

The John Liner Review

THE QUARTERLY REVIEW OF ADVANCED RISK MANAGEMENT STRATEGIES

VOL. 21 NO. 3

FALL 2007

■ GLOBAL RISKS AND INSURANCE COVERAGES

- The Rise of Systemic Risk
Lawrence Pistell
- Political Risk in Emerging Markets
Fredrik Mürer
- EPL Coverage for Smaller Companies
Anthony J. Trivella
- Pandemic Influenza and Continuity Planning
A.V. Riswadkar and Clayton S. Shoup
- **Insurance Archeology**
William G. Passannante and Sheila Mulrennan
- Stock Option Backdating Claims
David E. Wood, Esq.

-
- Agent-Broker Perspective
 - Loss Control
 - Insurance Law

Too Many Words Obscure Meaning
Salvage Supply and Demand
Judge-Made Law

Executive Summary

Finding and Proving Lost Insurance Coverage

William G. Passannante and Sheila Mulrennan

Companies under litigation pressure naturally look to their historic insurance assets, reexamining decades of coverage purchased to protect against liabilities that often have their origins in long-ago events. The ever-accelerating pace of merger and acquisition activity, with its attendant disruptions to personnel and information technology (IT) systems, creates daunting challenges for those seeking to piece together

the insurance record. In many cases, companies find themselves unable to locate actual policy documents for one or more key policies. In such cases, secondary evidence of coverage often suffices to validate a claim under the lost policy. Courts have regularly upheld the validity of secondary evidence in proving the terms and conditions of historic insurance policies. Secondary evidence can, among other things, consist of one or more documents other than policies themselves that provide evidence regarding the insured's coverage. This article describes how to find such secondary evidence.

*Environmental issues can lead to claims against old policies.
Do you know where your proof of coverage is?*

Finding and Proving Lost Insurance Coverage

WILLIAM G. PASSANNANTE AND SHEILA MULRENNAN

No one knows how fast the earth's climate is changing. What's certain, however, is that across the globe, political resistance to more active environmental regulation is melting faster than the polar caps. "What was considered left a year ago is now center, and in six months it will be conservative — that is how quickly the debate about climate change is moving here," an Australian businessman told *The New York Times* columnist Tom Friedman, who presented this state of affairs Down Under as a worldwide bellwether.¹

Environmental Enforcement Heating Up

In the United States, environmental enforcement is undergoing something of a resurgence. While global warming is the highest profile environmental issue, the pendulum has also swung back toward more active enforcement of existing regulation — prompted by a growing corps of activist attorneys general, and more recently, by the 110th Congress, which came in vowing, in Senator Barbara Boxer's words, to "reclai[m] the bipartisan consensus in favor of greater

environmental protection.”

The EPA also has ramped up enforcement. In 2006, EPA inspections were at their highest level ever, 23,231, up from 17,560 in 2001. Administrative enforcement penalties, which ranged from \$23.8 million to \$29.3 million from 1998–2005, jumped to \$42.0 million, and Penalty Order Complaints totaled 4,647, more than twice any previous yearly total.²

In short, after a period of relative quiescence, companies can expect increased cleanup and litigation costs as politicians, feeling the heat, turn up the heat on industry.

In many cases, companies find themselves unable to locate actual policy documents. In such cases, secondary evidence of coverage often suffices to validate a claim.

Where Are the Policies That Cover Old Liabilities?

Companies under litigation pressure naturally look to their historic insurance assets, reexamining decades of coverage purchased to protect against liabilities that often have their origins in long-ago events. Coverage gaps that may have seemed manageable only a few years ago can suddenly loom large as new liabilities emerge. These gaps widen over time as acquired companies bring their own liabilities, policy limits are exhausted, and insurance companies go into insolvency or run-off. At the same time, the ever-accelerating pace of merger and acquisition activity, with its attendant disruptions to personnel and information technology (IT) systems, create daunting challenges for those seeking to piece together the insurance record.

Proving Coverage When a Policy Is Missing: Legal Standards

In many cases, companies find themselves unable to locate actual policy documents for one or more key policies. In such cases, secondary evidence of coverage often suffices to validate a claim under the lost policy. Courts have regularly upheld the valid-

ity of secondary evidence in proving the terms and conditions of historic insurance policies. Secondary evidence can, among other things, consist of one or more documents other than policies themselves that provide evidence regarding the insured's coverage. In the cases discussed below, documents that were admitted as secondary evidence included invoices for premium payments, certificates of insurance, correspondence, policy applications, board minutes, and schedules of underlying insurance.

In the event that an insurance policy that applies to a loss is lost or “missing,” there are several steps a policyholder should take.

First, a diligent search for the insurance policy should be conducted. That search should establish that the policy was lost or destroyed through no bad faith of the policyholder. There is no precise definition of what constitutes a “diligent” search, although the usual factors associated with reasonableness of an activity apply to the conduct of such a search.

Second, contact previous insurance companies, if possible. Insurance companies often are required to conduct a comprehensive search for a lost policy sold to a policyholder.

Third, gather any secondary evidence that is available that shows the existence of the policy. Any type of relevant and authentic secondary evidence can be used to prove the material terms of the policy. Often, it is not necessary to prove the exact language of the particular insurance policy verbatim, but rather the material terms.

The Standard of Proof for Lost Policies Is Often “A Preponderance of the Evidence”

The two standards often discussed with regard to the burden of proof of the existence of insurance policies are the so-called “preponderance of the evidence” standard and the “clear and convincing” standard. There has been some movement towards a more uniform application of the preponderance of the evidence standard, rather than the more onerous “clear and convincing” standard, by many courts.

To prove the terms and existence of missing insurance policies by secondary evidence, policyholders often will show in discovery that the insurance company never provided copies of their insurance policies to the policyholders. Often, the policyholder then may introduce secondary evidence to establish the

existence and the terms of the missing policies.

Case Law

Following is some of the case law applying the preponderance of the evidence standard to the issue of lost or “missing” policies.

Preponderance of Evidence

According to the tenets of insurance policy interpretation, the standard of proof in an insurance case is normally a “preponderance of the evidence.” See *Couch on Insurance* 2d (Rev. Ed.)³ and *Borough of Sayreville*⁴ (existence, terms, and conditions of a missing insurance policy shown by preponderance of evidence).

The evidentiary standard faced by litigants in a “purely civil dispute” is the preponderance of the evidence. See *Mutual of Enumclaw* (finding that insurance fraud or false swearing is a purely civil dispute to which the preponderance of the evidence standard is properly applied).⁵

No Special Standard

Courts have held that no special standard need apply in proving the existence and terms of insurance policies. In both *Fraser v. Metropolitan Life Ins. Co.*⁶ and *Young v. Travelers Ins. Co.*,⁷ the Supreme Court of Washington found insurance coverage for policyholders where the original policies were unavailable and where the existence and conditions of the policies had to be proved by secondary evidence. The *Fraser* court held that oral testimony sufficed to indicate that a substitute policy form, introduced into evidence in place of a lost policy, was the same standard form as the one at issue in the action.⁸ In *Young*, testimony that a decedent had purchased a standard-form life insurance policy sufficed as evidence of a life insurance policy where the beneficiary did not have possession of the policy.⁹ In neither case did the court require that there be proof of the existence or the contents of a policy by any standard more stringent than a “preponderance of the evidence.”

Federal Rules of Evidence

California and Alaska courts are in accord. See *Mission Ins. Co. v. General Steel and Tire Co.*¹⁰ (“[a] dispute arose over whether [the policyholder’s] burden of proof was by a preponderance of the evidence or by clear and convincing evidence.

The preponderance standard applies.”) and *Ransom v. Penn Mut. Life Ins. Co.*¹¹ See also *MAPCO Alaska Petroleum, Inc. v. Central Nat’l Ins. Co.*¹² United States District Courts have found that, in the absence of the original policy, coverage may be established by a “preponderance of the evidence.” In *Remington Arms Co. v. Liberty Mutual Insurance Co.*, applying the Federal Rules of Evidence, the court determined that a preponderance of the evidence standard applies for lost insurance policies.¹³ The *Remington Arms* court concluded that the Federal Rules of Evidence specifically rejected a scheme of preferences for types of secondary evidence and that no special, heightened standard was applicable for proof of lost insurance policies.¹⁴ The *Remington Arms* court also observed that the circumstances under which a heightened evidentiary standard should be applied do not include proof of a lost policy. This is because a heightened standard is warranted only where there is a danger of fraud.

Not only is the example of lost insurance policies not included in a list which spares no level of particularity, but a search for the rationale behind the numerated exceptions demonstrates to this Court that *the problem of lost insurance policies does not mandate a standard of clear and convincing evidence*. The examples listed in ... Wigmore have only one common denominator; they all involve situations in which the danger of fraud is highly prevalent.¹⁵

The Federal Rules of Evidence specifically rejected a scheme of preferences for types of secondary evidence, and no special, heightened standard was applicable.

The *Remington Arms* court found that, unlike the proof necessary for wills, “[m]issing insurance policies are in no way analogously vulnerable to fraud because the nature of the documents used to prove the existence and contents of lost or missing insur-

ance policies are inherently more reliable than the majority of papers offered into evidence.” Accordingly, the court rejected the insurance company’s argument that a clear and convincing standard of proof should apply.¹⁶

Insurance Companies Have the Burden of Proving Any Limitations on Coverage

As to coverage exclusions, courts generally have held that insurance companies have the burden of proof that an exclusion applies to preclude coverage.¹⁷ For example, the burden regarding insurance policy exclusions is clear. “When an insured establishes a *prima facie* case giving rise to coverage under the insuring provisions of a policy, the burden is then on the insurer to prove that a loss is not covered because of an exclusionary provision”¹⁸ Similarly, the Supreme Court of California, for example, held that an insurance company has the burden of proof to show that a policy that was not introduced into evidence at trial contained exclusionary provisions.¹⁹

The massive expansion of information available on the Internet coupled with enhanced data-mining techniques have improved the ability to track down missing coverage.

Finding Evidence of Missing Policies: The Art and Science of Insurance Archaeology

A search for missing policies is not a *pro forma* exercise. While the developments in case law discussed above are encouraging to any company that is considering insurance archaeology research, current business conditions have heightened the difficulty of reconstructing lost policies. Records disappear with every merger, downsizing, and relocation. Information is also lost in the integration of legacy computer systems, as well as through the inevitable layoffs attending every merger.

Companies have had to adapt their insurance

archaeology efforts accordingly. While the task is more challenging than ever, the massive expansion of information available on the Internet coupled with enhanced data-mining techniques have improved the ability to track down missing coverage.

Conducting a Search — Corporate Records

Today, the investigation of corporate records often begins at the computer screen. Storage vendors now provide companies with electronic access to information detailing the contents of tens of thousands of boxes of corporate records retained off-site in warehouses. While access may be instantaneous, it is often incomplete — thanks, in large part, to consolidation within the storage industry itself. Critical information on coding, dates, locations, and even description fields has often been lost in the transfer of legacy systems in this industry. Identifying the relevant boxes is often a byzantine research project in itself and often requires running key-word searches, cross-referencing codes and department names, and comparing descriptions from various indices prepared at different points in time.

In addition to utilizing the above data-mining technologies, the following steps can also facilitate the in-house search.

- Include in the search any departments where records might document missing or incomplete policies or provide leads to possible outside sources of information.
- Interview records-retention personnel, as their first-hand knowledge may be invaluable in locating records that might otherwise never be spotted.
- Review the closing documents for each predecessor company to determine whether a schedule of insurance was obtained as part of due diligence and to identify crucial information on former employees, customers, and operations.
- When reviewing the corporate records, keep an accurate log of where and by whom documents were found.
- In the course of reviewing the corporate records, note any possible external sources of records, such

as brokers, additional insureds, or outside counsel.

Conducting a Search — External Sources

Much of the detective work in insurance archaeology research involves tapping into human intelligence, what the spy flicks call “HUMINT,” i.e., former employees, brokers, and outside counsel who can provide leads to outside sources of insurance records.

In an era when nearly every firm has merged and moved several times and, in many instances, spun off some operations, the Internet has revolutionized the ability to identify successor firms and to locate former key personnel. A company’s past corporate officers, advisors, outside counsel, accountants, etc., can often be identified in online government filings, as well as on numerous Web sites preserving various other forms of historic corporate information.

Once the names of key people are identified, online national phone directories and people-search Web sites can often locate these key individuals. Interviews with these people, in turn, often identify past insurance companies, brokers, companies that received certificates of insurance, and information on past claims and litigation. Given the loss of corporate records in recent years, these outside sources are often critical to documenting lost policies.

Former Insurance Companies and Brokers

Consolidation in the insurance industry has been so extensive that nearly every insurance company and broker identified in the search will no longer be operating under the same name. Requests for records should be submitted to all current successors.

Additional Insureds and Certificate Holders

Since so many commercial contracts contain hold harmless and indemnification provisions, it has been a routine requirement for companies to arrange to have customers, lessors, vendors, railroads, and financial institutions added as additional insureds onto their primary policies. Any of these parties may have retained copies of certificates and, in some instances, copies of actual policies.

Government Entities

Government contracts have historically been the most onerous in terms of insurance requirements

and documentation. In the past, simply locating the relevant agencies and the appropriate contacts was a prohibitively time-intensive process. Today, an online search generally makes this information reasonably accessible.

Companies that have done everything possible to piece together their historic insurance portfolio are learning to protect this investment.

Outside Counsel

Online Westlaw and LEXIS searches provide access to court decisions and other key documents from lawsuits that may have involved third-party liability coverage in years where policies are missing. Copies of policies and a variety of secondary evidence have been retrieved from both the court records and the files of defense counsel in these actions.

If the research involves predecessor companies, the closing documents will typically identify numerous leads to outside sources, including names of outside counsel, major contracts, customers, and details of civil litigation that may have involved insurance. If this information cannot be located in internal files, it can often be tracked down in the records of outside counsel for both the buyer and the seller.

Maintaining the Insurance Portfolio

Increasingly, insurance archaeology efforts segue into ongoing operations. Companies that have done everything possible to piece together their historic insurance portfolio are learning to protect this investment by developing policies and procedures, supported by appropriate database software, to ensure that the record is updated on an ongoing basis. This task has become ever more complex in the past decade as merger and acquisition activity, globalization, and outsourcing have rapidly accelerated.

According to the *Financial Times*, the number of global mergers and acquisitions more than tripled between 1995 and 2006, from 9,251 to 33,141, while the aggregate value of transactions more than qua-

drupled, from \$850 billion to \$3,861 billion.²⁰

With every merger, corporate records disappear — as do people who hold the knowledge of how IT systems and filing systems work.

Maintaining accurate insurance records internally is all the more imperative because those outside service providers that historically have helped companies to piece the record together — e.g., insurance companies, brokers, accounting firms, and law firms — all have undergone massive consolidation themselves. In all of these industries, mergers result not only in the outright loss of records but also in a degraded ability to retrieve data stored in legacy systems that have been imperfectly integrated.

The end product of an historic insurance audit should be a database that organizes complex and detailed coverage information for each insurance program. The ability to search hundreds of policies issued to numerous named insureds quickly will save critical time when notifying insurers and dealing with their inevitable demands for records and policy information.

Charts should be generated that illustrate the complex picture at a glance, showing:

- key coverage terms, e.g., the application of policy limits;
- aggregate limits that have been exhausted;
- insurance companies in insolvency or run-off;
- remaining gaps in the records; and
- type of documentation available. (See Appendix.)

Effective visual representation of an historic insurance portfolio is instrumental in formulating effective recovery strategies and negotiating with scores of insurers. As an extra safeguard, the policies can be imaged and stored off-site so that the record will be preserved in the event of a future merger or disaster, natural or otherwise.

As globalization continues apace, maintaining as complete a record as possible of historic insurance coverage becomes ever more challenging and ever more essential. Given the complexity of the task, however, even the most vigilant company will most likely need to rely on secondary evidence to establish

proof of coverage in some cases. Knowing how to find that evidence, and knowing the law to make it stick, are essential skills for any company seeking to maximize the value of its historic insurance assets.

Endnotes

1. Friedman, T.L., “The Aussie ‘Big Dry,’” *The New York Times* (May 4, 2007).
2. Environmental Protection Agency, Office of Enforcement and Compliance Assurance, *National Enforcement Trends Report* (2006).
3. 19 *Couch on Insurance* 2d (Rev. Ed.) § 79: 319, 345.
4. *Borough of Sayreville*, 320 N.J. Super. 598 (App. Div. 1998).
5. *Mutual of Enumclaw*, 295 Or. at 406, 667 P.2d at 499.
6. *Fraser v. Metropolitan Life Ins. Co.*, 5 P.2d 978 (Wash. 1931).
7. *Young v. Travelers Ins. Co.*, 215 P 383 (Wash. 1923).
8. *Fraser*, 5 P.2d at 979.
9. *Young*, 215 P.2d 384.
10. *Mission Ins. Co. v. General Steel and Tire Co.*, No. C532 184 (Cal. Super. Ct., Los Angeles Cty., Feb. 1, 1992) (reprinted in 6 *Mealey’s* 21 at D-1), slip op. at 2.
11. *Ransom v. Penn Mut. Life Ins. Co.*, 274 P.2d 633, 636 (Cal. 1954).
12. *MAPCO Alaska Petroleum, Inc. v. Central Nat’l Ins. Co.*, 795 F. Supp. 941, 948-49 (D. Alaska 1991).
13. *Remington Arms Co. v. Liberty Mutual Insurance Co.*, 810 F. Supp. 1420 (D. Del. 1992).
14. *Id.*, 810 F. Supp. at 1424.
15. *Id.* at 1425 (emphasis added).
16. See also *Rubenstein v. Royal Ins. Co.*, 694 N.E.2d 381, 384 (Mass. Ct. App.), *aff’d in part*, 707 N.E.2d 367 (Mass. 1998) (“The evidence used to establish the existence and terms of the missing policies is in large part evidence in possession of the party against whom it is being offered.”); *United States v. Gerhart*, 538 F.2d 807, 809 (8th Cir. 1976) (under the Federal Rules of Evidence “[a] clear showing of trustworthiness need not be made to admit secondary evidence of the contents of a writing ... [O]nce an enumerated condition of Rule 1004 is met, the proponent may prove the contents of a writing by any secondary evidence, subject to an attack by the opposing party not as to admissibility but to the weight to be given the evidence, with final determination left to the trier of fact.”); *Emons Indus. Inc. v. Liberty Mut. Fire Ins. Co.*, 545 F. Supp. 185, 187-88 (S.D.N.Y. 1982); *Phoenix Ins. Co. v. Nationwide Mut. Ins. Co.*, 335 F. Supp. 671, 672 (D. Mont. 1972).

17. *Intel Corp. v. Hartford Acc. & Indem. Co.*, 952 F.2d 1551 (9th Cir. 1991) (insurance companies have the burden to prove a claim falls within exclusions). See also *State Farm Fire & Cas. Co. v. Green*, 139 Or. App. 51, 55 & 57, 911 P.2d 357, 359 (1996); *Aetna Cas. & Sur. Co. v. Brathwaite*, 90 Or. App. 109, 111 n 2 & 118, 751 P.2d 237 (1988).
18. *American Star Ins. Co. v. Grice*, 854 P.2d 622, 625-26 (Wash. 1993). See also *Queen City Farms Inc. v. Central Nat'l Ins. Co. of Omaha*, 827 P.2d 1024, 1041 (Wash. 1992), *aff'd*, 882 P.2d 1024 (Wash. 1994) (once "an insured establishes a *prima facie* case giving rise to coverage under the insuring provisions of a policy, the burden is then on the insurer" to show that recovery for a loss is barred by an exclusion).
19. *Ransom*, 274 P.2d at 636; *American Star Ins. Co. v. Insurance Co. of the West*, 232 Cal. App. 3d 1320, 1325, 284 Cal. Rptr. 45, 48 (4th Dist. 1991) (holding that insurance company has the burden to prove that a claim falls within an exclusion); *Burroughs Wellcome Co. v. Commercial Union Ins. Co.*, 632 F. Supp. 1213, 1223 (S.D.N.Y. 1986); *Reliance Ins. Co. v. Morrison*, 297 S.E.2d 187, 188 (N.C. App. 1982).
20. Wolf, M., "The new capitalism: how unfettered finance is fast reshaping the global economy," *Financial Times* (June 19, 2007).

William G. Passannante, co-chair of the Insurance Recovery Group at Anderson Kill & Olick, P.C., and a member of the firm's executive committee, has represented policyholders nationwide in litigation and trial in major precedent-setting cases. He can be reached at (212)278-1328 or wpassannante@andersonkill.com.

Sheila Mulrennan, founder and president of Insurance Archeology Group, is one of the nation's foremost specialists in historic insurance reconstruction for environmental, product liability, and occupational health litigation. She can be reached at smulrennan@iagltd.com.

The Historic Insurance Audit

A comprehensive organization of the existing insurance records at the beginning of the research will facilitate the audit in significant ways. New policies worth millions will likely be discovered along with critical leads to researching missing policies. A coverage chart can then illustrate any gaps due to insolvencies, past settlements, and lost policies.

Once the gaps have been identified and priorities for the audit have been established, the following is an overview of the process.

Investigate Internal Sources:

- Include those departments where records might document missing or incomplete policies or provide leads to possible outside sources of information, such as accounting, legal, contracts, and corporate secretary.
- Review and compare current electronic indices with historical hard copies of record-retention information maintained on a departmental level.
- Interview records-retention personnel, as their first-hand knowledge may be invaluable in locating records that might otherwise never be found.
- Interview former employees to establish their recollection of the missing coverage and the internal procedures for records retention. Leads can also be developed to outside sources of information, such as former brokers, government entities, or other parties that required evidence of insurance.
- When reviewing the corporate records, keep an accurate log of where and by whom documents were found.
- In the course of reviewing the corporate records, note any possible external sources of records, such as brokers, additional insureds, or outside counsel.

Contact External Sources:

- Research and contact current successors to the professional firms and companies identified in the corporate records, including all brokers and carriers.

Obtain Sample Policies:

- Obtain a sample of the policy form for any missing policies to reconstruct the terms and conditions.

Map the Results:

- Update the coverage chart with the information developed in the research and use color coding to illustrate available documentation and key coverage issues.

The corporation that has quick access to its entire coverage history is prepared for the predictably unpredictable challenges of the 21st century. Whether the challenge is enhancing sale value in a merger or real estate transaction, dealing with competing claims for the same policy limits from former subsidiaries, or notifying hundreds of insurers over several decades of toxic tort litigation or environmental actions, the return on investment from conducting an historic insurance audit will be dramatic. Hundreds of millions of dollars of coverage will be preserved and at the ready.

The Historic Insurance Audit

SAMPLE HISTORIC INSURANCE AUDIT 1961 - 2006

