



Current Articles 2008 – February

Underinsurance (Part 1)

Underinsurance can be a broker's E & O nightmare! It accounts for the highest percentage of E & O claims and from the experiences I have been involved in as an expert witness in close to 50 claims for an inadequate limit or no coverage at all. The following examples which have originated from some of the cases of which I have been involved will illustrate this problem. Considering the decisions with these cases offers some suggestion of how a broker may minimize E & O claims for underinsurance. Some examples may seem ridiculous but remember – if a claim is presented it must be defended by the E & O insurer and even if it is dismissed there is incurred legal costs.

The largest class of insurance coverage for underinsurance is Business Interruption. The inadequate limit usually relates to an incorrectly calculated work sheet. In one case with underinsurance in the millions, the worksheet was completed by the comptroller. However, it was never reviewed by the broker and simple mathematics indicated that the numbers did not add up. The broker should give the advice with regard to the worksheets and most appropriate on a complex insured the advice should direct the client to his accountant. The broker should not complete the worksheet. Another issue with business interruption is when a formal proposal for coverages is presented and the client elects to NOT include the Business Interruption coverage. The broker should re-issue the proposal without the B.I. or at least confirm in writing that the client has decided to not include the B.I. coverage. In one such case this actually happened and there was no amended proposal or letter. Five years later, when a claim occurred without the B.I. the client took the proposal to his lawyer. The lawyer, on seeing the proposal included the B.I. alleged that the broker forgot to include the Business Interruption. The broker had nothing in writing to support his defense and a settlement was made from the broker's E & O.

Inadequate limits are a frequent problem for both commercial and habitational property. If the broker "sets" the limit and it is inadequate, the broker may be held responsible. The broker should give advice and in complex property the advice should include the recommendation to obtain a proper building appraisal. Brokers may not appraise! It has been deemed a conflict! The higher the limit; the higher the premium and higher the commission. If a client insists on a limit which you feel is inadequate, your file should be well documented as to your recommendation and being not accepted by the client. Even for Homeowners policies and where a building evaluation is obtained, the client should be informed that it is not an appraisal but an underwriting requirement of the insurer to obtain the best product or a GRC endorsement. In a commercial case on a church that took 15 years to settle, the broker recommended the limit from a square footage measurement of a different church and which did not remotely resemble the older church. When it burned the underinsurance originally was deemed to be over \$800,000 with the limit set by the broker.

A broker was invited to arrange coverage on a new home to be built for the insured. The clients met with the broker and showed to the broker the complete set of plans for their custom home. Using an evaluation method the broker established the limit for the dwelling. The detached structure was unusual but fully shown in the plans. It was a 1 ½ storey building with living quarters intended for the 2nd storey. Along with an area for their vehicles it contained a workshop. What was unusual was that all the services and mechanicals were contained in the detached structure including a combination oil and wood furnace, air conditioning and air

purification system, hot water tanks, electrical panel and telephone and communication equipment, all of which added immensely to the value. The services were delivered to the main building via underground piping and conduits. All of these were identified on the plans to the broker. The broker was alleged to have told the clients that they were "fully insured" and does not require and amendments for their detached building. When the detached structure burned it was insured for 10% of the building or approximately \$27,000. The replacement cost was \$87,000.

These are only a few examples but the lesson should be to give the correct advice and recommendations but not to set the limit. And above all, a well documented file including copies of any correspondence are invaluable for the E & O defense.

James E. Bonnay,
C.I.P., C.C.I.B.
Insurance Consultant

Phone 905-333-1727
Fax 905-333-0683
E-mail - jamesbonnay@cogeco.ca