THE RHA REVIEW

ROUTE TO:

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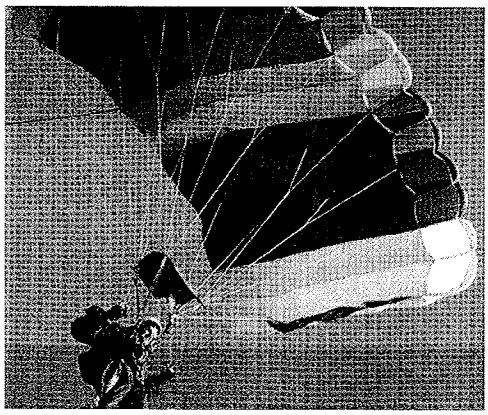
More Holes in the Parachute

By Robert N. Hughes, CPCU, ARM

When last we met I was in the process of listing the more prevalent reasons insurance companies offer for not paying liability claims (commonly known as affirmative defenses). You may recall I compared them to holes in your parachute. Here are some more for your edification, amusement (perhaps) and aggravation (most likely).

Known Loss

The concept of fire insurance in the United States arose in the late eighteenth century out of fire protection societies. The idea was that, in order to get a fire [illegible] your house extinguished, you would subscribe to one of the fire-fighting societies, affix a medallion to your house and when it caught on fire (as houses often did in those days) someone would see the medallion, or "fire mark," summon the proper firefighters, and all would be well. The issue never arose as to whether your house was already burned down or indeed on fire at the time you joined the society, because it made no difference in the bargain. Eventually, fire insurance policies which agreed to indemnify the homeowner for damage by fire replaced the agreement to actually fight the fire. Early policies simply agreed to cover damage by fire and did not state when such fire might have occurred. Apparently, a group of



highly enterprising rogues made a considerable amount of money by purchasing burned-out property, buying insurance on it and making claims for coverage. Ultimately, however, their efforts were thwarted by the courts, which decided, logically, that one should not be able to purchase coverage for property that was already damaged or destroyed. This has become known over the years as the "known loss doctrine."

Unfortunately, insurance companies are beginning to attempt to contort this perfectly logical doctrine into a justification for refusing to defend or indemnify their general liability policyholders. Let me give you an example. Suppose your company makes automotive radiators. You use a solvent approved and recommended by the U.S. government and your state government to degrease the final product. You dispose of that solvent in the manner dictated by federal and state governments. Further, the manner of disposal is also recommended by your insurance carrier through a national organization of which it is a subscribing member. Further suppose that some years later, new technology becomes available that shows the solvent to be actually dangerous and the disposal methods inadequate, and, lo and behold, John Jones sues you for making his family sick because your solvent allegedly polluted his water supply. You notify your insurance carrier. When you finally do hear from your carrier it denies the claim for many reasons, one of which is that you knew you were using a solvent, you knew you were disposing of it and, therefore, you have suffered a known loss. Your carrier will probably mention that it doesn't believe it was "fortuitous."

Sound ridiculous? Most policyholders think so. The fact is, in the context of liability insurance, you haven't even suffered a "loss" in the same context as

(**PARACHUTE**, continued inside)

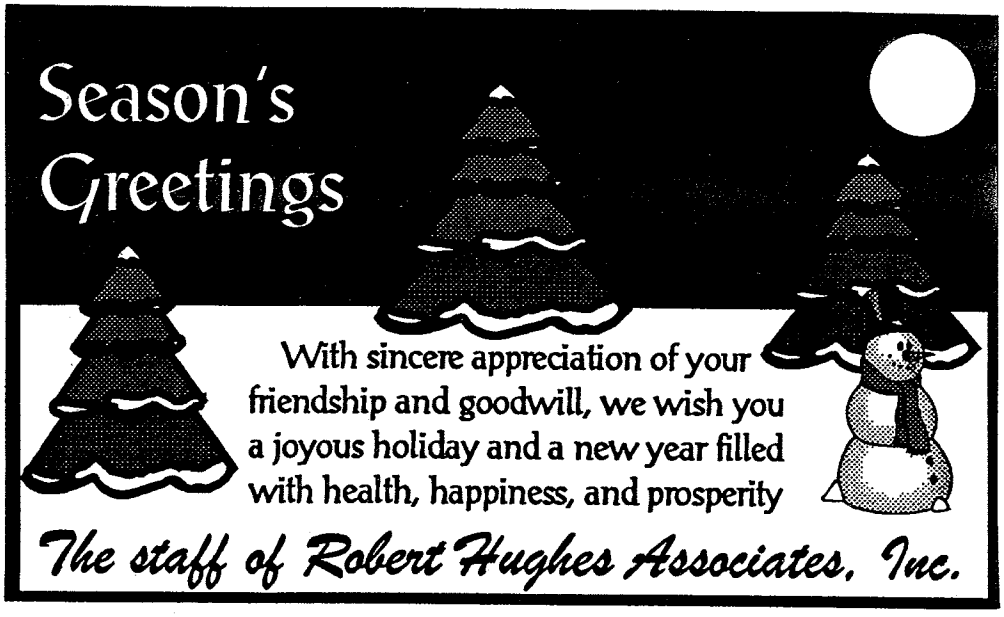
IN THIS ISSUE:

FROM NEAR AND FAR

The Panhandle of Florida took a double hit from Mother Nature, suffering damage from two hurricanes. The first, Erin, in August and then Opal in early October. Both storms made landfall in the Pensacola/ Mobile Bay area. Damages from Opal alone are estimated to be more than $2 billion.

The Caribbean was also dealt some severe blows this past storm season. Hurricanes Luis and Marilyn teamed up in September to rout the islands of Antigua, St. Martin, and the U.S Virgin Islands.

New Texas insurance commissioner Elton Bomer has ordered certain rate rollbacks. These changes will mean a reduction in premiums to liability insurers estimated to be about $425 million.



(**PARACHUTE**, continued from cover)

the burned house example. In order to have suffered a "loss" in the liability context, you have to have had an "occurrence" (which requires damage), a claim for damages, an adjudication of your liability for those damages and a quantification of the damages. The only elements you have in the previous example are an "occurrence" and a claim for damages. So if you haven't even had a "loss," how could it have been a "known loss"?

Objective Interpretation

Now, as if that were not bad enough, suppose you answer that argument by stating truthfully that you had no idea the solvent was dangerous and that you disposed of it in the manner prescribed by all the prevailing authorities. The insurance company counters with what has become known as "objective" policy interpretation (as opposed to "subjective" interpretation). In other words, it says, "Never mind what you (subjectively) actually knew or believed. You, as the user of the product, should have known it was dangerous and should have known better than to dispose of it in the manner prescribed." Now, you tell me how in the world you know what you are buying when you buy insurance that is going to be interpreted, not on the basis of what you actually do know or believe, but on the basis of some vague and unknown (perhaps even unknowable) objective standard. The answer, of course, is, "YOU DON'T."

> ***"How in the world do you know what you are buying when you buy insurance that is going to be interpreted, not on the basis of what you actually do know or believe, but on the basis of some vague and unknown objective standard?"***

Known Risk

Now that I've got your attention I unfortunately have time this issue only to really make you mad. Many insurance carriers and their lawyers, unsatisfied with the aforementioned defenses, are taking the issue even one step further. They are saying, "Since we know that you are prevented by the 'known loss' doctrine from obtaining coverage for something you know has already happened, isn't it therefore correct to say that you shouldn't have been able to buy coverage when you knew there was the 'risk' that the occurrence insured against would happen?" This little gem has been dubbed in legal circles as the "known risk theory." In other words, you have a meeting with your insurance agent and he/she says that you should consider purchasing liability coverage for injury or damage caused by one of your products, so you take the advice and purchase that coverage. This loop-legged "known risk theory" would hold that, because you perceived the risk, it was uninsurable.

I'm sure the ludicrousness of this position is clear to you, but I cannot resist closing with a true anecdote on the issue. The names have been omitted to protect the guilty. A paid expert testifying on behalf of a prominent U.S. insurance company being sued by a policyholder actually testified that because a large trucking firm could expect to have vehicular accidents which resulted in property damage and/or bodily injury, such an exposure was a "known risk" and as such not "fortuitous" and inherently uninsurable. I'll tell you what my response is to that. If this is so, then all the insurance companies in the world which have ever written general liability insurance should immediately declare that their coverage was a sham and should return every dime of premium ever collected. I have listened, but I don't hear any of them making that offer.

You have a couple of months to recover before I go on. By the way, if anyone has any special requests, please write the editor or contact me by E-Mail at "rhainc@onramp.net". Until then, be safe. RHA

Robert N. Hughes is founder and president of Robert Hughes Associates, Inc. Hughes has been retained as an expert witness in more than 100 cases involving insurance litigation.

Policyholders Win Coverage Case Against Lloyds of London

Recently, a client of Robert Hughes Associates brought a successful environmental insurance coverage action against Lloyds of London in the Denver District Court and obtained a judgment in excess of $8 million. The case was actually three coverage actions involving the same policyholder, Public Service Company of Colorado, against its various historic insurance carriers that were consolidated. When the case was initially filed in 1992, 18 insurance companies and three insurance brokers were sued by the utility. At the end of the trial, PSCC had settled with all parties except Lloyds. Lloyds had issued excess liability policies in favor of the Colorado utility for the years 1941 through 1977. In most of those years Lloyds syndicates or London insurance companies underwrote all of the various layers of coverage. Beginning in 1972 it gradually reduced its exposure.

These consolidated cases involved the utility's claim for reimbursement of a *de minimis* settlement with the Environmental Protection Agency for a Superfund clean-up at a municipal landfill outside Denver which was known, between 1965 and 1977, as the Lowry Site. They also involved the claim for reimbursement for remediation and clean-up costs for the premises of a Denver scrap dealer known as The Barter Salvage Yard, which had been used for recycling electrical equipment that contained PCBs, and the clean-up of a former manufactured gas plant site which operated at the turn of the century in Pueblo, Colorado.

The case was tried before a jury for three weeks. PSCC obtained verdicts against insurance companies in both the Lowry and Barter cases but lost the Pueblo site case on the basis of late notice to the insurance companies. All three cases are currently on appeal to the Colorado Court of Appeals.

Public Service Company of Colorado was represented by veteran Denver trial attorney Timothy Flanagan with the firm Kutak Rock. Although all post-trial motions and appellate issues have not been resolved, Mr. Flanagan indicated that he anticipated that once prejudgment interest and taxable costs were assessed, these judgments would exceed $10 million.

Mr. Flanagan was assisted by Robert Hughes Associates, Inc., in both the preparation and presentation of this complex case. Mr. Flanagan said that he used RHA's London office to assist in locating policy information from the 1940s and 50s. In addition, Robert Hughes testified as an expert witness on the London insurance market in general and, in particular, on the approximately 50 Lloyds policies at issue in this litigation.

Mr. Flanagan is a trial lawyer in the Denver, Colorado, office of Kutak Rock. RHA

ANOTHER YEAR OLDER, ANOTHER YEAR (HOPEFULLY) WISER

This edition of *The RHA Review* marks the first anniversary for us and thus will be numbered Volume 2, Number 1. It has been a busy year for both Robert Hughes Associates and *The RHA Review*.

The company has moved to larger offices, added staff members, celebrated 15 years in business, and been retained by a number of Fortune 500 companies. Robert Hughes Associates' staff members have celebrated several achievements as well. We have applauded the RHA staff members who have been promoted, earned new professional designations and celebrated important milestones with RHA.

The RHA Review has increased its circulation from a little more than 300 to almost 1,000. This is due in part to our client base growth but also to requests from all over for inclusion on our mailing list. We have received critical comment from all corners of the United States and from our overseas friends. Fortunately, most was of a positive nature, but all comment is welcome because it means you're reading and taking notice of what our writers have to say.

To those of you that have commented in the past, thank you — please write or call again. To those that have been tempted, go for it. I look forward to hearing from you. Once again, thank you for your input. Have a healthy and successful 1996.

Sincerely,

John Oakley

John R. Oakley
Editor

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CONGRATULATIONS — AGAIN!

Ms. Michele S. Martin is in the news again this quarter. Ms. Martin passed her final Chartered Property Casualty Underwriter exam in July and was awarded the CPCU designation in October. She adds the CPCU to the Associate in Risk Management (ARM) and the Certified Insurance Counselor (CIC) qualifications that she already holds. Ms. Martin joined with the largest ever incoming group of new CPCUs at The Society of CPCUs' annual meeting in Honolulu, Hawaii, this fall.

Company president Robert Hughes said, "Michele's conferment is evidence of her personal commitment to growth and excellence, and we at RHA congratulate her on the culmination of a long and difficult course of study. I think her effort is also reflective of the overall commitment by RHA and its highly qualified staff toward excellence in all things."

Ms. Martin is the lead consultant in the insurance management services area, where her responsibilities include all aspects of financial and accounting matters for the insurance companies managed by RHA. In addition to her consulting duties, she serves as an executive officer of the company, holding the position of treasurer. RHA

Michele S. Martin,
Treasurer

THE RHA REVIEW

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