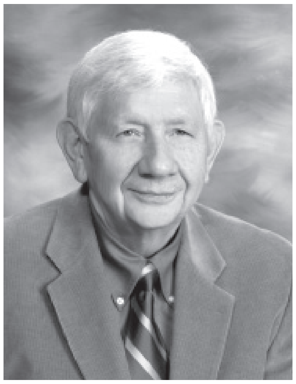
As our section grows and flourishes, those of us on the committee planning the future of the section hope you will take the time in this new year to offer ideas, visit our web site (we're working on it), and participate. ■

What's In This Issue

Contractual Liability: When Is a Contract Executed?

Some Risk Management Considerations to Avoid Problems

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, insurance company claims consultant, and as publisher of *Malecki on Insurance,* a highly regarded monthly newsletter.

Malecki is the author of 10 books, including three textbooks used in the CPCU curriculum. He is past president of the CPCU Society's Cincinnati Chapter; a member of the American Institute for CPCU examination committee; an active member of the Society of Risk Management Consultants; on the Consulting, Litigation, & Expert Witness Section Committee of the CPCU Society; and a past member of the Commercial Lines Industry Liaison Panel of the Insurance Services Office, Inc.

Normally, businesses that engage the services of others require an execution of a purchase order agreement or contract as a condition precedent to performing the work or services. Sometimes the purchasing or risk management departments of companies get somewhat lax about these requirements. While they, of course, still require the execution of a contract, it sometimes is not done until after the work has been completed.

These situations are common when the same entity's services are required throughout the year. An example is when a building's property manager hires the same electrician or plumber to perform services on an as-needed basis. These parties contract with one another so often that each knows its respective obligations, even if they do not formalize their agreements until after work has been completed. Sometimes these services are required to be so prompt, as for example in emergencies, that the contract's execution is knowingly postponed.

Unfortunately, accidents sometimes happen while work is being performed. When they do, and they involve subsequent claims or suits, questions sometimes arise regarding the timing of the contract's execution, particularly from among insurers.

Consider the situation where a manufacturer includes a hold harmless and indemnification in its purchase order agreements. An employee of a servicing contractor is injured on the premises and sues the manufacturer for failing to provide a safe place to work. The manufacturer, in turn, looks to the servicing contractor for protection, since the manufacturer's customary contract requires it to be held harmless for these types of incidents.

If the manufacturer's contract is otherwise valid and enforceable but was not signed until after the accident, the servicing contractor's insurer will likely balk at providing protection. The probable rationale for doing so is based on the contractual liability exclusion (2. b. [2]) of current commercial general liability policy provisions stating that this insurance does not apply to:[1]

> b. Contractual Liability
> "Bodily injury" or "property damage" for which the insured is obligated to pay damaged by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages: . . .
>
> (2) Assumed in a contract or agreement that is an "insured contract," *provided the "bodily injury"* or *"property damage" occurs subsequent to the execution of the contract or agreement. . . .* [Emphasis added.]

For history buffs, the above italicized wording was first introduced in standard liability policy provisions with the introduction of the Broad Form CGL Endorsement in 1976. When the CGL provisions were amended in 1986, there was no reference to the above italicized wording. Instead, subparagraph g. of the "insured contract" definition (currently subparagraph f.) stated that also covered was that part of any other contract or agreement . . . under which the named insured assumed the tort liability of another to pay damages because of bodily injury or property damage. . . *if the contract or agreement was made prior to the bodily injury or property damage*. [Emphasis added.]

It was with the 1988 CGL policy revisions of ISO that the italicized wording in subparagraph g. was moved to its current location within the contractual liability exclusion. Also, the word "execution" was introduced with the 1986 provisions.

The Big Question

An important question that comes up when reviewing the requirement that bodily injury or property damage or both arise after the contract is executed, is exactly when a contract is considered to be executed. Because all standard editions of the ISO-CGL forms issued beginning with the 1986 edition encompass oral and written contracts, the prevailing view is likely to be that there is no potential for problems. Yet, there are a number of factors that can still lead to disputes over whether a contract has been executed prior to any injury or damage.

One such important factor to consider is that many commercial general liability policies being issued today are non-standard in the sense that they are issued as independently filed policies of insurers or are issued by insurers in the excess and surplus market. Some of these forms may limit the definition of insured contract to written contracts.

With oral contracts, one of the parties may disavow specific contract terms inadvertently, or by design for self-serving purposes. Also, the contract itself may be disputed for a variety of reasons.

The Bottom Line

If there is any good news about these problems of a claim and suit involving contractual liability where injury or damage or both have occurred prior to the execution of a contract, it is that the courts appear to side with the parties, rather than with insurers. Of course, as time progresses and more of these types of cases arise, the outcome may be different.

It is difficult to even generalize about what the courts' rationale is but it appears to be that when parties contract with one another, there is at least oral agreement or implied understanding as to the contract's terms, even if there is no written proof. Another obstacle confronting insurers is over the meaning of an executed contract.

The bad news is that whenever an insurer disputes a claim or suit because a contract had not been executed prior to the injury or damage—and claims people are commonly the first people to read contracts after they are signed—it is going to cost time and money to get the matter resolved.

It therefore makes good risk management sense to resolve this issue before it arises. Realistically, there are only two options. The first one, requiring that no work or service can be provided until a contract has been signed is something that is difficult to control, especially when time is of the essence. The second alternative is to define in any contract what "execution" means.

It may be necessary to hire a competent attorney to add the proper phraseology to accomplish this end; or, it may take a simple statement to the effect that the contract is deemed to be executed at the time there is oral agreement. Another alternative is to state that the contract is considered to be executed at the time of performance.

The bottom line is that, unless something specific such as the above is inserted in a contract addressing the matter of when a contract is executed, people are asking for an expensive problem that can be avoided. ■

Endnote

1. Copyright, ISO Properties, Inc., 2003.

Look First to Your Company's Culture to Ensure Ethical Health

by Demmie Hicks

Demmie Hicks is president and CEO of DBH Consulting, a firm specializing in growth strategies and organizational development including: leadership development (with a specialty in leadership development for women), perpetuation planning, and executive coaching.

At one time or another, every organization faces an ethical challenge. It may not even come close to the type of legal scandal we've seen with Enron and others, but even a seemingly innocuous (and legal) toe over a fuzzy ethical line can erode your firm's reputation and ultimate success.

Many organizations feel confident in their ability to stay out of ethical hot water—but in the midst of increasing pressures from the economy, shareholder expectations, and shrinking margins, how do you ensure that your organization remains ethically healthy throughout the ranks?

Our Company's Values Are Defined—Isn't That Enough?

One item you are likely to find in the lobby of many businesses is "The Plaque." It hangs on the wall, handsomely framed, perhaps bathed in a soft spot of light. This is the company's philosophy statement, expressing ideals such as "teamwork," "values," "integrity," and "customer service."

This statement is intended to serve as a rallying cry and to guide the behavior of the organization's members. However, there is a more potent force that influences what people do and how they behave: the organization's culture.

Culture goes much deeper than "The Plaque" possibly could. In fact, culture resides so deeply within the firm, the "rules" are generally not even written down. According to Edgar Schein, author of *The Corporate Culture Survival Guide*, culture is defined as the basic shared assumptions about what is important and how people in the company will behave. Culture operates unconsciously, yet it looms large and impacts a company's success in keeping ethical dilemmas at bay.

The challenge for leaders is that culture influences everyone in the organization. It can be an asset if it is consistent with the philosophy statement and supports the organization's objective. It becomes a liability when it is inconsistent with the values statement and limits an organization's ability to adapt to its environment and engage its members. Leaders are responsible for making sure that culture stays in the asset column.

Why Culture Is Important

Culture has been viewed by many as a "soft" business metric. However, a number of business analysts and researchers have presented hard data that shows corporate culture to be a strong indicator of a company's success. John Kotter and James Heskett's 11-year study of more than 200 blue-chip companies in 22 industries revealed that strong culture companies increased revenue by an average of 682 percent versus 166 percent for companies with weaker cultures (discussed in their book *Corporate Culture and Performance)*. They assert that "strong" cultures contribute to high levels of performance because they:

- Emphasize and balance needs of all constituents (customers, stockholders, employees).
- Value leadership excellence from all managers.
- Exhibit goal alignment—everyone marches to the same drum.
- Elicit unusual levels of motivation among employees, and therefore, foster a sense of inclusion.
- Often provide structure and controls without relying on stifling bureaucracy.
- Fit the demands of the environment.
- Adapt and support change.

In his book *Who Says Elephants Can't Dance?*, Louis Gerstner Jr., the former IBM chairman and CEO who engineered the computer giant's historic turnaround in the mid-1990s, says:

> I came to see, in my time at IBM, that culture isn't just one aspect of the game—it is the game. In the end, an organization is nothing more than the collective capacity of its people to create value.

Do You Know Your Roots?

The culture of a company can be traced directly back to the company's founding members and is carried forth by current leadership. Leaders naturally embed their own values into the company's culture. Employees intuitively "get" the culture when they experience which behaviors are rewarded and which behaviors are punished. This can be quite unconscious on the part of the leader—and at times may even contradict the company's stated values.

For example, one of your company's written values might be around "serving the best interests of our customers." If your company's leaders consistently reward employees who bring in high revenues, despite cutting corners on quality service, the staff comes to learn that "profitability" is valued more readily than customer service. Everyone may agree in discussion that customer service is an important value, but because actions speak louder than words, the employees in this environment will tend to obey the unofficially encouraged culture of profitability more than the stated "rule" of service. This can be daunting for a new employee who must navigate these invisible—yet palpable—culture indicators, and it creates an environment ripe for ethics violations.

Multiply this example by hundreds of behaviors within a given organization, and you can see why issues around corporate culture can become so challenging to pinpoint and manage.

Inherited Culture

When a new leader steps into the mix, there are increased opportunities to blur the rules of culture. New leaders coming in may have an urge to make rapid changes within the company. Ideally, they will first spend time getting to understand the company's culture right along with learning all of the other critical aspects of the business. If the new leader finds it necessary to change one or more facets of the company's culture, it will be easier for the culture to accept small and gradual changes—a ship can turn 90 degrees eventually, in well-paced three-degree increments.

Reflect for a moment about your company's culture. What components of your culture foster unwaivering commitment to ethical behavior? How does your culture invite ethical challenges? How did it get to be this way? Are your leaders sending mixed messages? Has your leadership team proactively brainstormed strategies to deal with ethical issues that you may encounter in the future? Deepening your understanding of your company culture in this way goes a long way toward ensuring that your organization stays in tip-top ethical health. ■

Risk Management Section Committee Members

■ *Risk Management Section Committee members met at the CPCU Society's 60th Annual Meeting and Seminars held in October 2004, to plan section activities. Pictured from left to right: Daniel J. Finn, CPCU; Patricia A. Hannemann, CPCU; James W. Baggett Jr., CPCU, CIC; Jane M. Damon, CPCU, CPIW, CIC; and George J. Kolczun Jr., CPCU.*

Why Link Risk Management and Ethics?

by George L. Head, Ph.D., CPCU, CLU

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Author's Note: Some of you may recognize my name because of my past work with the Insurance Institute of America's Associate in Risk Management (ARM) designation program. You may wonder why, as a fledging commentator for IRMI, I have now chosen to write commentaries on the general theme of "ethics and risk management." You may well wonder why because, in writing about risk management for more than 30 years before retiring in 2000, I have used the word "ethics" in print probably less than 100 times. For any who may wonder, I am still at the Institutes, but now serving as director emeritus, without any direct responsibility or authority. The ARM program, like the other Institute offerings on which I worked, are in new, fine hands. Check out the programs at www.aicpcu.org.

The theme "ethics and risk management" signifies that each of these two worthy disciplines—risk management and ethics—depends on the other. Good risk management requires good ethics; and good ethics require good risk management. This implies, from a positive perspective:

- First, for an organization to manage its risks well, everyone who represents that organization must practice good ethics.
- Second, for an organization to act ethically, everyone who represents that organization must manage risk well.

And, conversely, from a negative perspective:

- First, an organization that permits or encourages unethical actions by anyone who represents it is not practicing good risk management.
- Second, an organization that permits or encourages anyone who represents it to manage its risks poorly is acting unethically.

"Risk Management" and "Ethics" Defined

To see why good risk management and good ethics must go together—why each needs the other—please start with definitions of these two fields. *Risk management* is a process for making and carrying out decisions designed to minimize the adverse effects of accidental or business losses on an organization by reducing the number or size of these losses or by cost-effectively financing recovery from any such losses. I have been privileged to teach a definition much like this to those who earned the ARM designation. That was a five-step process, but other processes with as few as two steps or as many as 12 can be just as valid. (Risk management, like an orange, can be sliced various ways. The exact number of slices really is not crucial; what matters is that nothing is lost in the slicing.)

For *ethics*, any good college text on business ethics gives a definition comparable to: any system of guidelines for appropriate conduct toward others, aiming to comply with certain rules or to achieve certain results in particular types of situations. For example, a rule-based system of ethics emphasizes guidelines like "always tell the truth" or "never steal." A results-based ethical system emphasizes achieving "the greatest good for the greatest number" or directs, "act as you propose only if the world would be bettered by everyone in your situation also acting as you propose." In difficult situations, different systems of ethics may condone or condemn a specific action as ethical or unethical, especially with respect to different groups. Some examples will be presented later in this article.

Commonalities

First, however, to see why the fields of ethics and risk management need each other, consider the common ground they share. Ethics gives guidelines for appropriate actions between persons and groups in given situations—actions that are appropriate because they show respect for others' rights and privileges, actions that safeguard others from embarrassment or other harm, or actions that empower others with freedom to act independently. Risk management is based on respect for others' rights and freedoms: rights to be safe from preventable danger or harm, freedoms to act as they choose without undue restrictions.

Both ethics and risk management foster respect for others—whether they be neighbors, employees, customers, fellow users of a good or service, or simply fellow occupants of our planet—all sharing the same rights to be safe, independent, and hopefully happy and productive. Respect for others, whomever they may be, inseparably links risk management and ethics.

Examples

Now for a few of the many possible examples of this linkage, drawing on the four bulleted implications that opened our discussion:

First, for an organization to manage its risks well, all its people must act ethically. For example, if someone misrepresents an organization's product, the organization is vulnerable immediately to products liability claims, and in the longer run may lose its reputation and market share. Again, if one of an organization's executives treats any subordinate employee unethically, that employee (and a good number of his or her fellows) may lose enthusiasm for his or her work, may begin to take advantage of the employer in any of hundreds of little ways, or may simply find another job. Or if one employee discovers that a second employee is embezzling from the organization, the second employee's failure to report this dishonesty causes financial loss to not only the organization and to each of its owners but, in the long run, also to those who rely on that organization for their livelihood.

Second, if an organization is to act ethically, everyone who works for that organization must manage its risks well. The maintenance staff who takes out the organization's daily trash must dispose of it properly; otherwise, neighbors upon whom it is dumped may sue the organization and it, in turn, may face fines and injunctions for environmental pollution. Furthermore, the organization's risk management staff must be scrupulously honest in providing information to the organization's insurers, not only to be sure that the organization has a good reputation among underwriters (and therefore favorable premium rates, an element of good risk management) but also to be confident that the organization pays its ethically fair share of the loss exposures that are pooled through insurance.

These examples also illustrate the third and fourth, converse, negative implications bulleted above. The third implication—that permitting unethical behavior within an organization is poor management of that organization's loss exposures—is demonstrated by the careless conduct of the trash-disposal crew. Their actions are likely to bring on lawsuits and, in time, a loss of reputation and market share for the organization.

Fourth and finally, if an organization's most senior executives allow—or worse, encourage—its risk management personnel to withhold or misrepresent information in dealing with underwriters to purchase insurance this year on unfairly favorable terms, then—come renewal times for perhaps a decade to come—senior management's short-range misconduct jeopardizes the organization's insurance protection in the long run.

Conclusion

These examples aim to drive home the point that good risk management and good ethics support each other. Hopefully, they are clear and beyond debate. My goal here has been to make this link through these examples and this reasoning, to explain why good risk management and good ethics are, and need to be, linked.

These examples are not like the ones that will be the focus of future commentaries in this series. Nor in the future will I deal with the headlined specifics of alleged insurance or other scandal. In the future, I hope to present situations that are more common, that present real ethical dilemmas that arise in practical risk management. These will be situations where neither the good/bad ethics nor the good/bad risk management are so black and white, and where together we can reason through how best to let good ethics and good risk management work together for the ultimate benefit of all. ■

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