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Issues in Municipal Insurance: Minding the Gaps

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I. Introduction

Cities and towns were once insulated from liability by the doctrine of sovereign immunity. States and their political subdivisions remained largely immune from suit unless (and to the extent) they expressly waived such immunity. Prompted, however, by the continued injustice of requiring citizens to bear the costs of injuries inflicted by wrongful governmental activities, sovereign immunity has, in most jurisdictions, been abrogated by judicial decree, statutory reform or constitutional amendment, at least in certain circumstances. In Monell v. New York City Dep't of Social Services, 436 U.S. 658 (1978), the United States Supreme Court held that a municipality qualifies as a "person" within the meaning of 42 U.S.C. § 1983 and, therefore, can be sued and held liable for civil rights violations resulting from an unconstitutional policy or practice.

Today, municipalities and municipal officials face exposure to third parties under state and federal remedies in a wide variety of areas – ranging from injuries suffered in accidents on public property, to employees victimized by unlawful harassment, discrimination or retaliation, to individuals deprived of their civil rights by government and government officials acting under color of state law. Given such exposures and the inability of most municipalities to operate without adequate protection from civil liability, a well-designed insurance plan is, therefore, essential. Comprehensive insurance allows a municipality to render governmental services without fear that an unfortunate accident or event will expose municipal coffers to unforeseen and unplanned expenses or debt.

Nonetheless, municipalities and municipal officials must remain aware that not all risks are insurable and, even with respect to those that *are* insurable, the policy terms may not provide full and complete protection. In short, even a well-designed insurance plan will still contain gaps – *i.e.,* risks and exposures that municipalities and municipal officials must continue to bear on their own. Knowing the gaps up-front will enable planners to better manage uninsured risk and, thereby, better protect limited municipal resources.

II. Gaps in Coverage – What are they?

A. Types of Insurance

The multitude of municipal policies available reflects the variety of risks to which cities and towns are exposed. Ordinarily, there is little overlap between policies, as each insurance contract is crafted (to the extent possible) to avoid or exclude risks better insured under other contracts. The following list of policies is not exhaustive.

1. Property

Property insurance protects the real and personal property of a municipality against damage or loss due to covered risks. Even small municipalities own, rent or control many facilities that would be prohibitively expensive for a community to repair or replace in the event of a catastrophic loss. Thus, it is important that all public facilities and their contents – town halls, schools, public libraries, fire stations, police stations, public works garages, senior centers,

community centers, field houses, treatment plants, etc. – be protected from damage or loss by property insurance. Issues that frequently arise with regard to property insurance include:

- Was the damaged property covered under the policy? For example, are computer data, records and other documents, the personal effects of others, or accounts receivable, considered covered property?

- Was the damage or loss caused by a covered peril? Municipal properties face numerous risks of loss due to a variety of perils, including, but not limited to, fire, smoke, floods, storms, weight of ice and snow, earthquakes, lightning, sewer backups, theft, vandalism, terrorism and explosion.

- To what extent is municipal property covered? In the event of a loss, will the insurer pay full replacement cost or only the actual cash value (ACV) of the lost property, defined as replacement cost minus depreciation?

- What are the policy limits? Are the limits adequate to protect the municipality in the event of a covered loss? How much is the policy deductible? Although a school building may be adequately insured, it is important that all personal property within the school – *e.g.,* desks, furniture, books, cabinets, appliances, computers and electronics, school records, etc. – also be covered.

2. Automobile

Municipal vehicles – *e.g.,* police cruisers, fire engines, ambulances, snow plows, public works trucks, tow trucks, school buses and vans – must not only be insured against damage or loss due to an accident or collision, but must also carry insurance to protect the municipality from liability for bodily injury or property damage caused to others by municipal officials or employees operating such vehicles within the scope of their employment. In most jurisdictions, an automobile policy or liability bond issued to cover a vehicle registered in that state is required to carry certain coverages with mandatory minimum limits. Also, because a municipality faces automobile liability exposure when a municipal official is driving his or her own vehicle on government business, it is important that an automobile policy protect against this risk as well. Issues that may arise under an automobile policy include:

- What vehicles are covered or “listed” under the policy?

- Was the operator of the vehicle a municipal employee or a permissive user?

- To what extent is the equipment in the vehicle – *e.g.,* firefighting, medical, electronics – also covered?

- Was the operator of the municipal vehicle acting within the scope of his or her employment at the time of the accident? If not, this may affect the immunity protection of both the operator and the municipality.

- If the municipal official was operating his or her own vehicle on municipal business at the time of the accident, does the municipality qualify as a permissive user and, therefore, an additional insured under the operator's personal automobile policy?

3. General Liability

General liability insurance, typically provided under a Comprehensive (or Commercial) General Liability policy (CGL), affords a municipality with a variety of protections against a great many liability risks. (See sample CGL form attached). Such coverages typically include protection against claims for damages brought by third persons alleging bodily injury or property (Coverage A), claims for damages brought by third persons alleging personal injury and advertising injury (Coverage B), and medical payments to persons injured while on municipal premises as a result of an accident (Coverage C). As set forth in the CGL policy, each coverage is subject to its own definitions and exclusions. Risks typically insured under a general liability policy include:

- Claims arising out of the physical condition of schools and other municipal buildings, parking lots, ball fields, stadiums, bleachers, benches, playgrounds, parks, beaches, piers, golf courses, etc.;

- Claims arising out of hazards or defects in public ways and sidewalks – *e.g.,* potholes, missing guardrails, missing signs, defective traffic signals, poor lighting, excavations, falling trees or branches, road work or construction;

- Sewer backups, water main breaks and power outages;

- Claims arising out of supervised field trips, proms and tours;

- Claims arising out of athletic camps, practices, competitions and events;

- Claims arising out of fairs, parades, concerts and fireworks displays;

- Claims of negligent security; and

- Certain enumerated torts, such as false arrest, false imprisonment, malicious prosecution, wrongful eviction and defamation (Coverage B).

4. Public Officials Liability

Public Officials Liability (POL) insurance typically protects a municipality from allegations that a duly-appointed or elected official engaged in a "wrongful act," a term broadly defined as "any actual or alleged error or misstatement or act or omission of neglect or breach of duty, including misfeasance and nonfeasance . . ." by a municipal official in the discharge of his duties for the municipality. State of Mississippi v. Forum Ins. Co., 817 F.2d 1203, 1205 (5th Cir. 1987); City of Pigeon Forge, Tenn. v. Midland Ins. Co., 788 F.2d 368, 369 (6th Cir. 1986). (See sample POL form attached). It is akin to the Directors and Officers (D&O) insurance policies routinely purchased by private corporations. POL insurance is typically written on a "claims-made" basis, which means that it only insures the municipality and its officials for claims made during the policy period (or an extended reporting period). (Compare POL insurance with automobile and CGL policies which insure against claims for bodily injury or property damage caused by an "occurrence" that takes place within the policy period, regardless of when the claim is actually made.) POL policies typically insure municipalities and municipal officials against claims of civil rights violations.

5. Educators Legal Liability

Similar to POL insurance, educators' legal liability insurance protects a municipality from claims against its educational entity for the wrongful acts of school officials – typically, the school committee, the superintendent and other administrators. Like POL insurance, educators' legal liability insurance is usually written on a "claims-made" basis. *See, e.g.,* Coleman v. School Bd. of Richland Parish, 418 F.3d 511, 514 (5th Cir. 2005).

6. Law Enforcement Liability

Law enforcement liability insurance protects a municipality and its police officers against claims arising out of law enforcement "wrongful acts," activities or duties. Kootenai County v. Western Cas. & Sur. Co., 113 Idaho 908, 911, 750 P.2d 87, 90 (1988) (negligent act of sheriff in executing sale of real property without complying with statutory requirements held covered under law enforcement endorsement to automobile liability policy); LeJeune v. Allstate Ins. Co., 365 So. 2d 471, 479 (1978) (failure of deputy sheriff to secure intersection of highway as funeral cortege passed, which resulted in accident and death of passenger riding in hearse, held covered under professional liability policy issued to sheriff's office). Typically, a law enforcement liability policy protects both the police department and the individual police officers (full-time, part-time, auxiliary and volunteer) against claims of false arrest, malicious prosecution, abuse of process, assault and battery, and violation of a person's civil rights. (See sample law enforcement form attached).

7. Employment-Related Practices Liability

Because most liability policies exclude coverage for claims brought against the insured by an employee (and his spouse or child), a municipality would be wise to purchase employment-related practices liability insurance which protects against claims arising out of allegations of wrongful termination, discrimination, harassment and retaliation deriving from the employer-employee relationship. In an age when most municipal employees are afforded a variety of

statutory protections under (among other provisions) the Family Medical Leave Act (FMLA), the Fair Labor Standards Act, the National Occupational Safety & Health Act (OSHA), and a number of federal and state whistleblower acts, the opportunities for a disgruntled or mistreated employee to pursue a claim against his employer are no longer limited to the wrongful discharge claim. The risks that an employee may be "wronged" because he was not fully compensated for his services, was disciplined, demoted or passed over for promotion, was required to perform a task (or tasks) without adequate precautions taken for his health or safety, or was subjected to an unreasonable invasion of privacy, require a municipal employer to shift those risks, to the extent possible, to an insurance carrier.

8. Workers' Compensation

Worker's compensation insurance (required in nearly all jurisdictions) protects an employer from liability for claims for lost wages and medical expenses made by employees injured on the job. Note that some jurisdictions permit municipalities, unlike private employers, to "elect" whether to provide workers' compensation coverage to employees in lieu of remaining exposed to liability under the common law. *See, e.g.*, Mass. Gen'l Laws c. 152, § 25B. As a practical matter, however, few municipalities choose the common law option.

B. Insuring Agreements

An insurance policy is a contract between the parties and should be interpreted according to contract principles. Absent ambiguity, the words of a policy must be construed "in their usual and ordinary sense." Cody v. Connecticut Gen. Life Ins. Co., 387 Mass. 142, 146 (1982); Clark v. Sputniks, LLC, 368 S.W.3d 431, 441 (Tenn. 2012). The starting place for contract interpretation is often the insuring agreement – the language that sets forth the duties and obligations of the insurer and the specific circumstances under which such duties and obligations are triggered. The two primary obligations of a liability insurer are (1) to defend the insured; and (2) to indemnify the insured for covered losses to third parties. Thus, the insuring agreement in Coverage A (Bodily Injury and Property Damage Liability) of a standard CGL policy states, in part, as follows:

> **We [the insurer] will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply.**

The first sentence of the insuring agreement sets forth the insurer's **duty to indemnify**, and the second sets forth its **duty to defend**. Note that a policy may contain more than one insuring agreement. The standard CGL policy contains three – one each for Coverages A, B and C. When determining whether a claim is covered under an insurance policy, it is important to review all available

coverages.[1]

An insured bears the burden of proving the existence of a potential claim for coverage. Barrett Paving Materials, Inc. v. Continental Ins. Co., 488 F.3d 59, 67 (1st Cir. 2007); COMSAT Corp. v. St. Paul Fire & Marine Ins. Co., 245 F.3d 1101, 1107 (8th Cir. 2001); Shanahan v. State Farm General Ins. Co., 193 Cal. App. 4th 780, 785, 122 Cal. Rptr. 3d 572, 576 (4th Dist. 2011); Pelkey v. Gen'l Elec. Capital Assur. Co., 804 A.2d 385, 387 (Me. 2002). In other words, the insured must show that the claim asserted against it potentially falls within the insuring agreement. If it cannot make such a showing, coverage will be denied.

While somewhat broad, the language of an insuring agreement (such as the Coverage A insuring agreement set forth above), provides only limited protection. In Coverage A, for example, those limitations include:

1. "Damages"

An insurer's duties to defend and indemnify frequently turn upon the meaning of the term "damages." Although not always defined in the policy, "damages" is ordinarily interpreted to refer to monetary relief only.[2] Citing Black's Law Dictionary, the Fifth Circuit construed "damages" to mean "pecuniary compensation or indemnity, which may be recovered in the courts by any person who has suffered loss, detriment or injury . . .." Aetna Cas. & Sur. Co. v. Hanna, 224 F.2d 499, 503 (5th Cir. 1955) ("damages" do not include cost of complying with injunctive relief). See 116 Commonwealth Condo. Trust v. Aetna Cas. & Sur. Co., 433 Mass. 373, 376 (2001) (the word "damages" "expresses in dollars and cents the injury sustained by the plaintiff"); Jaffe v. Cranford Ins. Co., 168 Cal. App. 3d 930, 935 (1985) ("'Damages' describes a payment made to compensate a party for injuries suffered"). Thus, an insurer's duties may not be triggered by a claim or suit seeking only non-monetary relief, such as reinstatement, rescission, injunctive relief or other equitable relief.

2. "Suit"

Not every proceeding commenced against an insured will necessarily trigger an insurer's duty to defend. Frequently, the duty to defend depends on the filing of a "suit" which, under the CGL, is defined as: "[A] civil proceeding in which damages because of 'bodily injury,' 'property damage,' or 'personal and advertising injury' to which this insurance applies are alleged." This typically includes binding arbitrations or other alternative dispute resolution proceedings to which an insured submits with the insurer's consent, but does not include a criminal proceeding, an administrative proceeding, or any other proceeding in which the plaintiff or petitioning party does not seek relief in the form of damages. Dotson v. Chester,

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1 The Supplementary Payments provision sets forth several additional payments an insurer is required to make (in addition to indemnifying those sums its insured "becomes legally obligated to pay as damages"), such as court costs, a per diem to cover the insured's expenses in assisting in the investigation or defense of a covered claim, pre-judgment interest and post-judgment interest.

2 Most Public Officials Liability policy do include a definition in which "damages" is defined as "money 'damages.'"

37 F.3d 1493 (4th Cir. 1994) (per curiam).

3. "To which this insurance applies"

Finally, even if the plaintiff files "suit" against an insured seeking "damages" for "bodily injury" or "property damage," coverage will not be available if the "bodily injury" or "property damage" is not of the right *type.* In other words, the relief sought must be for "damages" because of harm "to which this insurance applies." Under a standard CGL policy, whether the insurance "applies" may depend upon several factors, such as the place of the "occurrence" (*e.g.*, within the "coverage territory"), when the harm occurs (*e.g.*, during the policy period), and prior knowledge of the "occurrence" (if any) on the part of the insured. Also, if the harm is excluded, it is not (by definition) harm "to which this insurance applies."

C. Policy Period

The effective dates of an insurance policy will ordinarily be stated on the Declarations page. Most policies are in effect for a period of one year. But if coverage is not timely placed or a policy is not renewed upon its expiration, a municipality may be uninsured for the period when insurance was not in effect.

CGL and automobile policies are routinely written as "occurrence" policies. This means they cover harm that "occurs" during the policy period, regardless of when the claim is actually made against the insured. In situations involving long latency periods – *e.g.,* environmental harm or "bodily injuries" caused by exposure to asbestos – a claim may not be made until years after a policy expires. For that reason, copies of expired policies should be retained indefinitely.

As stated above, Public Officials Liability and Educators Legal Liability policies are typically written on a "claims-made" basis, which means that they only insure the municipality and its officials for claims made during the policy period (or an extended reporting period ("ERP")). Township of Center, Butler County, Pa. v. First Mercury Syndicate, Inc., 117 F.3d 115, 118 (3rd Cir. 1997) ("[A] 'claims made' policy provides coverage for a wrongful act regardless of when it took place, as long as a claim is made during the relevant policy period.") There are two types of claims-made policies: (1) claims-made and reported policies; and (2) pure claims-made policies. Knowing which type you purchased can make the difference between a covered claim and an uncovered claim. A claims-made and reported policy requires that the claim be made during the policy period or ERP and reported during this same period. Jones v. Lexington Manor Nursing Center, LLC, 480 F. Supp. 2d 865, 869 (S.D. Miss. 2006). Timely reporting is, in effect, one of the conditions of coverage. First American Title Ins. Co. v. Continental Cas. Co., 709 F.3d 1170, 1175 (5th Cir. 2013). A pure claims-made policy requires that the claim be made during the policy period and reported "as soon as practicable," or promptly, but not necessarily during the policy term. Note, "The Inapplicability of the Notice-Prejudice Rule to Pure Claims-Made insurance Policies," 42 Conn. L. Rev. 235, 247 (2009). Under the former – claims-made and reported policies – an insurer may ordinarily deny coverage for a claim not timely reported without a showing of prejudice. Gulf Ins. Co. v. Dolan, Fertig & Curtis, 430 So. 2d 512, 516 (Fla. 1983). Under the latter – pure claims-made policies –

some jurisdictions have held that the notice-prejudice rule applies. In other words, an insurer cannot deny coverage for late reporting unless it can prove it was prejudiced. *See, e.g.*, East Texas Med. Ctr. v. Lexington Ins. Co., 207 WL 2048660, *9 (E.D. Tex. July 12, 2007); Coregis Ins. Co. v. Caruso, 2006 WL 3762026, *1 (E.D. Pa. Dec. 19, 2006).

D. Who is insured?

Each insurance policy is issued to a "named insured," who is typically identified on the Declarations page. Depending on the nature of the insured entity – whether an individual, a partnership, a corporation, etc. – others affiliated with the "named insured" will also enjoy protection under the "Who Is An Insured" section. Thus, for municipalities and public entities, others insured will typically include elected and appointed officials, volunteer workers, managers and municipal employees. Be aware, however, that such additional insureds will only be protected while performing their duties as municipal officials or managers and/or while acting within the scope of their employment. See McLaren v. Imperial Casualty & Indemnity Co., 767 F. Supp. 1364, 1371 (N. D. Tex. 1991) (police officer who acted outside the scope of employment by sexually assaulting a motorist held not covered under employer's law enforcement policy). Further, the scope of coverage provided to additional insureds may not be as broad as the coverage provided to the "named insured." For example, under most policies, employees do not qualify as "insureds" for claims of "bodily injury" to a co-employee, or to family members of a co-employee, even if the employee was acting within the scope of his employment.

Note that the following will ordinarily *not* qualify as "insureds" under a policy issued to a municipality: temporary workers, volunteers who act under the direction of others not employed by the municipality, vendors and independent contractors. It is, therefore, important that in retaining the services of a vendor or independent contractor, the municipality ensures that the vendor or independent contractor has its own liability insurance, that such insurance is evidenced by a certificate of insurance and, whenever possible, the municipality is named as an additional insured on the vendor's or independent contractor's insurance policies.

E. Exclusions

Even if an insuring agreement applies to a claim, coverage may nonetheless be eliminated by the application of one (or more) policy exclusions. Exclusions are typically designed to eliminate from coverage those risks more suitably protected under other insurance policies (*e.g.*, workers' compensation, employer's liability, aircraft and auto), risks deemed uninsurable as a matter of public policy (*e.g.,* harm expected or intended from the standpoint of the insured), risks regarded as business risks of the insured (*e.g.,* work performed or insured's own product), or risks that insurance underwriters cannot accurately estimate in order to calculate a premium (*e.g.*, pollution, war, nuclear incident). *See* Diamond Shamrock Chemicals Co. v. Aetna Cas. & Sur. Co., 258 N.J. Super. 167, 609 A.2d 440 (N.J. Super. Ct. App. Div. 1992).

Every insurance policy contains exclusions – some more than others. In most jurisdictions, the court places the burden on the insurer to establish that an

exclusion applies to preclude coverage. *See* Boazova v. Safety Ins. Co., 462 Mass. 346, 351 (2012); Bodewes v. Ulico Cas. Co., 336 F. Supp. 2d 263, 272 (W.D. NY. 2004); Colorado Intergovernmental Risk Sharing Agency v. Northfield Ins. Co., 207 P.3d 839, 842 (Colo. App. 2008); American Motorists Ins. Co. v. L-C-A Sales Co., 155 N.J. 29, 41, 713 A.2d 1007, 1013 (1998). Typical exclusions found in Public Officials Liability (POL) policies exclude coverage for:

- Claims for "bodily injury," "property damage," "personal injury" or "advertising injury"
- "Insured vs. insured"
- Dishonest, malicious or fraudulent acts

  Be sure to determine whether this sort of exclusion applies only to the person committing the wrongful act or if it applies to any claim involving such a wrongful act by any insured, even if the result is no coverage for a so-called "innocent co-insured."

- Employment practices
- Labor disputes
- Unlawful profits
- Pollution
- Fines or penalties
- Sexual abuse or molestation

POL policies may also include exclusions specific to uniquely-municipal exposures, such as:

- Zoning decisions
- Eminent domain, including inverse condemnation proceedings
- Issuance of bonds
- Tax assessments or valuations of real estate

The above are among the most common exclusions found in municipal policies. If you are familiar with the exclusions ahead of time, you will not be surprised to learn that a particular claim is not covered. More importantly, a municipal official familiar with the exclusions can take appropriate steps *before* a claim arises in order to protect the municipality's interests.

F. Conditions

In addition to payment of the policy premium, an insured also owes various duties and obligations to an insurer, many of which are set forth in the conditions section(s) of the policy. Thus, depending on the policy language, an insured must (among other things) give notice of an "occurrence" or "wrongful act" to the insurer "as soon as practicable" after a loss, must "immediately" send the insurer copies of all suit papers, must cooperate in the insurer's investigation, settlement or defense of a covered claim, must sign over to the insurer any subrogated rights, and must refrain from making any voluntary payments to others without the insurer's consent. If an insured should breach one (or more) of these conditions, the insurer may have a right to disclaim or withdraw coverage, typically

upon proof that it suffered prejudice as a result. *See, e.g.*, City of Harrisburg v. International Surplus Lines Ins. Co., 596 F. Supp. 954, 959 (M.D. Pa. 1984) (insurer owed no duty to defend mayor-elect who failed to give timely notice of claims of libel and wrongful use of civil proceedings made against him); National Cas. Co. v. Floyd County Bd. of Commissioners, 2002 WL 31045373, *5 (S.D. Ind. 2002) (insurer owed no duty to defend commission that did not give notice of suit until after four days after court entered adverse findings of fact and conclusions of law).[3]

Typically, the policy conditions further define the nature of the insured-insurer relationship, by detailing (among other things) the effect on coverage of other insurance available to the insured for the same loss, the effect of the insured's bankruptcy, the insurer's right to conduct a premium audit, and the insurer's duty to treat each insured (the named insured and any additional insureds) as separate and independent for purposes of applying coverage. In other words, the exclusion of coverage to one insured will not automatically result in the exclusion of all.

G. Definitions

Certain terms in the policy appear in quotation marks – *e.g.,* "bodily injury." The definitions of such terms are set forth in Section V of the standard CGL and must be reviewed in order to understand the full scope of the coverage afforded. Thus, "bodily injury," as used in the insuring agreement to Coverage A, is defined to mean "bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time." In most jurisdictions, courts have reasoned that "bodily injury" does not include mental anguish, humiliation or emotional distress unaccompanied by physical manifestations. The Coverage A insuring agreement, therefore, is typically not triggered by a pure emotional distress claim.

Thus, under certain circumstances, a narrow policy definition can have the same effect as an exclusion or breached condition – *i.e.,* the claim is not covered. For example, under the standard CGL policy, "employee" is defined to include a "leased worker," but not a "temporary worker." Under most Public Officials Liability policies, "damages" does not include liquidated damages awarded pursuant to any federal or state statute, nor does it include punitive damages.[4]

III. Gaps in Coverage — Are they unavoidable?

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3 In some jurisdictions, an insurer may deny coverage for late notice under an occurrence policy upon a showing of prejudice. New England Extrusion, Inc. v. American Alliance Ins. Co., 874 F. Supp. 467, 470 (D. Mass. 1995); Brakeman v. Potomac Ins. Co., 472 Pa. 66, 76-77, 371 A.2d 193, 198 (1977). The burden of proving prejudice, however, rests with the insurer. Las Vegas Metropolitan Police Dep't v. Coregis Ins. Co., 256 P.2d 958, 963 (Nev. 2011); Jones v. Bituminous Cas. Corp., 821 S.W.2d 798, 803 (Ky. 1991). However, this rule is not universal; municipal practitioners should be sure to check the law in their own states.

4 In most jurisdictions, punitive damages are not insurable as a matter of public policy.

The short answer is “yes.” It is a simple fact that, despite your best efforts to obtain insurance that covers every possible form of liability or loss, you will not be able do so. By virtue of exclusions, conditions and other policy considerations, gaps in coverage are unavoidable. However, you can take steps to try to *reduce* the number of gaps. When you are familiar with the exclusions, conditions and other policy terms and provisions, you will be in a better place to take steps to reduce the gaps in coverage and protect your interests.

A. Retain an insurance adviser, not just a broker

- It may be a surprise to some, but brokers are not liable for giving you bad advice on what insurance to buy (or not advising you of gaps in coverage) unless you pay for that service. *See* Baldwin Crane & Equip. Corp. v. Riley & Rielly Ins. Agency, 44 Mass. App. Ct. 29, 32, 687 N.E.2d 1267, 1269-1270 (1997); Fayette v. Jose S. Castelo Ins. Agency, Inc., 83 Mass. App. Ct. 1111, 2013 Mass. App. Unpub. LEXIS 150 at *3.

- As the court held in Fayette, an insurance broker will only be held to a heightened duty of care regarding advising the client about the sufficiency of its insurance where he “holds himself out as an insurance specialist, consultant or counselor and has received compensation for consultation and advice apart from premiums paid by the insured."

- An insurance advisor can help you make informed decisions about insurance. Instead of getting a commission from the insurance company, you pay your advisor to explore the best options available that meet your needs. For instance, say your 100 year old town library is destroyed by fire. In repairing/rebuilding the structure, you will encounter significant increased costs because the new building will have to comply with today’s code requirements (building codes; architectural access regulations; sanitary codes etc…), Likewise, most first party property policies have time limits within which repairs must be completed, often as short as two years. The process of identifying the necessary code or ordinance upgrade items may take longer than two years. Further, if you have not purchased a policy that includes so-called “increased cost of construction” coverage for code upgrades, then financing the necessary upgrades may require the proposal and passing of a tax override or other long range financing that could substantially delay the completion of repairs putting you in conflict with the policy’s 2-year completion requirement. An insurance advisor would help you to identify issues such as these that are particular to your city or town and assist you in avoiding such subtle, but foreseeable gaps in coverage.

- If you have not specifically retained an insurance advisor, all is not lost as a broker may have a heightened duty of care where there is "an expanded agency agreement, arrangement or relationship,

sufficient to require a greater duty from the agent . . . Facts relevant to this inquiry include (1) the complexity and comprehensiveness of the insurance business; (2) whether a continuing relationship had existed between [the insured and his insurance broker], over a period of years; (3) the frequency of contact [the broker] had with [the insured] to attend to his insurance needs; and (4) the extent to which [the insured], because of the complexity of the policies, had come to rely on the advice of the broker." *See* McCue v. Prudential Ins. Co. of America, 371 Mass. 659, 661-663, 358 N.E.2d 799 (1976); Schwartz v. Travelers Indem. Co., 50 Mass. App. Ct. 672, 680-681 (2001). You should consult with counsel in your Law Department (or outside counsel if your town counsel or city solicitor is not familiar with these issues) to determine whether you may have recourse against your insurance broker.

- Be particularly wary if your insurance broker steers you to the surplus lines insurance market. Surplus lines insurance policies are written by companies that are not admitted to issue insurance policies in your state and as a result are not subject to many state regulations regarding insurance. They also are not required to have their forms approved by the state insurance commissioner and thus you should expect to see "manuscript" endorsements, exclusions and other policy limitations that may broadly exclude certain risks, such as coverage for lead paint claims or coverage for liability claims made by employees of contractors or subcontractors retained to do work on municipal property, etc. If you go the surplus lines route, you are also not eligible to recover from the state guaranty fund if the insurer becomes insolvent.

- Therefore, unless you actually retained an insurance advisor or unless you can establish that your broker owed a "greater duty" to you, you cannot point fingers at your broker for giving you bad advice. While an insurance advisor may be more expensive than just going through a commercial insurance broker, it could pay significant dividends in the long run where (a) an insurance advisor is better equipped at procuring you a policy that best suits your needs resulting in fewer gaps; and (2) if the advisor gives you bad advice, he (and more to the point, his Errors & Omissions carrier) may be a source of relief from the financial consequences resulting therefrom.

B. Read your policy

- Understandably not the most compelling reading, it is important to actually READ YOUR POLICY! If you do not have a member of your Finance Department who is experienced in insurance coverage issues, it would be well worth the cost to have an insurance advisor or outside counsel review the policy for you before you commit to purchasing it. The more complex your insurance requirements – and cities and towns can have more diverse insurance requirements than even some Fortune 500 corporations – the more

important it is to seek the advice of an insurance expert. That may be an in-house finance department head; your in-house counsel; your outside counsel specializing in insurance issues; or your trusted insurance advisor. But three old saws are worth remembering in this regard: 1) “An ounce of prevention is worth a pound of cure;” 2) Plan for the worst and hope for the best;” and 3) “Measure twice, cut once.” The fact that there are three old saws that all stand for essentially the same proposition – pre-planning – tells you how important the concept is.

- Make sure that you have all of the necessary forms of coverage:

  - ✓ General Liability
  - ✓ General Liability
  - ✓ Worker’s Compensation
  - ✓ Employment Practices Liability Insurance
  - ✓ Environmental Impairment Liability Insurance
  - ✓ Public Entity Liability Insurance
  - ✓ Educators Liability Insurance
  - ✓ Employee Benefits Liability Insurance
  - ✓ Commercial Property Insurance
  - ✓ Law Enforcement Liability Insurance
  - ✓ Builder’s Risk Insurance

- If you choose not to (or cannot afford to) purchase one or more of these coverages, then consider other ways of managing these risks.

C. Negotiate

- Do not simply accept what is given to you; you may be able to negotiate to eliminate exclusions (or create exceptions to exclusions). Depending upon the size of your municipality and the number of different kinds of insurance you are procuring (and therefore the size of the premium you likely will pay) and the particular insurer involved (some specialize in providing insurance to municipalities and are anxious to get and keep your business) you may have more leverage than you realize. Surplus lines insurers are also often amenable to negotiation regarding some of their manuscript exclusions.

D. Contract with others

- Some exclusions are present because they presume there is other insurance to cover the risk. For instance, a commercial general liability policy contains a worker’s compensation exclusion because it expects insured will have workers’ compensation coverage. Make sure you have such other policies in place to cover these gaps.

- Sometimes exclusions highlight the fact that liability insurance only protects against liability for unexpected and unintended losses. Therefore, a contractual liability exclusion bars coverage because a breach of contract typically is not unexpected or unintended. Commercial general liability policies typically contain numerous "business risk exclusions" because liability insurance is not a substitute for a performance bond. You can minimize/manage some such exposures by virtue of careful, thoughtful contracting with builders/architects/engineers and service providers:

  - ✓ Indemnity provisions in contracts

    - Make sure the indemnity provisions are comprehensive (not indemnifying only "to the extent" of the indemnitor's negligence). N. Am. Site Developers, Inc. v. MRP Site Dev., Inc., 63 Mass. App. Ct. 529, 532-533 (2005).

    - Make sure the contracts include an independent, affirmative *defense* obligation (not just the obligation to reimburse for defense costs as a part of the indemnification obligation).

  - ✓ For standard third-party liability exposures arising out of operations performed by contractors or service providers, have a standard form of contract or work order that requires the contractor or service provider to have your city, town, and contracting agency or authority named as "additional insureds" on the contractor's or service provider's liability policies.

    - Specify the policy limits required and any specific forms that you require to be used. ISO Form CG 20 10 11 85 (for naming additional insureds) is the broadest form available. Specify its use or its "equivalent."

    - Specify that the additional insured coverage is to be primary and "non-contributing" with any liability insurance held by the city/town.

    - Specify that the additional insured protection must include both ongoing operations and completed operations exposures.

    - Specify that the insurance shall be written on an occurrence basis (not a claims made basis); and

    - Specify that the city/town will be provided at least 30 days advance written notice by the insurer if the policy covering the contractor or service provider is to be cancelled.

- *Be aware that a certificate of liability insurance alone indicating that your city or town is an additional insured does not by itself establish coverage. Be sure to require that the contractor or service provider supply you with a copy of their liability insurance policy, not just a certificate of insurance.*

IV. Gaps in Coverage; Uninsured/Uninsurable Exposures

A. What are they?

- Some exposures will be uninsured just by the nature of the claim. Some risks, for example, cannot be the subject of insurance or indemnification, as a matter of public policy (e.g., most jurisdictions hold that an insurer cannot insure against criminal acts and many jurisdictions prohibit an insurer from insuring against punitive damages).

- Some are uninsurable because they are not exposures that are within the philosophical nature of insurance coverage (e.g., an insurer cannot insure against known losses or losses that are substantially certain to happen. This is known as the "fortuity doctrine" and applies to most forms of insurance.

- Similarly, policies typically exclude coverage if the insured intended or expected to cause harm because such harm cannot be said to have been "accidental" – a fundamental precept of general liability insurance.

- Here are just some examples of claims that are of particular concern because they may allow for punitive damages and/or attorney's fees which typically would be uninsurable:

    - Employment discrimination claims;
    - Civil rights claims against police, schools; and
    - Consumer protection claims against municipality, public utilities (liability is possible when acting in a non-legislatively mandated "business context". *See* Park Drive Towing, Inc. v. City of Revere, 442 Mass. 80 (2004).
    - Although the doctrine of sovereign immunity may protect cities/towns from some exposures to punitive damages, civil rights and discrimination statutes (such as M.G.L. c. 151B) may list political subdivisions of the state and/or agencies thereof as entities subject to the statute and therefore are interpreted as reflecting the consent of the state (and its political subdivisions) to be subject to the statute (including punitive damage awards).

B. Protect your interests

Because these losses are inherently uninsurable, the steps listed above to reduce insurance coverage gaps are inapplicable. You can however still take other steps to try to reduce the likelihood of such insured claims.

1. Risk management/loss prevention

The best (and to some extent the only) form of protection against uninsured/uninsurable risks is thoughtful risk management/loss prevention. Make sure that employees are aware of risks and exposures and that they learn and follow policies and procedures designed to avoid claims, suits and losses in the first instance.

2. Train employees

Train employees in proper workplace behavior. Conduct training sessions geared to safety and host discussions to bring employees up to date on changing regulations and laws. For example, the onslaught of social media has created unanticipated exposures. For instance, alleged hiring and firing decisions based upon information found through social media could lead to a discrimination claim. A municipality could potentially be variously liable for defamatory Facebook posts or tweets. Having social media policies in place can help prevent such claims.

V. Self-Insured Retention (SIR)

Self-insured retentions may seem like a good way to save money on premium, but may be short-sighted. With SIRs, the insured is responsible to subsidize defense costs from dollar one for coverage up until the SIR limit is reached. Unlike a deductible, where the insurer (absent of course any reservation of rights discussed below), has the right to assign counsel, to investigate and to make settlement decisions, with a SIR the insured frequently is responsible for securing counsel, conducting the investigation, etc. Be careful before you agree to dispense with the legal defense provided by most liability insurance policies and what is arguably the most valuable aspect of the policies. (Some quip that *liability* insurance should be called *litigation* insurance because the insurer's duty to defend is very often the most valuable aspect of the coverage provided.)

VI. The insurer denied coverage—now what?

When your insurer denies coverage, retain coverage counsel to advise you if you are not convinced it is correct – the denial of a defense is expensive to you and most insurers will outright disclaim only if they are 100% sure there is no coverage. If your coverage counsel advises that the disclaimer is invalid, seek reconsideration from the insurer (through counsel). If the insurer refuses to change its mind, consider filing a declaratory judgment action. The expense alone of a declaratory judgment action may convince some insurers to change their minds:

- In many jurisdictions, if the insured must incur the expense of a declaratory judgment action to establish the insurer's duty to defend, the insured recovers its attorney's fees incurred in doing so.

- A totally unjustified denial of coverage can constitute bad faith (although merely taking an incorrect position on coverage -- if the position is reasonable and taken in good faith – will not support a claim of bad faith claim practices).

- If you have a viable bad faith claim against the insurer, that can be actionable under the state consumer protection laws and may permit recovery of attorney's fees, not only in proving entitlement to a defense, but also in proving entitlement to indemnification from the insurer. It also sometimes entitles the successful insured to recover punitive (or multiple) damages in addition to recovering its attorney's fees.

- Most states now impose severe penalties upon insurers that default on their coverage obligations, and especially on the duty to defend. This gives you, the insured, leverage. Use it.

VII. The insurer reserved its rights—now what?

In the case where the insurer offers to defend the claim under a so-called "reservation of rights" (in some jurisdictions a non-waiver agreement), there are several important things to know:

- In most jurisdictions, the insurer must offer to defend the entire case if even one claim is potentially covered under the insurer's policy. In Massachusetts, this is commonly known as the "in for one, in for all" defense rule. Once can imagine how difficult it would be for counsel to segregate out costs incurred in the defense of a covered claim versus costs incurred in the defense of an uncovered claim. *But see* Alaska Stat. § 21.96.100: "In providing independent counsel, the insurer is not responsible for the fees and costs of defending an allegation for which coverage is properly denied and shall be responsible only for the fees and costs to defend those allegations for which the insurer either reserves its position as to coverage or accepts coverage."

- The insurer may not reserve its right to deny coverage while at the same time retaining control of the defense of the case.

- If insurer wishes to press its reservation of rights, then in most jurisdictions the insured is permitted to select the attorney to defend him and the insurer must pay the reasonable cost for that defense. The next question: what is "reasonable" in terms of the hourly rate the independent counsel should be permitted to charge?

- In some jurisdictions, what is considered "reasonable" is controlled by statute. See e.g., California - Cal Civ Code § 2860: The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended. See also Alaska Stat. § 21.96.100: "Unless otherwise provided in the insurance policy, the obligation of the insurer to pay the fee charged by the independent counsel is limited to the rate that is actually paid by the insurer to an attorney in the ordinary course of business in the defense of a similar civil action in the community in which the claim arose or is being defended."

- In other states, such as Massachusetts where there are no applicable statutes, the only limitation on the rate that the insurer must pay independent counsel is that the fees must be "reasonable." *See* *Northern Sec. Ins. Co. v. R.H. Realty Trust*, 78 Mass. App. Ct. 691 (2011). While this, of course, is subject to interpretation, the courts have made it clear that the lower rates that insurers pay their "panel counsel" is not the standard. As one Massachusetts superior court judge said: "an insurer cannot reserve its rights and thereby surrender control of the defense, and still reasonably expect that it will pay the same amount of legal fees that it would have paid had it accepted coverage and retained control of the defense. Through its reservation of rights, the insurer's duty to defend is transformed into a duty to reimburse its insured for reasonable attorneys' fees incurred by the insured's chosen counsel. What is reasonable is not what an insurance company would pay to the attorneys it would retain, but what a reasonable person in the insured's position would pay for capable attorneys it chose to retain." *See* Watts Water Techs., Inc. v. Fireman's Fund Ins. Co., 22 Mass. L. Rep. 659 2007 Mass. Super. LEXIS 266. (This opinion is considered to be strong authority in Massachusetts because the judge who authored the decision, Ralph Gants, although a superior court judge when the opinion was issued in 2007, is now the Chief Justice of the Massachusetts Supreme Judicial Court.)

- Monitor case closely and if facts develop that warrant asking the insurer to withdraw its reservation of rights, do so.

- Consider filing a declaratory judgment action to obtain a binding determination on the coverage issue. (It may be premature to obtain a declaration on the duty to indemnify if there is no judgment or settlement.)