

# What Attorneys Need to Know About Insurance

By Billy L. Akin



Of course a corresponding declaration might be, "What insurance people need to know about the law and the legal system!" Ideally, enough professional humility might prevail that each profession can complement the other.

Having invested over a half century of my professional career in the property and casualty insurance business, the last decade being involved as a consultant and expert witness, I feel an urgency to mention a few

areas that can be of help to attorneys. Although many principles of operation and practice overlap in the two major divisions of insurance, this article primarily involves the property and casualty business.

The insurance business, not unlike the legal profession, is intricate and technical. The insurance trade involves a wide variety of skills, varying degrees of professional involvement and experience. The range varies from minimum entry level and agency licensing requirements to graduate degrees and prestigious professional educational opportunities.

The complexity of the insurance industry must be realized. For example, the commonly used Comprehensive General Liability (CGL) policy contains 16 pages. A highly regarded book explaining the CGL policy has 238 pages of text and 100 pages of appendices. A reference publication on the policy has more than 1,500 pages. The complexity of the industry is too often unrecognized.

Expressed in the form of questions, here are a few basic areas with which, I feel, attorneys involving themselves with insurance cases should have a

basic understanding. Let us consider each item separately:

### 1. What is the purpose of insurance? Is it not a form of gambling?

In the most basic form, the purpose of insurance is the transfer of risk from the individual (or company), known as the insured to a risk-bearing entity, known as the insurer. This system works successfully since the insured is able to transfer the risk for a relatively small payment (the premium), while the insurer facilitates the spreading of risk of loss by the application of the "law of large numbers." It is important that attorneys realize that all risk of loss is not transferable and that some risks are necessarily left with the insured, to be handled in some other manner. This is sometimes done by simply assuming the risk themselves, or transferring it in another manner, such as contracts or reduction of risk. Policy terms and exclusions are critical and most important. Incidentally, the principle of insurance is just the opposite of gambling. Gambling creates a risk of loss that did not otherwise exist. Insurance strives to transfer and thus minimize a risk of loss that is already present.

### 2. Do insurance policies (contracts) fit into a similar mold?

Unlike a few decades ago, insurance policies (composed of a Jacket, a Declaration Page and related Coverage Forms) are now much less likely to have any uniformity. In years past most insurance companies subscribed to national rating organizations (such as Insurance Services Office) that prepare and have their forms approved by the various insurance departments, on behalf of the companies. Such is no longer the case. Even companies that belong to rating organizations often file for exceptions or use forms in areas of insurance that are not regulated. This requires close examination of each insurance policy and its related forms

when analyzing insurance cases. The difference between forms may be as few as one or two words.

### 3. What is the difference between a broker and an agent?

Although the terms are often used interchangeably, an insurance broker is technically a person who is paid by an insured to evaluate risks and seek insurance coverage for an insured. In contrast, technically an insurance agent is an individual or company that represents an insurance carrier and receives a commission for placing business with that carrier. In some jurisdictions, a broker is licensed by the state, separate and apart from the licensing of an insurance agent. In actual practice, the distinction between broker and agent has been blurred, and both terms are used for those entities procuring coverage.

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### 4. What is expected of insurance agents?

Insurance agents are human beings, or companies comprised of human beings! Therefore, perfection cannot be expected. However, agents typically present themselves as experts in insurance coverages. Many factors are

involved in the determination of whether an agent acted in a manner that he should, when it comes to placing coverage. One of the major factors involves the relationship between the agent and insured, and the length of time and the extent that the agent has in handling the insurable risks of a particular insured. In my opinion, agents do not receive their commission from the insurance companies they represent by simply being "order takers."

### 5. Do insurance agents have binding authority from their companies?

Contrary to popular understanding, all insurance agents do not have authority to bind all coverages, verbally or in writing, for companies with which they might place business. The "direct writers" (such as State Farm Insurance Company) generally have agents who are employed by their company and are given guidelines as to coverage that they can and cannot accept on behalf of their company. In contrast, "independent" agents typically represent many insurance companies and have a contract with each company specifying what and when coverage can be bound. Of course when a coverage is legitimately bound by an agent, that coverage is the responsibility of the appropriate insurance carrier.

Many agents have contacts with "Excess and Surplus Lines" insurance carriers (such as Lloyds of London), which are normally not licensed by state Insurance Departments, but are on lists of Approved Non-Admitted Carriers. Usually the more difficult business to place is with these carriers. Normally agents do not have authority to bind these carriers without prior approval. Typically, the local, independent agents have access to the "excess and surplus lines" carriers via a "broker" or "managing general agency" for that non-admitted carrier. This "middle-man" set-up sometimes makes it confusing in establishing fault when an obvious error

*Continued on page 24*

has been made in the process of providing insurance coverage.

### 6. What difference does co-insurance make when settling a claim?

Most property losses are not “total” losses. To encourage an insured to purchase an amount of insurance that approaches total value, most property insurance policies are written with a co-insurance percentage. The insured has a lower premium for this provision. This means that, at the time of a loss, should an amount of insurance not equal the percentage shown times the value of the property, the corre-

their agent and/or broker.

### 8. Are all application questions of equal significance to underwriters?

From decades as an underwriter and later underwriting vice president of an insurance company writing business in most jurisdictions of the United States, it seems to me that not all questions on an insurance application are of equal significance. Sure, the prospective insurance carrier prepares the application and must feel that the questions have some underwriting significance. However, whether their company should, or will, accept coverage is determined by their underwriters, who invariably put different weight of decision on various

items. This gets into the legal question of “materiality.” For example, whether or not a prospective insured had a small electrical fire six years ago does not carry the same weight in the decision-making process as whether the prospective insured is a convicted

arsonist and asking for an amount of insurance twice the property’s value!

### 9. What are some special insurance terms that should be understood?

Many insurance-related terms are peculiar to the industry ... some attorneys contending that the terms are peculiar to the English language! Nonetheless, these unique phrases must be understood as insurance cases are analyzed and processed. In addition to those items discussed in this article, there are several other terms that attorneys need to understand. These include such terms as

- “occurrence” vs. “claims-made” forms
- “double recovery”
- “loss of income”
- “all risk” vs. “named peril”
- “reporting forms”

- “audit provisions”
- “equity clauses”
- “depreciation” vs. “replacement cost”

Access to a hard copy and/or Web site dictionary of insurance terms is a must for attorneys and their staff when handling insurance cases. These sources may be enhanced by the use of persons with “hands on” insurance experience.

### 10. What is a “reservation of rights”?

Under a Duty-to-Defend policy, insurers are sometimes asked to provide a defense for lawsuits that include both non-covered and covered claims. Insurers usually provide a defense to their insured for the entire lawsuit, pursuant to a “Reservation of Rights” letter. This letter normally seeks reimbursement for defense cost that an insurer pays for claims encompassed within a lawsuit that are determined not to be covered under the policy. The specific provision(s) give an insurer the privilege of issuing a “Reservation of Rights” letter might vary from policy to policy. Without a “Reservations of Rights” statement, an insurer would normally assume payment of their legal costs and claim payment.

With what might be termed a “disclaimer,” let me mention that these remarks are made with the realization that there are many exceptions to general rules and principles in the insurance industry. These thoughts are expressed in generalities, based on my past training and experience, and deal more with “Standard of Care” as well as “Custom and Practice” issues rather than statutes and legal precedent. <sup>ATA</sup>

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sponding adjustment is made in the claim settlement. Thus, the insured becomes a “co-insurer.” This subject is often poorly understood. Sadly, many insurance agents do not understand the consequences.

### 7. What are excess insurance policies?

Especially with today’s ever-increasing need for higher limits of insurance coverage, many insurance carriers (along with their reinsurers) are unable to provide adequate limits. To fill this gap, other companies offer “excess” insurance coverage, making available higher and higher limits, sometimes in multiple layers. Unfortunately, not all “excess” policies “follow form,” that is provide the same coverage as the primary/underlying policy. This offers a special challenge to the insured and



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