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10 Tips That Will Increase the Odds that Your Insurance Will Work for You

By Michael Conley and Darin J. McMullen

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As municipalities deal with unprecedented financial distress and budget pressures, maximizing insurance coverage has never been more critical. Increases in frivolous lawsuits and lawsuits arising out of reductions in staff often accompany a sagging economy. Worse yet, a recent wave of highly publicized misconduct by company executives and public officials alike is likely to spawn even more litigation. When litigation strikes, insurance looms large as a resource to cover defense and indemnity. But maximizing insurance coverage requires a risk management program that embraces far more than simply buying the right policies. Following these ten tips — some specific to municipalities, some applicable to all institutional policyholders — will vastly increase the odds that your insurance will work as you intended to when you purchased it.

1. The Purpose of Insurance is to Insure. The most fundamental, yet often overlooked, concept in insurance is simple — a policyholder buys insurance in order to transfer risk before a loss occurs. Policyholders should give careful consideration to evaluating risks, reducing risk, and determining their specific tolerance for risk. These assessments should be conducted through an inclusive organization-wide process in order to minimize the possibility that a risk is not identified. Once the risks are identified and the organization's tolerance is determined, insurance should be thought of as a means to transfer risk in order to minimize or avoid municipal exposure.

2. Insurance is a Key Asset, and Should be Treated as Such. If insurance is properly considered as a way to transfer risk at the time of purchase, it should be treated as such post-purchase as well. Insurance policies should be thought of as critical assets and treated as the equivalent of cash. Insurance can also serve as a significant defense against unanticipated liability as certain types of claims, including environmental liability claims, may not reveal themselves until decades after the damage occurs. As a result, insurance policies that were purchased decades ago may be your most valuable. In our digital age, we recommend scanning and properly securing a digital image of all policies in order to readily access these assets when coverage is sought years after the policy was purchased.

> *"When litigation strikes, insurance looms large as a resource to cover defense and indemnity."*

3. Pay Attention to Certificate of Insurance Requests from Contractors. Access to all available insurance coverage is a critical component of any overall risk management plan. The activities of outside contractors and vendors often generate claims against those who hire them, including the types of frivolous lawsuits which increase in difficult economic times. As such, all contracts with outside vendors should, at a minimum, require that the municipality or other hiring entity be listed as an additional insured, and all vendors should be required to provide proof of compliance with the contractual requirements. It is important to recognize that not all additional insured endorsements are the same. When drafting insurance contractual requirement provisions, specific attention needs to be given to the form of the additional insured endorsement required. In addition, all contracts should provide evidence of workers' compensation insurance and if a contractor takes the position that he/she is a sole proprietor and exempt from the

"Increasing the Odds" continued p2

Workers' Compensation Act, make sure you obtain appropriate forms from the contractor to confirm this. Municipalities and corporations should make sure that there are procedures in place to receive and store the evidence of insurance received from contractors.

4. Think Insurance After a Loss. Whether by receipt of a lawsuit, demand letter, an interruption of services, or financial loss (property damage, theft, etc.), your first question should be whether the loss is covered by insurance. At a time when municipal and corporate budgets are being slashed, insurance is an invaluable resource. The analysis of available insurance should not end with the organization's own policies, but must also consider the insurance and indemnification obligation of any third-party, such as contractors. If your municipality or other organization is listed as an additional insured, the contractor's policy should function as if it were written for the municipality, which often includes a defense obligation.

5. Give Timely Notice of a Claim or Loss. Timely notice is a requirement under most insurance policies. All too often, policyholders get caught up in defending a lawsuit or responding to an economic loss and forget to inform their insurance company of a loss. Do not wait to give notice and give your insurance company an opening to disclaim coverage based upon late notice. Note, too, that receiving formal notice of a suit is not the only event that should prompt you to give notice to your insurance company. Municipalities in particular now deal with aggressive investigative journalism and viral videos of, for example, alleged excessive force by police officers, posted and aired on websites such as YouTube. Your insurance company may try to raise these media events to argue that notice of a loss was untimely. We recommend that notice be sent directly to the insurance company. If a broker/agent is utilized, make sure the broker copies you on the notice to the insurance company.

6. Give Notice Under all Potentially Applicable Insurance Policies. When a claim comes in, coverage may potentially exist under multiple insurance policies, such as General Liability Policies, Public Officials Liability, Police Professional Liability, Crime, and Employment Practices Liability Policies, and span multiple policy years. This is often the case where a suit includes multiple counts and the individual counts may trigger different policies. Make sure when giving notice of a loss that you provide timely notice under all potentially applicable insurance policies.

7. Carefully Examine the Insurance Implications of Participating In Regional Organizations. Many municipalities participate in regional organizations, such as emergency response teams. These joint organizations may not be covered under the municipality's insurance coverage and your representative(s) may not be covered under the regional organization's insurance program. The issues can generally be resolved fairly easily by your broker, but participation in the joint regional organizations must be identified as an issue to be addressed before a coverage dispute arises.

8. Understand the Ramifications of Participating in Co-Insurance Programs or Trust Programs. Municipalities often participate in co-insurance or trust programs to purchase insurance and handle claims. While these types of programs can be an effective way to reduce costs, you must recognize the ramifications of participation. One significant issue is claims management, particularly for larger claims. Often a trust can be very effective in managing smaller claims, such as auto and workers' compensation, but not nearly as proficient in dealing with more complicated claims, such as large property damage claims. In addition, there can be significant costs ramification from withdrawing from these types of programs. The bottom line is to understand the benefits and limitations of these programs.

9. Understand the Distinction Between SIRs and Deductibles and How the Difference Can Affect Claims Handling and Cash Flow. Generally, a self-insured retention or "SIR" is similar to a deductible, except that the insurance company may not have to pay for either defense and/or indemnification until the SIR amount is reached. As a result, with an SIR, the policyholder is faced with not only paying the first dollars of the loss, but also potentially arranging for and managing the underlying litigation. For smaller municipalities, each of these issues could present problems as few, if any, municipalities are operating at a surplus in the wake of the economy and decreased federal and state funding.

10. Understand the Insurance Impact of "Going Green." Much has been said and written recently concerning the benefits of LEED-certified buildings. "Going Green" raises unique risk transfer and insurance issues, such as:

- What contractual rights does the policyholder have against contractors and/or architects if

your construction project fails to obtain LEED certification?

- Will your property coverage pay for the additional cost associated with obtaining LEED-certification?
- Will your property coverage pay for the increased construction costs associated with LEED-certification?
- Does your insurance have to pay to replace sustainable materials damaged in a fire?
- For municipalities, will your insurance company pay to defend the potential legal challenges to new municipal codes and ordinances that require heightened levels of energy-efficiency? A federal judge has already granted a preliminary injunction barring enforcement of such laws pending the outcome of a lawsuit brought by HVAC contractors and distributors against the city of Albuquerque, New Mexico. In *The Air Conditioning, Heating and Refrigeration Institute v. City of Albuquerque*, the plaintiffs charge that Albuquerque's 2008 Energy Conservation Code, which requires more insulation in single-family houses, outlaws electric water heaters, and imposes high efficiency standards for heating and cooling equipment, is preempted by the federal Energy Policy and Conservation Act, which sets efficiency standards for HVAC equipment.

These are just some of the issues that need to be considered in risk analysis relating to LEED-certified properties. While many insurance companies are now developing new products to specifically address compliance with LEED standards, the starting point is determining what your current insurance will cover.

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The Basics of Insurance Company Insolvency and Financial Distress

By Mark Garbowski

With recent announcements that Berkshire Hathaway (a holding company for many insurance companies) has received a credit downgrade, and that federal TARP funds will be made available to life insurance companies, it is becoming apparent that no sector of the insurance industry is completely immune from the financial meltdown that has affected nearly all financial service companies. As a result, many policyholders are starting to consider their options should their insurance company face financial difficulties.

Supervision, Rehabilitation, and Liquidation

Insurance companies are not subject to the federal bankruptcy law, and their financial health is monitored by state regulators. The rules vary by state, but the first step in a regulatory process for financially troubled insurance companies is often an order of supervision. This often does not involve court intervention but does mean increased regulatory oversight. If formal supervision is unsuccessful, an insurance commissioner may seek an order of Rehabilitation. Such an order is generally issued by a court, upon motion of the Insurance Commissioner. A Rehabilitation proceeding is similar to a Chapter 11 bankruptcy. Insurance companies under both supervision or Rehabilitation should continue to pay claims subject to regulatory approval. Usually, however, companies in Rehabilitation cannot be sued, and disputes with policyholders are usually handled by a referee.

The final step is an order of Liquidation, similar to a Chapter 7 proceeding. The Insurance Commissioner gathers the assets of the insolvent company, collects proof of claim forms from policyholders and other creditors, and eventually (often many years later) pays out the company's remaining assets to the policyholders and other creditors. In addition to the delay, policyholders can expect to receive only a limited percentage of their claim value.

Under all three of these proceedings, policyholders can expect some level of increased delay and outright refusal to pay claims, with the delay problem, in particular, getting worse at each stage. That some recovery might be afforded years away is of small comfort to policyholders who were counting on insurance to protect them from their own troubled times.

Liquidation Claim Process

Policyholders can obtain a direct distribution from the estate of the liquidating insurance company by filing

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a proof of claim, often subject to a strict deadline. The Liquidator will create a blank proof of claim form and send it to policyholders and known claimants. Usually, proof of claim forms can be obtained on the Insurance Department's website in the state where the insurance company was domiciled and is being liquidated.

Eventually, often after years have passed, the Liquidator will begin making distributions to policyholders. It is not unheard of for domestic insolvencies to wait 20 years before paying claims (as one would expect foreign insolvencies are subject to different procedures). If the Liquidator rejects the claim a policyholder may object, often within 30 or 60 days.

Guaranty Associations

When an insurance company enters liquidation, or in some instances whenever a finding of insolvency is made, guaranty associations in the various states can respond. Guaranty associations are generally charged by statute to avoid excessive delay in payments and to alleviate financial loss to claimants and policyholders because of an insurance company insolvency. Although the requirements for obtaining recovery from state guaranty associations vary, there are many similarities. The website for the National Conference of Insurance Guaranty Funds (www.ncigf.org) is very helpful.

Note, however, that there are usually severe limitations to the relief afforded by guaranty funds. While multiple state funds might possibly respond, many provide limited or no protection for out-of-state residents. Guaranty relief might also be subject to per claim limits, and larger business policyholders might not be eligible under net worth limitations. Another area of concern is that policyholders who buy policies from insurance companies that do business in a particular state on a "surplus lines" basis might not have any guaranty fund protection whatsoever.

Other Issues

Other areas for policyholders to consider when their insurance company is financially distressed include:

(1) potential recovery from brokers who are usually considered to have some duty to advise their clients as to the financial health of the companies with whom they place their insurance;

(2) special considerations concerning captive companies who might have relationships with financially distressed "fronting" insurance companies; and

(3) potential recovery directly from reinsurance — although somewhat rare, cut-through clauses that allow direct recovery against reinsurance do exist and should be investigated.

In short, policyholders have a variety of options, and possible paths to recovery, when their insurance company is in financial trouble, but none of them offer the same protection as a fully solvent company.

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