CPCU SOCIETY INSURING YOUR SUCCESS

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Chairman's Corner

Greetings to Risk Management Interest Group Members!

by Stanley Oetken, CPCU, ARM

Stanley Oetken, CPCU, ARM, is senior vice president in the alternative risk financing unit in Marsh's Denver office. He has been involved in servicing and marketing large corporate and public entity clients, and in the implementation and administration of professional liability programs for attorneys, accountants and real estate professionals. During his tenure at Marsh, Oetken has been actively involved with clients in areas such as the oil and gas industry, electric and gas utilities, and environmental remediation, among others. Oetken earned a bachelor's degree in mathematics from Wake Forest University in North Carolina and a master's degree in insurance management from Boston University.

I hope you were able to attend the CPCU Society's Annual Meeting and Seminars in September and that you attended the two seminars produced by your Risk Management Interest Group: "Workable Wrap-Ups for Large Construction Projects," co-produced by the Underwriting Interest Group, and "Workers Compensation for the 21st Century."

Through the tireless work of **Jerry Trupin, CPCU, CLU, ChFC,** we conducted a webinar in June, entitled "Contractual Liability — What's Covered and What's Not?", and are planning to present another one in late October. Please keep in mind that you may view archived, taped versions of all interest group webinars on demand by visiting the Society's Web site, www.cpcusociety.org.

I continue to be amazed by the work of our committee members. It makes me tired just to see all they are doing. I feel fortunate to just do my day job to the best of my ability and make it home each night!

Whether you are on the insurance company side, the brokerage side or the risk management side, we continue to be in challenging times. With the economy being the way it is, we face new "opportunities" each day. Please avail yourself of all the resources that the CPCU Society offers to assist you in making the most of those opportunities.

Again, please let us know if you are interested in participating on the Risk Management Interest Group Committee. We are very appreciative of those who are willing to get involved. ■

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Editor's Note

by Jane M. Damon, CPCU, CPIW, CIC

Jane M. Damon, CPCU, CPIW, CIC, is an assistant vice president and commercial account executive with Wachovia Insurance Services in Dallas, Texas. She earned a bachelor of business administration in management and master of business administration in strategic leadership from Amberton University.

Damon has more than 20 years' experience in the insurance industry, and works on large complex accounts in the real estate, construction and technology fields. She has administered the two largest privately held construction projects (at the time) under a Contractor Controlled Insurance Program (CCIP) through a captive program. Damon joined Wachovia Insurance Services in October 2001.

Another wonderful issue of the *RMQ* is here for your reading enjoyment:

Bill DiSalvo, CPCU, and **Patricia Hannemann, CPCU,** have written an article on risk management and how it affects everyone, and **Earl D. Kersting, CPCU, ARM, ALCM, AIC, AAI, AIS,** helps you consider, "Do You Practice What You Preach?"

Rhonda D. Orin has provided an article on how policyholders perceive their coverage and how insurers see things differently. Insurance companies need to review their insurance provisions, in light of Hurricane Katrina issues, and policyholders need to be in a buyer-beware position and work on understanding their policy coverages.

An article by **Mark Jablonowski, CPCU, ARM,** shows how to approach insurance in a precautionary world. Insurance can only go so far, and other measures should be considered. Everyone should work together to provide a safer world and to make a difference.

Return-to-work-program implementation is discussed in an article by **Margaret Spence, CWC, RMPE. Jerry Trupin, CPCU, CLU, ChFC,** one of our regular contributors, has provided an article entitled, "Coverage Beyond ISO," and **Robert Velasco, CPCU,** writes about risk management for organizations with oversight of children.

George Head, CPCU, Ph.D., CLU, ARM, wrote an article on taking the proceeds from a loss and not rebuilding. I thought this was an interesting article and that insurance carriers would never allow such a thought. Then I read an April 28, 2008, article on SignOnSanDiego.com, the online site of *The San Diego Union-Tribune*, advising that the "wildfire victims can use their insurance money to buy or rebuild burned-out homes at a new location, according to a legal opinion released Monday by the California Department of Insurance and stemming from last fall's devastating San Diego County conflagrations." I am sure this will be a highly debated topic among the insurance carriers, the insureds and the lenders involved.

Please enjoy another wonderful issue provided by our authors. As always, please feel free to let us know your thoughts on the articles, what you would like to see, what you like and what you don't like. If you would be interested in providing an article, please contact me at jane.damon@wachovia.com. We welcome all authors and commentaries.

For more information on what's new in risk management, visit our Web site at http://riskmanagement.cpcusociety.org ■

Coverage Beyond ISO

by Jerome Trupin, CPCU, CLU, ChFC

Jerome Trupin, CPCU, CLU, ChFC, is a partner in Trupin Insurance Services, a property-casualty insurance consulting firm located in Briarcliff Manor, N.Y. He provides risk management and insurance coverage advice to commercial, non-profit and governmental entities — he is, in effect, an outsourced risk manager. Trupin has been an expert witness in numerous cases involving insurance policy disputes. He is the coauthor of numerous insurance textbooks published by the American Institute for CPCU and Insurance Institute of America. Trupin recently completed work on the eighth edition of the CPCU 551 text, which was published in August 2008.

In previous articles, I've pointed out the advantages of certain ISO forms. Lest I lose my charter membership in the AGC (Association of Grouchy Consultants — our motto: Why be difficult? With a little effort you can be impossible.), I want to discuss some provisions that can improve coverage whether the insurer uses ISO forms or its own. There are innumerable clauses that can be added to policies; I'll just discuss a few of the more general ones.

Adding manuscript clauses to an insured's policy is seldom possible for BOP-type policies. While it's no longer the case that you can have any wording you want in a BOP as long as it's black (ISO, and many other insurers, now have huge portfolios of available endorsements), it is still the rule that if it's not in the manual it's not available. However, coverage for larger, more complicated accounts that are not written using BOP forms can usually be tailored to improve the insured's protection. One caveat: tailoring a manuscript may be a job for the insured's attorney.

Broad Named Insured

The larger the account the more likely it is that there are multiple entities that should be named as insureds. If an affiliated firm is not shown as a named insured, or included by policy wording, there's no coverage. Thus, if Stan and Beth Inc. runs a business in a building that it owns, there will be no coverage for claims by or against the building owner when the building is owned by Stan Smith and Beth Jones as tenants in common and the policy shows only Stan and Beth Inc. as insureds.

One way to avoid this problem is to ask insureds to provide you with the names of all their related firms and to add them to the policy. However, the larger the organization, the more difficult this becomes. In addition, even if you develop all the information at inception, changes occur during the year, and insureds often forget to tell you about it until they report the claim.

To close this gap, ask for a broad named insured endorsement. One possible wording is:

> "The named insured shall include all subsidiaries, affiliated, or associated entities as may now, heretofore or hereafter be constituted. The named insured also includes any entities for which any named insured has the responsibility to purchase insurance unless such insurance is otherwise provided."

Knowledge of Occurrence

Insurance policies impose a duty on the insured to promptly report claims. The ISO CGL policy wording is:

> "You must see to it that we are notified as soon as practicable of an 'occurrence' or an offense which may result in a claim."

ISO property forms say:

> "You must see that the following are done in the event of loss or damage to Covered Property … (2) Give us prompt notice of the loss or damage."

Who are the "you," "we," and "us" in these provisions? To answer that you have to, as is so often the case when interpreting insurance coverages, look someplace else in the policy. The lead-in language in both forms points out that "you" means the named insured and "we" and "us" refer to the insurance company. The named insured is, of course, the entity named in the declarations as the insured.

That's uncomplicated when the named insured is "Ma & Pa Kettle d/b/a Kettle's Kookware." (They manufacture kitchen utensils and unusual clothing — spelling was never their strong suit.) It's Ma's or Pa's knowledge that will trigger the duty to report. However, if their business

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Coverage Beyond ISO

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catches on and their financial advisers tell them to incorporate as Ma & Pa Inc., they may soon have directors, officers, department heads, managers and employees at various locations across the country. Now, who is the "you" who has the duty to report? In one case, a branch office manager was aware of the loss but never reported it to the central office. The insurance company denied for late notice.[1]

What's more, as noted above, many policies include numerous entities as named insureds and, if you've added the broad named insured provision shown above, the "named insured" may include many others who are not even shown by name in the policy. What to do?

The answer is: add what is generally called a "knowledge of occurrence" provision. Here's one version, not an ISO form, that's widely available:

> "Knowledge of an occurrence or an offense by your agent, your servant, or your employee will not in itself constitute knowledge to you unless the Director of Risk Management (or one with similar or equivalent title) or his/her designee, at the address shown in the policy declarations, will have received such notice."

There's one problem that this won't solve: failure to forward legal papers to the insurer as required by the policy. In large organizations, these papers sometimes can be properly served upon or sent to any one of a number of individuals, some of whom may not appreciate the importance of promptly sending the documents to the insurance company. One case involved a summons served on a regional vice-president; he just ignored it. When a default judgment was served on the company and the sheriff seized a local store to satisfy the judgment, it did get the risk manager's attention, and he then referred the claim to its insurer. The insurer denied liability. The risk manager argued that the knowledge-of-occurrence clause in the

policy provided for coverage. The insurance company's position was that the duty to forward a summons is a separate duty from the duty to report an occurrence, and the court agreed with the insurer.[2]

Here's a suggested provision that might avoid that problem:

> "Wherever this policy imposes a duty based on knowledge of an occurrence, claim, suit, offence or other incident or on the receipt of any demand, notice, summons, or other papers, knowledge of or receipt by any director, officer, partner, manager, member, agent, servant or employee of any insured shall not in itself constitute knowledge of or receipt by the insured unless (insert name and title of the person responsible for reporting claims, such as risk manager, controller, CEO, CFO, etc.) or successor shall have such knowledge or shall have received such papers."

Notice of Workers Compensation Claims

Another clause that consultants regularly request is Notice of Workers Compensation Claim, sometimes titled Notice of Claim. It deals with the submission of a claim to the insured's workers compensation insurer that later turns out to be a liability claim, perhaps because the injured party was an independent contractor rather than an employee. It's not a very common problem, and I mention it primarily because, as you will see below, it is frequently packaged with some of the other provisions we've discussed.

Typical wording for such a clause is as follows:

> "Notice of occurrence to workers compensation carrier shall be accepted as notice to liability carrier for workers compensation claims that subsequently become liability claims."

Inadvertent Errors and Omissions in Reporting Occurrences

The knowledge-of-occurrence endorsement puts the duty to report on the risk manager, or whoever else is named in the endorsement. Can the risk

manager slip up and forget to forward it to the insurance company? Never, right? If you believe that, I have a bridge for sale that you might be interested in. To close this gap, you can request this endorsement:

> "An error or omission in reporting claims or occurrences or in submitting documents shall not prejudice the interest of the insured provided such an error is inadvertent or unintentional and that prompt notice is given to the insurance company as soon as the oversight is discovered."

Availability of These Provisions

At first blush even knowledgeable insurance practitioners might think that these clauses are difficult to obtain. After all, wouldn't insureds be tempted to avoid reporting claims by creating a "don't ask, don't tell" environment? Experience argues otherwise. I have never reviewed a national account policy that did not include some of these provisions; many middle-market insurers freely provide them.

Several years ago when I was reviewing the insurance coverage for a relatively small business (it was headed by a long-time friend, and it was more a favor than a consulting project), the broker proposed using a relatively small insurance company that wrote mainly smaller businesses. Because I expressed doubt about placing coverage with that company, the broker put me in touch with the underwriter to make me more comfortable with the carrier. One of the questions that I asked the underwriter was about the availability of a broad named insured endorsement. Her response, "Oh, you mean our 3-in-1 endorsement." She then reached into her drawer and pulled out a preprinted form containing the broad named insured knowledge of occurrence and notice of claim provisions. It was available, without charge, to insureds who asked for it.

The broader versions of these clauses, and the inadvertent errors or omissions in providing notice, are not as widely available, but getting them for your clients is what makes you stand out from the herd.

> ■ ***A well run middle-market or larger business realizes that the cost of insurance is driven by loss experience and that a delay in reporting claims does nothing but increase the cost of settling them.***

There's another reason why underwriters should be willing to provide this coverage. A well run middle-market or larger business realizes that the cost of insurance is driven by loss experience and that a delay in reporting claims does nothing but increase the cost of settling them. If the underwriter does not feel confident that the insured will do all he can to properly report claims and provide information about named insureds, it's probably not an account that the underwriter should write in the first place. There is some risk that claims will be covered that might otherwise be denied, but it's slight — the amount charged for these endorsements (zippo) shows that — and isn't risk-bearing. Isn't this what insurance is all about? ■

Endnotes

1. Based on an e-mail posed on RiskList on 6/26/08. See http://finance.groups.yahoo.com/group/RiskList/.
2. *Royal Insurance Co. of NY v The Cato Corporation,* 481 S.E.2d 363 (N.C. App. 1997).

Do You Practice What You Preach?

by Earl D. Kersting, CPCU, ARM, ALCM, AIC, AU, AAI, AIS

Earl D. Kersting, CPCU, ARM, ALCM, AIC, AU, AAI, AIS, is assistant risk manager for The Kroger Co., Delta Division, in Memphis, Tenn., where he oversees all areas of risk faced by more than 100 retail stores located throughout a five-state area, a position he has held since 1986. Kersting is a past president of the CPCU Society's Memphis Chapter and a past member of the Risk Management Interest Group Committee. He may be contacted at earlkersting1@yahoo.com.

Abstract

As risk management professionals, we have dedicated our careers to teaching the theories and the applications of risk management to our clients, customers and colleagues. However, if we were to hold ourselves to those standards we expect of, and demand from, our clients and customers, how would we be judged? Do we live as we teach, or are we hypocrites projecting an image of "do as I say, not as I do?"

On Tuesday evening, Feb. 5, 2008, a tornado tore through Memphis and Western Tennessee, leaving death and widespread devastation in its path. Seventeen days later, I watched from my office, as 40 pieces of fire-fighting equipment were unable to prevent the only Benihana restaurant in Tennessee from literally burning to the ground. You're probably wondering what these seemingly unrelated events have to do with each other, yet the answer is quite simple. In the aftermath of these events, it occurred to me that although we have spent our careers teaching the theories and applications of risk management to our clients, customers, and colleagues, do we ourselves actually practice what we so adamantly preach?

If we were to study the recommendations we've made over the years — review our inspection worksheets and audit forms, company memos and rating manuals, training and seminar notes, and many years of written and mental notes — do we apply those techniques in our own businesses and homes? Do we expect one thing of our clients, yet hypocritically ignore our own advice? Consider the following:

Life Safety and Preservation

We'd be horrified if one of our clients didn't have an emergency evacuation plan, have fire extinguishers in kitchens and areas susceptible to fire or containing concentrated flammable materials, or did not train employees in first aid, CPR and emergency response. Yet when you go home tonight, if a fire were to break out, would your family know the quickest and safest method of escape? How about from a second story or higher? Or a basement? Where would you meet each other to verify everyone made it out safely and that no one was left behind? Is there a fire extinguisher easily accessible in your kitchen, garage or near the furnace to prevent a small fire from escalating into a devastating, life-threatening inferno? Do your family members know how to use it? Perhaps more importantly, do they know when not to attempt to extinguish a fire but rather to just get out and get other family members to safety? Have you practiced an evacuation drill, or is that just something we tell our clients to do? If a loved one or guest were to choke, stop breathing or suffer a heart attack, could you save his or her life or sustain life until paramedics arrive? Do your children know what to do if the only adult home with them becomes ill or loses consciousness? Are we practicing what we preach?

Electronic Data Storage and Computers

As the world continues to evolve toward electronic data storage and data interchange, and as hard-copy documents become less significant, the transition is not limited to national and multi-national corporations. It's occurring in sole agencies, in-home offices, and in our home and personal lives. How many of us

bank from home via the Internet, store our financial records and compile our tax returns using various software offerings, save all of our critical records and precious photographs electronically, and depend upon our personal computers in the course of our daily lives? How many of us ever back up our hard drives? If we're among the minority that does, then how many of us store that back-up media in a remote location, as opposed to in the same office or house as the computer we're backing up? What if your office or home computer is stolen in a break-in? Is your information safe, or could someone gain access to account numbers, passwords, and the means to wipe out retirement accounts, 401(k)s, and unrecoverable assets much more devastating than simply a credit or checking account? Are we practicing what we preach?

Emergency Preparation and Provisions

I look at the tornado victims who live in communities that were devastated and now have no utilities, operating food stores, fuel stations or transportation to allow them to reach outside their community or neighborhood, and wonder how many days could I survive on what I had readily available at hand. I've helped hospitals incorporate my employer into their disaster plans as an alternative source of food and drink for resident patients, yet what would you or I do if trapped in our own neighborhood? I look at those who lost not their homes, but their lives or the life of a loved one. Could the modest investment in a weather-alert radio have provided earlier warning, allowing more time to seek shelter? Could practice with families or coworkers regarding how and where to take shelter reduce confusion during an actual event when every second counts? Have we done these seemingly simple things? Are we practicing what we preach?

Summation

These are just a few of many realizations that confronted me, and prodded further contemplation, following those seemingly unrelated events of early February. My objective in putting my thoughts in print is simply to stimulate your thinking process. Your life and career experiences have been different from mine, and your potential threats are unique to your environment. My tornados may be your hurricanes; your floods may overshadow my earthquake exposure. But regardless of the differences, the underlying question remains the same: do we take time from our busy careers to remember that those same events for which we prepare our clients and customers can strike our business and home, our family and loved ones? Do we lead by example, or do we present our clients with a certain level of expectation, while blindly ignoring the fact that we too are at risk? The ultimate question becomes: Do you practice what you preach? ■

CPCU Journey Helps Me Save Kids Through Risk Management

by Robert Velasco, CPCU

Robert Velasco, CPCU, has more than 20 years' experience in the insurance industry. His business path has taken him from accounting to sales, claims and subrogation. Velasco received his CPCU designation (with a focus on commercial lines) in 2007. Currently, he is the risk manager for Abel Screening in Atlanta, Ga.

Editor's note: This article is based on one that Velasco wrote for an upcoming issue of *National Underwriter*.

Around 20 years ago, I worked as a bookkeeper for a large insurance company in New York. There I became friends with all of the underwriters. I quickly learned that only one person in the department — the director of underwriting — had the CPCU designation. When I made the connection between her position and the designation, I made it my goal to get the CPCU designation as well. I reached this goal Sept. 8, 2007.

While that was just about a year ago, a lot has changed. I made a career move from claims at a large insurer to risk manager at a small privately owned behavioral research company. How I ended up here is a colorful story — if you meet me in person, I'll tell you all about it.

As it turns out, this company has developed an innovative employee screening tool, which I will discuss later. This tool and its application have led me to focus on risk management principles that can be applied by any organization that has oversight of children and the insurers that cover them.

For years now we have read headlines of plaintiffs receiving multi-million dollar settlements against churches due to child sexual abuse. Recently, headlines have been popping up identifying schools, hospitals and other businesses receiving similar lawsuits.

How does this affect you? Here are some questions to ask: Is my organization exposed to this risk? If so, how should my organization deal with it? Can we reduce the risk, or stop this from happening to us?

When you insure an item that's easily appraised, the formula is pretty simple:

> If in a class of 1,000 similar homes, you may calculate that one $250,000 home is likely to be destroyed over the next year. If that is your calculation, then you simply price out premiums to cover this single potential loss, your overhead, and reserve a little extra in case a second one is destroyed.

However, the formula isn't nearly as simple when you are trying to estimate future liability cases. Pools of "similar" groups are actually not as similar as you would like them to be. Over the past 10 years, your pool may not have experienced any large losses, so how do you determine your potential "worst-case scenario?" Additionally, an environmental change may suddenly trigger multiple "worst-case scenario" losses.

If the liability exposure is not calculated properly, the insurer and insured may face some expensive and ugly surprises. In fact, receiving a sexual abuse related claim is truly a horror. Besides the staggering dollar amounts of the lawsuits, a painfully ugly situation resides at the center of the case.

While some may convince themselves that child abuse cases are isolated, the way things are trending, many more child abuse cases will be filed than ever before. For example, think of mold-related claims. Twenty years ago, the average American did not know they could file a claim for this. Once it hit the headlines, however, everyone suddenly noticed the discoloration on the side of *their* house.

Currently, there is a constant flow of child abuse lawsuits in the pipeline. Not all of them get the headlines. An organization can go many years without incident when it suddenly finds itself on the receiving end of a multi-million dollar lawsuit. Like a time bomb, everything appears normal, until suddenly it goes off.

This is why managing this risk is tricky. Organizations get a false sense of security because they have been in business many years and no one has ever accused them of anything having to do with child molestation.

Addressing the Risk

The first thing to realize is that it does not take a lot of employees to jeopardize the whole business. The next thing is that an employee's outward appearance may belie the fact that he or she is a risk to children. Risk managers should ask: Is my organization at risk? Can we reduce, or eliminate, this from happening to us?

Besides attempting to purchase insurance to transfer the risk, organizations need to understand that risk management techniques are available. The key is preventing, or reducing, the likelihood of these losses. How does an organization tackle this? An objective approach is needed.

Risk Management Checklist

Some available techniques include:

- Adopt stricter hiring guidelines.
- Rotate operational reviews (risk management reviews).
- Oversight of employees' Web traffic.
- Interaction with parents.
- Document every allegation of abuse and hold every related employee accountable.
- Take a zero tolerance stand.
- Remove any employee who receives a verifiable complaint, or receives more than one "questionable" complaint.
- Conduct mental and behavioral evaluations (behavioral screenings) of all employees who may potentially come in contact with children.

Of special importance is the inclusion of psychological screenings to satisfy the last bullet point above.

For many years, some in the mental health community have attempted to utilize a screening test known as plethysmography. However, this test was very cumbersome and was impractical for the typical business to administer.

The advancement to this approach is impressive. We now find successors to this old exam that are non-intrusive and far more reliable. For the past 10 years, a variety of standardized exams/screens have been available for use primarily by the criminal justice system. Courts rely on these screens to help them in various phases of prosecution to understand their defendant's sexual interest in children.

This brings me back to the innovative screening tool, which I earlier said that I would discuss. Known as The Diana Screen,® this tool provides organizations with a convenient and practical method of specifically testing an individual for sexual interest in children. Similar to most "multiple choice" computerized exams, the test-taker simply goes to a computer and selects answers on each page. In less than an hour, the test is over — and the administrator has the results in less than 15 minutes.

If properly implemented, an organization can drastically reduce its likelihood of ever experiencing an abuse-related loss. What's more, it can administer the psychological screen as part of a hiring practice. Organizations that have oversight of children can now be more confident about the people they hire. And as an added precaution, the organization could elect to administer the screen to existing employees.

Insurers that recognize the value of preventative measures, including use of psychological screens, may offer significant discounts to policyholders. By taking these precautions, the result is that the ticking time bomb is removed. Future losses are reduced. Most importantly, children are safer.

I never guessed that taking the CPCU path could lead me to such a rewarding position. ■

What organizations are at risk?

- Churches and worship centers.
- Schools, including pre-schools.
- Hospitals and pediatric offices.
- Residential treatment homes.
- Foster care agencies.
- Summer camps.
- Amusement parks.
- Law enforcement agencies.
- Family service agencies.

If your organization includes oversight of children in any capacity, you are at risk.

Dear Injured Employee: We Would Like You to Return to Work Tomorrow!

Can Injured Employees Return to Work Successfully?

by Margaret Spence, CWC, RMPE

Margaret Spence, CWC, RMPE, is a board certified workers' compensation consultant, speaker and trainer. She is the president of Douglas Claims & Risk Consultants and WorkCompSeminars.com. She works with companies who want to implement injury management, decrease litigation and costly settlements, and learn how to incorporate return-to-work strategies that eliminate lost work days. Spence is the author of *From Workers' Comp Claimant to Valued Employee: Employer's Guide to Implementing a Proactive Return to Work Program*. The book is available on either of her two Web sites, www.WorkCompSeminars.com or www.TheyCanReturntoWork.com, and at Amazon.com. Spence may be reached at (561) 795-3036.

Editor's note: This article is reprinted with the author's permission.

Several months ago, I received a phone call from an employer who was frustrated that an employee was awarded $5,500 by her insurance carrier for lost wages because the company could not produce documentation to prove that the employee refused to accept a light-duty position. When I questioned the employer regarding their return-to-work program, the employer told me that she called the employee several times to tell him to "come back to work" and they would "find something" for him to do. I asked her to identify the light-duty position and she could not — she insisted that she would find him something to keep him busy.

In this instance, the employer could not prove she made a valiant effort to bring the employee back to work. She had no written documentation to prove that she made the job offer. She could not readily identify the light-duty position, nor could she prove that she had a job available that would accommodate the employee's restrictions.

Without a clear return-to-work policy, good documentation and written communication with your injured employees, you are setting your program up for failure. Your company's return-to-work program should not be a secret. Every employee who works for your company should understand the policies and procedures that must be followed if they are injured on the job. Your return-to-work policy should be a clear, concise set of rules that must be followed by the injured employee until the workers' compensation claim is closed.

If I walk into your company today to apply for a job:

- Is your return-to-work policy visible?

If I sustain an injury:

- Did you relay your return-to-work expectations immediately?

Most employers passively expect their employees to return to work without effectively communicating their return-to-work policy.

What are the Essential Components of a Successful Return-to-Work Program?

An effective injury management program starts before the injury happens, not on the day the employee files the First Report of Injury or Illness. Many companies have return-to-work programs, but few realize the full benefits of the program because they omit or overlook key elements of the process. Before the injury you should:

- Create a written return-to-work policy.
- Review the policy with new employees during their new-hire orientation or with existing employees during their annual review.
- Write a detailed job demand evaluation that identifies the specific tasks and physical demands associated with each job within the company.
- Create a detailed job description for every position — this is not the job description used to advertise the position in the newspaper. It is an evaluation of the job demands, tasks, essential and marginal functions of the job.
- Establish a working relationship with a walk-in clinic or occupational medical center, if your state allows you to select the initial treating facility.
- Assign a specific person in your organization that will be responsible for administering the return-to-work program. This person should have a thorough knowledge of the Americans with Disabilities Act (ADA), the Family Medical Leave Act (FMLA) and the Workers' Compensation Statutes.

One of the complaints I hear from employers is, "I tried to bring the employee back to work but they complained the whole time they were here. Finally, in frustration we let the employee go home and they never returned to work." The question asked by most employers is, how do I avoid this scenario?

To eliminate or reduce the employee's ability to manipulate the return-to-work process, you should implement the following post-accident procedures:

- Identify tasks that can be grouped together to accommodate the injured employee's restrictions. Focus on matching the employee's ability to do the job versus focusing on what they cannot do.
- Send a copy of the proposed modified-duty job description to the treating physician, and ask him or her to approve the position. You are asking the physician to acknowledge that the employee can complete the tasks based on the restrictions imposed. This avoids the "I'm in too much pain to do this job" scenario.
- Notify the injured employee by phone and in writing that you *can* accommodate the restriction. Ask the employee to come back to work.
- When the employee returns to work, review the position and inform the employee that the treating physician confirmed his/her ability to perform the modified tasks.
- Educate your supervisors so they can effectively manage the injured employee.
- Communicate the job offer to your insurance carrier.
- Continue to monitor the employee until they are released to work full-duty or until they are at Maximum Medical Improvement. Review the final work status and any permanent restriction to ensure compliance with the provisions set forth in the Americans with Disabilities Act (ADA).

Conclusion — Injured Employees Can Return to Work Successfully!

Workers' compensation return-to-work programs have to be an integral part of your retention policy or strategy. Your employees are your most valued asset, even if they have an occupational injury. If employees *are* your most valued asset, then you should recognize the importance of implementing a comprehensive return-to-work program. Your obligation as the employer does not end when the injury begins. Returning an employee to work is an investment in your company, and it shows that you still value your employees after they are injured.

The answer to getting injured employees back to work starts before you hire them and definitely before they are injured. Having well defined return-to-work policies and procedures that can be implemented immediately will ensure that the employee returns to work — successfully. ■

Insurance in a Precautionary World

by Mark Jablonowski, CPCU, ARM

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Abstract

The increasing complexity of risk in the world, along with the potential for cataclysmic losses it entails, demands a more precautionary approach to risk. This approach suggests that potentially catastrophic impacts be avoided. This article examines how insurance "fits in" to a more precautionary world. While insurance can itself be viewed as "financial precaution" in the context of the individual or the business entity, its statistical nature and emphasis on financial impacts suggest that insurance has a limited role in the wider notion of preventing societal risks. Nonetheless, a more precautionary world can impact the function of insurance. Insurers and risk managers need to be clear on what insurance can and can not do to further the cause of a safer world.

Introduction: The "Risk Society"

Sociologist **Ulrich Beck** coined the term "Risk Society" to indicate that modern society is dominated by questions about risk and its control.[1] Though some would suggest that this increased concern is a result of overblown fears and alarmism, the conclusion that progress entails some element of increasing risk on an increasing scale seems inescapable. After all, 150 years ago, the cannonball was the "weapon of mass destruction." Today we face nuclear and biological weapons with the potential for wide-scale, possibly total, destruction.[2] Recognizing these risks take nothing away from the ability of science and technology to achieve progressive goals. More powerful tools, however, come with the need to exercise greater responsibility.

The idea of "risk management" in the new age of complex risks, and our recognized responsibility in the face of these risks, is captured in the so-called precautionary principle. Perhaps the most widely adopted definition of the principle arose out of the Wingspread Conference on global responsibilities to the environment:

Where an activity raises threats of harm to the environment or to human health, precautionary measures should be taken even if some cause and effect relationships are not fully established scientifically.[3]

"Precautionary measures" entail avoidance of exposures, or reduction of the likelihood of harm to suitable levels.[4] Key to the precautionary approach is the recognition that complexity breeds uncertainty. We can not know for sure the large loss potentials of new activities. As a result, we must seriously consider the worst-case even though it may only be very imperfectly known.

The emergence of Beck's Risk Society means that we need to interpret risk management within this new setting. Simply extrapolating a few tried and true techniques, such as loss prevention based on statistical feedback (the simple "identify-assess-treat" model) or insurance, can have bad consequences when we enter the realm of high-stakes decisions. Their unique nature, including our inability to have a second chance to get things right, means we have to use our powers of anticipation to an ever greater degree and support high-stakes risk management with a thorough assessment of safe alternatives. This does not mean we abandon traditional techniques. We simply have to better realize how they "fit in" to the bigger risk picture.

The Hallmarks of Precaution

Precaution is a very commonsense idea. Arguably, it has guided us and other life forms through a rather remarkable streak of evolutionary survival. As the world gets more complex, however, it behooves us to take a more formal look at this very basic form of risk management. The hallmarks of precaution include:

(1) The existence of potentially catastrophic impacts that threaten the very existence of the entity (the "catastrophe problem").

(2) The irrelevance of cost. (Under the minimax principle, the individual decision maker is theoretically willing to spend up to the amount of loss to prevent it. A corollary is that cost-benefit comparisons are seldom used in precautionary situations: We recognize potential danger and act to avoid it.)

(3) The existence of "precautionary dilemmas" that follow from the possible "all or nothing" outcome of the application of precautionary minimax. When the cost of avoiding catastrophe becomes large (i.e., expensive), we are faced with a dilemma of the "doomed if we do, doomed if we don't" variety.

From this description, we can see that insurance is itself a form of "financial precaution."[5] We proceed not so much on the basis of any complicated cost/benefit analysis, but rather on the basis of "are we covered?" That is, we want to know if our insurance program will provide the proper safety net against accidental losses. Likewise, when we face insurance that is "too expensive," we find ourselves in a sort of risk dilemma. This is why the affordability of insurance is a social issue, and hence, at least to some extent, regulated.

From the wider perspective of risk today, it is clear that insurance itself is a statistical mechanism. As such, it can be overwhelmed by losses that are sufficiently large on an aggregate basis. Recent examples include the terrorism attacks of September 11, 2001, and Hurricane Katrina in 2005. So while insurance capitalization grows in response to increasing frequency and severity of risk at the statistical level (the property-casualty industry is currently capitalized at almost $500 billion), it has not, nor should it be expected to have, grown to fulfil all our risk management needs.

This means that no insurance policy can assure our existence in the face of large-scale catastrophic risk potentials, such as global warming, for example. Indeed, the boundaries of insurance in this regard are continuously tested in debates of just how much insurance can protect us, as a society. In many cases, even the widespread financial effects of risk need a wider mechanism. In the private sector, this wider mechanism may consist of various forms of indemnification financed by the over $30 trillion capital market. From a public standpoint, the federal government, with its ability to generate emergency funds through re-channelling private financial resources, the use of public funds and taxation, can help provide a greater backstop. All these mechanisms still qualify as insurance, or at least, indemnification. As such, they all suffer from the fact that they can compensate us only financially. No small matter, of course, but life itself, and the health of our planet, can not be completely quantified in monetary terms.

That leaves precautionary prevention. To some extent, insurance will remain on the "outside looking in," itself just another tool in the management of overall risk. On the other hand, a more precautionary regime applied on a social basis will have effects on insurance as well. These effects are important, not only to the effective functioning of the insurance mechanism, but also to help promote our movement to a more effective recognition of wider precautionary goals.

For one thing, precaution includes a redefinition of responsibility for potentially dangerous activities. This redefinition includes a reversal of the burden of proof. In the case of ultra-hazardous activities, that means those who propose some activity would have to reasonably prove its safety, rather than waiting for evidence that the activity or action is not safe. The burden in this way falls on those who would promote the activity, say some product, service or operation. From the standpoint of legal liability, this suggests a shift from ordinary negligence to some absolute or strict liability standard for hazardous acts.

An example is recent pollution legislation in the European Union, which supports a more precautionary stance with the threat of strict liability. Such actions are based on the so-called "polluter pays" principle. And while again we cannot expect money to completely compensate us for catastrophic losses, especially those involving life or health, strict liability is viewed as a tool that requires those that would promulgate some activity to stake their "organizational lives" on the safety of that activity. For insurers, this could mean an increased exposure under liability coverages, as the legal standard for liability changes.[6] The threat, however, simply requires more rigorous underwriting, or account selection, based on the insureds' genuine commitment to precaution. In the longer run, a properly precautionary stance will likely reduce the potential for losses in the insured spectrum as well.

Insurers and the Problem of "Permissive" Regulation

Some form of regulation, in terms of legal sanctions and government policies, is the usual response to high-stakes public risks in the world today. To the extent that this regulation relies on statistics, it can only handle the visible "tip of the iceberg" of loss potentials in the world today. Requiring statistical evidence before we regulate potential high-stakes risks removes the inherent safety net that precaution provides in protecting us against the inherent uncertainty of such risk. This form of permissive regulation, therefore, can make the world more dangerous, rather than safer.

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From an insurance standpoint, permissive regulation in the face of increasing risk would certainly increase insurers' costs. This increase in costs results from the fact that when regulations don't keep pace with risks, insurers will be called upon to fill the void. Insurance is in this way made to perform a regulative function, rather than merely one of indemnification.

New risks with unknown, yet potentially catastrophic, consequences are known as emerging risks. Examples include nanotechnology and genetic engineering. Traditionally, insurers have relied on a clean regulatory bill of health as a valuable underwriting criterion that helps guard against the negative effects of emerging risks. When regulation does not keep up with the pace of risk, for whatever reason, insurers become more exposed, perhaps unknowingly.

Many insurers are encouraged by today's increased emphasis on enterprise risk management (ERM) in industry. While ERM encourages a more holistic view of risk within the managed entity, it can turn a blind eye to wider, societal exposures.[7] Indeed, sometimes internal risk management may be at odds with the external. For example, a large food manufacturer may be worried about increased concern over social trends on obesity prevention. Certain of its products may be looked at as targets of informal or formal boycott, or at least increased public concern. This concern may or may not be directly reflected in regulation. To the extent it is not, it usually does not register on ERM "radar."

In any case, treating a potential consumer backlash from obesity as a mere public relations risk can easily backfire, offering no real solution to the social problem at hand (which, arguably, the entity contributed to). By responding to operational risk only on the basis of regulation, the failure of regulation to identify and control important issues could present a significant defect in the ERM view of risk. To the extent that these risks eventually become internalized, it very may well be through insurance.

Insurers can take a positive role in reducing permissive regulation by rejecting those insureds who present a higher risk due to increasing risk profiles in the face of weak regulation. That means monitoring both the risks of the industries they insure, as well as the current status of regulation in those industries. Where a significant gap exists, insurers should become wary. By refusing to take risks that are more effectively handled through precautionary action, insurers can themselves encourage increased precaution.

The Implications for Risk Managers

For risk managers, this all means that insurance can only take them so far in a precautionary world. There are wider risks which insurance, itself a form of financial precaution for the insured itself, cannot properly resolve. These need to be handled by strict precautionary loss prevention, or avoidance, on a social scale of responsibility. In this regard, ERM and other managerial systems need to provide a wider view of risk management, that is, as not only something that protects the entity from large losses, but also the life and health of the community. Adoption of more precautionary regulation suggests some guideposts, but ultimately the task is up to the individual entity. To avoid the associated risk dilemmas of a strict application of precaution (i.e., doomed if we do, doomed if we don't), proper precautionary action on the part of companies includes the assessment and development of safe alternatives early on in the process of planning for progress. This new form of risk management adds another dimension to the risk manager's options: risk anticipation. Anticipatory risk management requires both a new perspective of loss prevention and a reappraisal of insurance's place in the complete risk management framework.

The failure of risk management to meet the precautionary challenge could cause substantial losses for not only the insurance industry (for non-traditional mechanisms such as capital markets or government safety-nets), but also, and perhaps most importantly, for society itself. The proper role of private and public concerns in the wider process of planning for safe progress will have to work itself out in the near future, as the possibility for wider potential risks builds. Insurers and risk managers should not watch this process unfold from the sidelines, but rather they should be active participants in it. Above all, this will require that these decision makers consider their wider responsibilities to society and the natural world, and not base these critical decisions solely on self-interest or their catering to the limited self-interest of others in order to promote their own.

The ideas here can be represented by various "risk layers" of increasing intensity of impact, as shown in Figure 1. The risks with the widest potential, and hence occupying the most encompassing layer, are the irreducible "natural" risks we face. Ultimately, these grand risks of existence are those that we can do little about. They might include things like a catastrophic meteor impact, a sudden gamma-ray burst from outer space or natural climate changes. The comfort we gain, if any, is that these risks have a very low likelihood of occurrence, which we can infer from nature's having supported a rather lengthy period of human and ecological evolution. At the other extreme are those more mundane risks that can be handled statistically. That is, they occur with sufficient frequency that we can deal with them through loss prevention and control methods whose benefits can be ascertained over the relatively short run. These include,

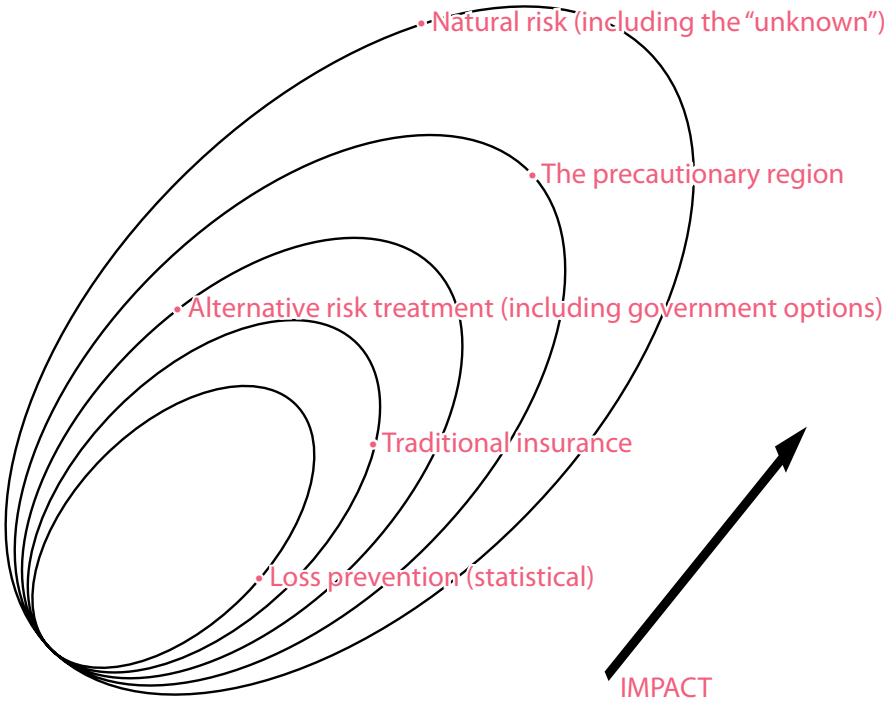
for example, businesses preventing slips and falls in the parking lot or requiring employees to use protective gloves to obviate hand injuries in the workplace. On a wider social scale, these may include crime prevention programs and the installation of guardrails on highways.

In spite of doing our best to control the statistical aspects of risk through loss prevention and control, some residual risk may remain. This risk may be reasonably handled by the form of financial precaution we call insurance. Here the financial risks of the few, due primarily to physical hazards such as fires and windstorms, are mitigated by pooling the results among a wide group (the "policyholders") under the commercial insurance mechanism.

Eventually, we get to a point where the pooling mechanism of traditional commercial insurance mechanisms might itself be overwhelmed. We turn in this case to alternative risk transfer mechanisms, such as capital markets or government solutions. These alternatives continue to rely on the pooling mechanism, however. Last, but not least, we come to those losses that could overwhelm pooling mechanisms and are, at the same time, both too large and too uncertain to be handled by statistical methods. Instead, we rely on precautionary methods. As we can't avoid all risks (i.e., a genuinely zero level of risk is impossible), it makes sense to set the precautionary risk acceptance level at the level of naturally occurring risk. Once again, we recognize some absolute level of risk that, though it can have huge consequences, we simply can not do anything about. This includes what we might call unknowable risk as well (the "unknown unknown"). After all, we can only manage what we know.

Figure 1

The "Layers" of Risk in Our World and Their Treatment



Our thesis here is that while all layers of risk are expanding, the "outer layers" provide the greatest challenge to human (and ecological) survival. This expansion in turn is due to various human-induced activities. It behooves us, therefore, to take extra caution when planning for progress, assuring the risk layers do not expand a rate greater than our ability to handle them.

Conclusions: Cooperating for a Safer World

Precaution demands that when activities expose us or our environment to the reasonable potential for serious or irreversible damage, they be avoided. It is a natural response to a world in which risks are becoming bigger, and at the same time more complex. While in the context of protecting individuals and individual businesses, insurance can be viewed as "financial precaution," although it is unlikely to play a particularly prominent role in the new era of precaution. Insurance remains fundamentally a statistical method of handling losses. As such, it can be overwhelmed by losses of sufficient magnitude.

Nonetheless, precautionary policies can have impacts on insurance and the way risk managers utilize insurance. To the extent increasingly complex, emerging risks outstrip the ability of traditional regulations to control them, insurers may find themselves "in the middle," that is, expected to indemnify for at least the monetary aspect of such losses. It behooves insurers in such cases to be on the lookout for emerging risks, assess the state of regulation with regard to these emerging risks, and select insureds on the basis of their ability to cope with these risks (through loss prevention or avoidance). By refusing to place themselves between permissive regulation and emerging risk, insurers can in this way also hasten the adoption of a more

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precautionary attitude toward both risk management and risk regulation.

On the other hand, a more precautionary view of risk can result in the wider application of absolute, or strict, liability standards. With regard to insureds who themselves do not take a properly precautionary attitude toward risk, this could once again put insurers in harm's way. In this regard, insurers need to assess the ability of potential insureds to react in a properly precautionary fashion, hence avoiding danger.

For risk managers, the rise of precaution will mean that they need to go beyond insurance, and regulation, in crafting a socially responsible risk policy which ensures the sustainability of their entity within the new "Risk Society." The commitment to precautionary risk management is a strong one, with observable goals and outcomes. To avoid potential dilemmas of applying precaution, risk managers need to add the idea of risk anticipation to a toolkit that already includes avoidance, acceptance and insurance.

The wider community this new risk management is designed to serve also needs to recognize the importance of a more precautionary approach to the way it regulates and plans, both socially and economically, for safe progress. That means active support of the things we value, not just standing by waiting for things to happen. Expecting risk managers, government regulators or some other outside entity to take care of risks for us underestimates the complexity of the task. No, we can't do it all by ourselves, but we can take a greater interest in what goes on. We need to recognize what insurance and risk management, as practiced today, can and can't do for us in achieving a safer world, and then work together to make up the difference. ■

Endnotes

1. Beck, Ulrich. *Risk Society: Towards a New Modernity*, Sage, 1992.
2. For a comprehensive review of the risk we face today, the reader is referred to the latest *Vital Signs* publication from the Worldwatch Institute (www.worldwatch.org). Worldwatch annually convenes a panel of diverse experts to assess food, agricultural resources, energy and climate, global economy, resource economics, the environment, conflict and peace, communications and transportation, population and society, and health and disease.
3. From the Wingspread Conference on the Precautionary Principle, Racine, Wisconsin, January 23–25, 1998 (available at http://www.gdrc.org/u-gov/precaution-3.html).
4. For background on the precautionary approach, see M. Jablonowski, *Precautionary Risk Management: Dealing with Catastrophic Loss Potentials in Business, the Community and Society*, Palgrave Macmillan 2006.
5. See M. Jablonowski, "Insurance as 'Financial Precaution,'" *The John Liner Review*, Fall 2006.
6. On the insurance implications of the European Directive on pollution, and the potential for strict liability, see J. Busenhart, Bauman, P., Schauer, C., Orth, M. and Wilke, B., "Insuring Environmental Damage in the European Union," *Swiss Re Technical Publication – Casualty, Swiss Re*, 2007 (available at www.swissre.com).
7. For pitfalls in the accepted view of ERM, including an insensitivity to social objectives, see D. Williamson, "The COSO ERM Framework: A Critique from Systems Theory of Management Control," *International Journal of Risk Assessment and Management*, Vol. 7, No. 8, 2007. On its relation to a wider commitment to precaution, see M. Jablonowski, "The Real Value of ERM," *Risk Management*, February 2006.

Not Me — I Don't Use It

by Salvatore W. DiSalvo, CPCU, and Patricia A. Hannemann, CPCU

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Risk management? I don't use it … I'm a producer!!! My job is to place business on the books and bring in accounts — in other words, ***sell.***

Well, if you are in sales, let us remind you that you use risk management techniques daily, whether you realize it or not. And that is the problem. We need to recognize it in a more formal manner.

You need more than the risk management class you took ***way back when.*** The insurance world has changed since many of us cracked open the old books, and it continues to change. Even if you have your ARM, you need a handy resource. That's where the Risk Management Interest Group can assist you.

Producers who have access to in-house experts, such as a major brokerage, may not need additional help. But what about those of us who are not so blessed? That's when your participation in the Risk Management Interest Group begins to shine. The tons of cutting-edge knowledge the Risk Management Interest Group can bring to bear upon a problem is enormous. ***And it's free!!!***

You recall that risk management does not mean just insurance solutions. When you seek an account that has a resident risk manager, can you "talk the talk?" Can you provide an alternative solution to the exposure other than insurance? Everyone has medium-sized accounts that can't afford a risk manager. It's your responsibility to provide those answers and to keep the client happy.

So you're ***not*** a producer? Think you don't need risk management? Well, tune in next time to find out how others also are helped through risk management. ■

Is It a Vase or Are There Two Faces?

Policyholders See One Thing; Insurers Another

by Rhonda D. Orin, J.D.

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A Danish psychologist named Edgar Rubin became famous around the turn of the past century for designing a "vase/profile illusion," namely a picture that can be perceived as either a white vase against a black background or as two black faces against a white background. Since the picture's been around since 1915, you've probably seen it by now.

With apologies to Dr. Rubin, an analogy can be drawn between the vase/profile illusion and certain modern-day conflicts between policyholders and insurance companies. In short, these disparate groups can look at the same circumstance and come to completely opposite conclusions.

One of the clearest examples of these differing viewpoints can be seen in the 2005 hurricane season. To policyholders, when Hurricanes Katrina and Rita swept along the Gulf Coast, each one looked on television news like a cohesive whole. The swirling shape, with an eye in the center, was a single event — what most policyholders recognized as simply a hurricane.

But not so for the insurance industry. Insurance companies saw each hurricane as a series of wholly separate and unrelated events. One event was wind. Another was rain. Still others were high water, waves, storm surges, and so on.

The same is true for the consequences. To the "untrained" eye, the flooding of New Orleans, the power failures that rendered businesses inoperative, the evacuation orders that closed down entire communities, and the looting and thefts that followed the physical devastation all arose from single events: the hurricanes.

Here again, the insurance industry disagreed. It viewed each of the above as a separate event, rather than a collective consequence of the hurricanes.

There is a reason for the insurance industry to draw such distinctions. By parsing the hurricanes into separate parts, and especially by including "anti-concurrent causation" provisions that purport to justify the complete denial of coverage whenever there is a single uncovered part, insurance companies increase the likelihood of denying coverage for claims.

This entire system is confusing to policyholders. Often, when policyholders buy insurance policies that cover property damage and other losses that might follow in the wake of hurricanes, they think that they have purchased all the coverage that they need. They think that if a hurricane roars through their area and leaves physical and economic devastation in its wake, the damages that result from that hurricane will be covered.

Another problem is that the insurance policies are drafted by the insurance companies. The insurance companies define the key terms, such as "flood." The insurance companies draft the exclusions, even including draconian language that purports to exclude coverage whenever an excluded peril is among many causes of alleged harm. Finally, the insurance companies interpret the provisions that they drafted, leaving the policyholders with the relatively undesirable option of arguing against a *fait accompli*.

Certainly, there are checks and balances in this system. One of them is the role played by state insurance departments, which typically are empowered to review and approve the policy forms that the insurance companies propose to sell in their states. Another is the role played by state attorney generals and the courts in reviewing the insurance company denials. Still another is the role of the courts in reviewing policyholder challenges to denials of coverage, and in using state bad faith law to deter insurance companies from wrongful and bad faith denials.

Substantial activity in the courts following Hurricane Katrina should be immediately apparent to even the most casual observer. A brief review of Westlaw shows that in Louisiana alone, approximately seventy

decisions regarding Hurricane Katrina were handed down by the end of 2006. Mississippi ran a close second, with approximately 50 such decisions.

It should be no surprise that many of these early decisions have addressed the threshold issue of jurisdiction. To the extent that a pattern can be generalized, policyholders tend to file suit in the state courts, insurance companies tend to remove these actions to federal courts, and policyholders tend to respond with motions for remand. Whether or not those motions are granted often reflects a careful analysis of the specific allegations in the complaints. Policyholders who sue for insurance coverage under policies issued as part of the National Flood Insurance Program ("NFIP") should expect an uphill battle in seeking remand. Policyholders seeking recovery under state statutes, such as state Valued Policy Laws, or under state common law, such as negligence actions against the insurance agents who sold them their policies, should not expect the struggle to be as hard.

Only one post-Katrina case had been tried to completion by the end of 2006: *Leonard v Nationwide,* in the Southern District of Mississippi. That outcome, which is discussed in more detail below, clearly illustrates that Katrina litigation is proving to be fact-intensive, with policyholders facing a high burden of proof with regard to the cause of their damages and insurance companies facing a serious challenge to the enforceability of their coverage provisions.

State governments, state insurance departments and state attorney generals have been notably active in Katrina-related activities. In Louisiana, for example, Governor Blanco issued several Executive Orders that extended various legal deadlines that were deemed impossible to meet under the twin circumstances of physical devastation of property and displacement of citizens. Also, the Louisiana Legislature enacted Act Nos. 739 and 802, which extend the prescriptive period within which citizens may file certain claims under their insurance policies. The Louisiana Attorney General filed suit on behalf of the state on July 10, 2006, seeking a declaratory judgment as to the constitutionality of these acts. The action was removed to federal court and then remanded back to state court, where the attorney general filed a writ of certiorari with the Louisiana Supreme Court. Ultimately, that court found that the legislative acts at issue are constitutional.

The Texas Department of Insurance ("TDI") and the Texas attorney general have taken affirmative actions to prevent insurance companies from denying insurance coverage to Texas residents who have been deprived of access to their property due to power failures. They have sought and obtained a court order against Allstate Insurance Company, providing such relief.

The Mississippi Attorney General's office has been particularly aggressive in challenging anti-concurrent causation provisions as unenforceable. On September 15, 2005, Attorney General Jim Hood filed a lawsuit in Hinds County, Mississippi, First Judicial District, alleging that insurance companies are interpreting their policies in an overly restrictive manner; that they are taking advantage of policyholders who do not understand their rights; and also that they are selling insurance policies that are so difficult to understand as to be unconscionable and therefore void.

The insurance companies filed a Notice of Removal the very next day, removing the case to the Southern District of Mississippi on grounds that the complaint interprets not only private homeowners' policies, but also Standard Flood Insurance Policies (SFIPs) that are relegated to the administration and supervision of the Federal Emergency Management Agency (FEMA). Attorney General Hood responded with a Motion to Remand, which was granted on March 8, 2006. The federal court granted that motion, ruling that the Attorney General's complaint does not pertain to the SFIPs.

On December 19, 2006, the case was transferred to Judge L.T. Senter, Jr., who then remanded the action back to the Chancery Court of Hinds County, Mississippi, First Judicial District, on December 26, 2006. Ultimately, the case was resolved by settlement, yet there is an ongoing issue now regarding enforcement of the settlement's terms.

Anti-concurrent causation provisions have come under attack — albeit unsuccessfully, thus far — in the Louisiana legislature as well. In 2005, and again in 2006, State Sen. Julie Quinn (R-Metairie) and State Rep. Tim Burns (R-Mandeville) have proposed legislation precluding the enforcement of these clauses. Both times, the proposed legislation died during the session.

Policyholders and others, often acting through the vehicle of class actions, have turned to the courts for relief in a wide variety of situations. For example, in Louisiana on September 15, 2005, some 160,000 property and business owners filed a class action lawsuit against the Commissioner of Insurance, Robert Wooley, and a number of insurance companies, captioned *Gladys Chehardy, et al. v Louisiana Insurance Commissioner J. Robert Wooley, et al.* That lawsuit was one of the first class actions against the insurance industry as a result of Hurricane Katrina.

There, the plaintiffs were asking the court for an order requiring the insurance commissioner to nullify the exclusions for damage caused by rising water. They took the position that the flooding in New Orleans was caused by negligence in the construction and maintenance of the levees, rather than an excluded "Act of

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God." Accordingly, they alleged that the high water exclusions were not intended to apply to the flooding.

As with Attorney General Hood's lawsuit in Mississippi, the insurance companies immediately filed a Notice of Removal in Chehardy, removing the case to the U.S. District Court for the Middle District of Louisiana. The grounds were that the plaintiffs based their claims on "a construction of the National Flood Insurance Act (NFIA) and National Flood Insurance Program (NFIP)", and on the recently enacted Class Action Fairness Act (CAFA). In that case, the plaintiffs' remand motion was unsuccessful. That case was transferred to the Eastern District of Louisiana, where it has been consolidated with a class action, *In re Katrina Canal Breaches Consolidated Litigation, C.A. 05-4182,* which includes claims against the Orleans Levee District and its insurer for negligence in design, construction and maintenance of levees.

Against this backdrop of events, the following is a brief review of the standard policy language on wind, water and hurricanes, and the legal issues about causation under these policies.

Standard-Form Policy Language

Insurance for losses caused by hurricanes typically is provided under property policies, which are available to businesses as part of comprehensive or package policies, and to residents in such forms as homeowners' policies and renters' policies.

Commercial property insurance policies generally fall into two types. The first type covers losses caused by "all risks of direct physical loss or damage," except risks that are specifically excluded in the policy. In these broad policies, known as "all risk" policies, once an insured proves that it has suffered a loss, the insurance company has the burden of proving that the loss is not covered.

The other type of commercial property policy takes the opposite approach. It covers property damage or loss caused by listed perils, such as: fire, wind, hail or vandalism. Known as a "named perils" policy, it typically contains a wide variety of exclusions, including exclusions for many different types of weather conditions. The policyholder typically is found to have the burden of overcoming these exclusions, in accordance with basic principles of insurance law.

Both types of property insurance policies contain provisions insuring personal property. This coverage usually provides coverage for specified types of personal property contained within the covered premises. Often the coverage extends to property found within a certain distance from the covered premises.

Useful examples of this policy language can be found in the standard commercial policy of the Texas Windstorm Insurance Association ("T.W.I.A."). With regard to buildings, labeled "Coverage A," the policy expressly states that it covers:

> Building or structure, meaning everything which is legally part of the building or structure described in the Declarations. However, we do not cover machinery which is not used solely in the service of the building.
>
> Personal property owned by you that is used for the service of and located on the described location
>
> . . . .

Next, with regard to personal property, labeled "Coverage B," the policy expressly states that it covers:

> Business personal property located in or on the building described in the Declarations, or in the open on the described location, or in a vehicle or railroad car located within 100 feet of the described building.
>
> . . . .

These coverage agreements are followed by sections that delineate what types of personal property are and are not covered. Then comes a section called "Covered Causes of Loss," in which the policy specifies:

> We insure for direct physical loss to the covered property caused by windstorm or hail unless the loss is excluded in the Exclusions.

The next section – and the most important one, for purposes of this article – includes, but is not limited to, the following exclusions:

> The following exclusions apply to loss to covered property:
>
> Flood.
>
> We will not pay for loss or damage caused by or resulting from flood, surface water, waves, tidal water of tidal waves, overflow of streams or other bodies of water or spray from any of these whether or not driven by wind.
>
> Power Failure.
>
> We will not pay for loss or damage resulting from the failure of power or other utility service supplied to the described premises, if the failure occurs away from the described premises. However, we will pay for loss resulting from physical damage to power, heating or cooling equipment located on the described premises if caused by windstorm or hail.
>
> Rain.
>
> We will not pay for loss or damage caused by or resulting from rain, whether driven by wind or not unless wind or hail first makes an opening in the walls or roof of the described building. Then we will only pay for loss to the interior of the building, or the insured property within, caused immediately by rain entering through such openings.

The structure of this policy places causation directly into question. The problem is that, while some events are covered and others are not, damages often arise after a series of events take place. Hurricane Katrina is a perfect example. It

involved a wide variety of perils, including wind, wind-driven water, flooding, levee breaches, sewage overflows, power failures, court-ordered evacuations, fire, looting, pollution and mold.

The courts have developed various tests for determining whether there is coverage when a covered peril and an excluded peril combine in some proportion to cause a loss. Most prominent among them is the doctrine of "efficient proximate cause." This doctrine provides for coverage if the covered cause is the efficient and dominant cause: the one that sets the loss into motion.

The highest courts of two of the states most affected by Hurricanes Katrina and Rita — Louisiana and Mississippi — have adopted the doctrine of efficient proximate cause. The Texas Supreme Court has no clear authority on this question.

The "efficient proximate cause" generally is defined as the "dominant" cause. If the dominant cause of the loss is a covered peril, there is coverage; if the dominant cause of the loss is an excluded peril, there is no coverage or, in some instances, reduced coverage. Although the "efficient proximate cause" doctrine most commonly has been applied where a loss was caused in part by a covered peril and in part by an excluded or non-covered peril, it is equally applicable where, as here, different limits of liability and may apply depending on what is determined to be the cause of the loss.

The "efficient proximate cause" doctrine sounds simple on paper. In practice, though, it is complicated to apply. One helpful explanation of "efficient proximate cause" offered in a respected treatise on insurance, and followed by many courts, is that it is the "risk [that] set[s] the other causes in motion which, in an unbroken sequence, produced the result for which recovery is sought."

This definition of "efficient proximate cause" may be helpful in arguing that the damages at issue with respect to Hurricanes Katrina and Rita were caused by wind, and not by flood, since it was the hurricanes that set in motion all the other events that led to the property damage at issue. Policyholders will argue (and insurance companies no doubt will disagree) that all subsequent events, including the breaches of the levees in New Orleans, were set in motion, in an unbroken sequence, by the hurricanes.

The insurance company's response to this coverage-friendly doctrine seems to be the addition of language designed to defeat coverage. Although not used by the T.W.I.A. in the sample policy highlighted above, many insurance policies contain a prefatory clause to the exclusions section, generally known as the "anti-concurrent causation" provision.

As published by the Insurance Services Offices ("ISO"), a typical anti-concurrent causation lead-in provision states as follows: "We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss."

This provision is significant because, if enforceable, it has the capacity to alter substantially the scope of coverage under a policy. Accordingly, many challenges have been raised to its enforceability. The lawsuit filed on September 15, 2005 by Mississippi's Attorney General is one example.

The most recent decisions in this area should be greatly encouraging to Mississippi business owners and homeowners (if they are not otherwise discouraged by certain holdings regarding the facts). In Leonard, Judge Senter found anti-concurrent causation clauses to be ambiguous and unenforceable as a matter of law in the context of hurricane damage. He ruled that enforcement of such language: "would mean that an insured whose dwelling lost its roof in high winds and at the same time suffered an incursion of even an inch of water could recover nothing under his Nationwide policy. Read literally, this provision would exclude all coverage when a windstorm did damage to both an insured dwelling (a covered loss) and adjacent 'screens, including their supports, around a pool patio or other areas.' (an excluded loss). I do not believe this is a reasonable interpretation of the policy."

Notably, there is no state law yet in Texas, Louisiana and Mississippi as to the enforceability of this provision, as the highest courts of these states have not had occasion to examine it. However, were the Mississippi Supreme Court to adopt Judge Senter's reasoning, if and when this important issue ultimately comes before it, that court would be in accord with the precedent of the highest courts of a number of other states.

The highest court in Washington State, for example, has held that as a matter of public policy, insurance companies may not use so-called anti-concurrent causation provisions to avoid the efficient proximate cause doctrine. West Virginia's highest court similarly has held that anti-concurrent causation clauses are ambiguous and that it offends the reasonable expectations of a policyholder to read them as precluding coverage for damage proximately caused by a covered peril.

On the other hand, this favorable response has not been universal. The highest court of Utah held that provisions like the anti-concurrent causation provision are enforceable, as insurance companies are entitled to contract around any applicable causation rule.

Applicable Doctrines and Statutes

Historically, the courts have considered a number of additional matters when called upon to decide insurance coverage disputes.

Principal among these is the doctrine of *contra proferentem*. This doctrine

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Is It a Vase or Are There Two Faces?

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requires ambiguities in insurance policies to be interpreted against the insurance companies that drafted the policies, and in favor of coverage.

Courts typically agree that ambiguities are proved when courts adopt different interpretations of the same provision. Thus, the mere existence of a dispute over the meaning of the flood, rain and water exclusions, and the citation of supportive — yet contrary — authority by both policyholder and insurance company, should be sufficient to prove ambiguity, and tip the scales in favor of coverage.

Another important resource for the courts has been state statutes, which often are policyholder-friendly. For example, all three of the states being studied here — Texas, Louisiana and Mississippi — have statutes designed to protect policyholders against bad faith practices by insurance companies, particularly including unfair settlement practices and late payment practices. Also relevant are the Valued Policy Laws found in many states, which can lead to 100% recovery by policyholders in certain circumstances. Such statutes are likely to be studied carefully by both sides in the battlefields over hurricane coverage.

Conclusion

The principle of "buyer beware" extends all the way through the claims process for policyholders. As shown above, there are many possible reasons why policyholders may not receive the coverage they may believe that they purchased. But the inverse principle of "seller beware" applies to insurance companies. The developing precedent of Hurricane Katrina appears to be that ambiguous language in insurance policies will be "outed" by courts deciding hurricane cases. Insurance companies who sell ambiguous provisions may find themselves with serious legal problems, extending far beyond the particular framework of Katrina-related liabilities. ■

It's My Money, and I'm Movin' to Memphis!

by George L. Head, CPCU, Ph.D., CSP, CLU, ARM, ALCM

George L. Head, CPCU, Ph.D., CSP, CLU, ARM, ALCM, , has been a risk management educator for over 40 years. After retiring in 2000 as a Director Emeritus of the American Institute for CPCU, he continued to write and advise on risk management matters. He is currently pursuing the study of theology.

Many insureds — particularly homeowners insureds — believe that the money an insurer has paid them for a legitimate insured loss is their money to use as they see fit. Especially after they have paid premiums faithfully for years, perhaps even decades, have maintained their property in safe condition, have done nothing to cause the loss, and have honestly complied with all the requirements for filing a valid claim, they believe the insurer has no right to restrict how they will spend "their money."

For example, a widow whose Minot, N.D., home burns to the ground in November may want to use "her money" from her insurer to move to Memphis, Tenn., where it's warmer. She does not understand why her insurer is requiring her to first rebuild her 40-year-old house before she goes. Furthermore, what if the widow wants to move to Memphis to be with her dying mother? Most likely, the insurer will still require her to first rebuild her house; then she could sell it before she moves. Alternatively, she can leave her burned house now and use her own money out of pocket to be with her dying mother.

Those of us whose careers center on insurance can give her good actuarial, contractual and business reasons why the insurance money is not really hers to use as she wishes. Actuarially, we know her premium payments have for years gone into a pool from which the insurer has paid other insureds' losses. Contractually, we know that all Homeowners replacement coverage presumes actual replacement of the dwelling. If an insured chooses not to replace the damage to the dwelling, the insurer pays only the depreciated historical cost (actual cash value), which, for this widow and for many long-time homeowners, is a very small amount. Requiring the restoration of the insured property also controls any temptation the insured may have to destroy the property or to otherwise commit fraud.

But *let* me now pose three other, rather extraordinary, cases that may cause us to rethink this reasoning. In each, the insurer has an opportunity to act beyond the scope of its insurance contract, more fully meeting a policyholder's expectations and thereby strengthening our industry's public image without (I believe) endangering the integrity of the insurance enterprise.

But I may be wrong, especially if, as I recognize, these extra-contractual innovations may subject insurers to additional fraudulent claims and new floods of litigation. After you consider these three cases, ask yourself how harmful would it actually be for our industry, under similarly extraordinary circumstances, to be driven by humane values rather than by actuarial or contractual guidelines? In similarly unusual cases, might the compassionate handling of an insurance claim really be the best action, serving our industry in the long run, even though it bypasses some of our basic actuarial and contractual principles? Think about it, and tell me your thoughts.

Example One: Making Exposures More Insurable

Suppose our widow, who wants to move to Memphis just because it is warmer, lived instead in New Orleans and her 40-year-old home had been lost to Hurricane Katrina. She has paid her homeowners premiums on time, insuring her home for 90 percent of its replacement cost; in addition, she also has flood insurance. Her entire neighborhood was devastated by Katrina, and is unlikely to be rebuilt any time soon. Should the insurance company let her take the pre-Katrina replacement-cost value of her home and move to Memphis?

Factually, the widow wants to use "her money" to relocate to a better place without rebuilding her destroyed home. Financially, the insurer would be in the same position as it would be if it had simply paid to rebuild her house as the replacement-cost coverage requires. Contractually, giving her the pre-Katrina replacement-cost value of her house so she can relocate would be a violation of the insurance contract; but now the area in which she had lived stands largely condemned. Would enabling her to relocate to Memphis from New Orleans not only improve the widow's life, but also make her new home a better underwriting risk, in the long run benefiting our industry?

Example Two: Insurer Cannot Fulfill Promise to Current Insured

In this second case, assume that our widow is still in Minot and that she has no children and no known relatives. Moreover, she has stage four cancer; the medical consensus it that she has just four to six months to live. Two months after this diagnosis, her house burns to the ground. Because of its age, her home's actual cash value (depreciated historical cost) just before the fire was essentially zero.

As a sound business practice, should the dying widow's homeowner's insurer force her to find someone to start — and then actually finish — rebuilding her home before the insurer pays her any money?

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Factually, the insured won't live to see her home rebuilt.Yet, contractually, it would be a violation to the homeowners policy for anyone representing the insurer to authorize any of the money generated from the widow's 40 years of premium payments to be used for her terminal care in a comfortable location. Ethically, is the insurer entitled to benefit from the insured's impending death?

Example Three: Higher Priority Personal Need

Here, our Minot widow is older, on a fixed income, and has no relatives. Perhaps just her porch gets blown down in a January snowstorm. She paid her premiums, she has insurance and the damage to her porch is covered. As the representative of her insurance company, you learn she needs a new furnace and does not have the money to get one. She since has been wearing a winter coat to keep warm, and winter has yet to show its fury. That insurance check would purchase the new furnace, and the old porch wouldn't be missed. What do you do with the check?

Factually, the insurance money that would cover the rebuilding of the porch would be enough to purchase the new furnace. Financially the insurance company would be in the same position whether its check is used for the porch or the furnace. But, contractually, it would be a violation for the money to be used for the furnace instead of the porch. As the insurer's representative, should you suggest to the widow that she use the insurance check for a new furnace?

Do any of these three cases suggest that it may sometimes be good business for an insurer to look beyond the words of its insurance contracts to fulfill insureds' expectations in ways that reflect well upon our industry? If, in exceptional cases, we do look beyond these words, to what extent do we risk losing the legal precedents that history has given us? ■

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